



FEDERAL ELECTION COMMISSION
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April 17, 2003

Memorandum

TO: The Commission

THROUGH: James A. Pehrkon *JAP*
Staff Director

FROM: Robert J. Costa *RJC*
Deputy Staff Director

Joseph F. Stoltz *JFS*
Assistant Staff Director
Audit Division ,

Russell Bruner *RB*
Audit Manager

Nicole Burgess *NB*
Lead Auditor

SUBJECT: Audit Report on LaRouche's Committee for a New Bretton Woods

AGENDA ITEM
For Meeting of: 04-24-03

Attached for your approval is the subject audit report. Also attached are the legal analysis provided by the Office of General Counsel and the narrative portion of the Committee's response. Recommendations from the General Counsel have been incorporated in the report.

Recommendation

The Audit staff recommends the report be approved.

It is requested that this matter be placed on the Open Session agenda for April 24, 2003. If you have any questions, please contact Nicole Burgess or Russell Bruner at extension 1200.

Attachments:

Audit Report of the Audit Division on LaRouche's Committee for a New Bretton Woods
OGC's Legal Analysis, April 17, 2003
Committee's response to the Preliminary Audit Report.



FEDERAL ELECTION COMMISSION

WASHINGTON, D.C. 20463

***REPORT
OF THE AUDIT DIVISION
ON
LAROCHE'S COMMITTEE
FOR A NEW BRETTON WOODS***

I. BACKGROUND

A. AUDIT AUTHORITY

This report is based on an audit of LaRouche's Committee for a New Bretton Woods (LCNBW). The audit is mandated by Section 9038(a) of Title 26 of the United States Code. Section 9038(a) states that "After each matching payment period, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of every candidate and his authorized committees who received payments under section 9037." Also, Section 9039(b) of the United States Code and Section 9038.1(a)(2) of the Commission's Regulations state that the Commission may conduct other examinations and audits from time to time, as it deems necessary.

In addition to examining the receipt and use of Federal funds, the audit seeks to determine if the campaign has materially complied with the limitations, prohibitions, and disclosure requirements of the Federal Election Campaign Act of 1971 (FECA), as amended.

B. AUDIT COVERAGE

The audit of LCNBW covered the period from its inception, September 10, 1997 through September 30, 2000. LCNBW reported an opening cash balance of \$-0-; total receipts of \$4,833,426; total disbursements of \$4,818,815; and, a closing cash balance of \$14,611. In addition, a limited review of LCNBW's disclosure reports filed through December 31, 2002 was conducted for purposes of determining its matching fund entitlement based on its financial position.

C. CAMPAIGN ORGANIZATION

LCNBW registered with the Federal Election Commission (the Commission) on September 10, 1997, as the principal campaign committee for Lyndon H. LaRouche, Jr., candidate for the Democratic Party's nomination for the office of

President of the United States. LCNBW maintained its headquarters in Leesburg, Virginia. The Treasurer since LCNBW's inception is Ms. Kathy A. Magraw.

During the audit period, LCNBW maintained one checking account in Leesburg, Virginia. From this account the campaign made approximately 1,800 disbursements. LCNBW received about 36,700 contributions from 12,200 individuals, which totaled \$3,541,382. In addition, LCNBW accepted \$1,245 from five political committees.

In addition to the above, the Candidate was determined eligible to receive matching funds on September 30, 1999. LCNBW made 13 matching fund requests totaling \$1,465,530 and received \$1,448,389 from the United States Treasury. This amount represents 9% of the \$16,890,000 maximum entitlement that any candidate could receive. For matching fund purposes, the Commission determined that the candidacy of Lyndon H. LaRouche, Jr. ended August 16, 2000. On April 2, 2001, LCNBW received its final matching fund payment to defray qualified campaign expenses and to help defray the cost of winding down the campaign.

D. AUDIT SCOPE AND PROCEDURES

In addition to a review of expenditures made by LCNBW to determine if they were qualified or non-qualified campaign expenses, the audit covered the following general categories:

1. the receipt of contributions or loans in excess of the statutory limitations;
2. the receipt of contributions from prohibited sources, such as those from corporations or labor organizations;
3. proper disclosure of contributions from individuals, political committees and other entities, to include the itemization of contributions when required, as well as the completeness and accuracy of the information disclosed;
4. proper disclosure of disbursements including the itemization of disbursements when required, as well as, the completeness and accuracy of the information disclosed;
5. proper disclosure of campaign debts and obligations;
6. the accuracy of total reported receipts, disbursements and cash balances as compared to campaign bank records;
7. adequate recordkeeping for campaign transactions;

8. accuracy of the Statement of Net Outstanding Campaign Obligations filed by LCNBW, to disclose its financial condition and to establish continuing matching fund entitlement (see Findings II.B. and II.C.);
9. compliance with spending limitations; and,
10. other audit procedures that were deemed necessary in the situation (see Finding II.A and Finding II.D.).

As part of the Commission's standard audit process, an inventory of campaign records was conducted prior to the audit fieldwork. This inventory was to determine if LCNBW's records were materially complete and in an auditable state. The records were found to be materially complete and the audit fieldwork commenced.

Unless specifically discussed below, no material non-compliance was detected. It should be noted that the Commission may pursue further any of the matters discussed in the audit report in an enforcement action.

II. FINDINGS AND RECOMMENDATIONS - AMOUNTS DUE TO THE U.S. TREASURY

A. APPARENT NON-QUALIFIED CAMPAIGN EXPENSES

Section 9032.9(a)(1) of Title 11 of the Code of Federal Regulations states that *qualified campaign expense* means a purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value incurred by or on behalf of a candidate or his or her authorized committees from the date the individual becomes a candidate through the last day of the candidate's eligibility as determined under 11 CFR 9033.5.

Section 9033.1(b)(1) of Title 11 of the Code of Federal Regulations states, in part, that the candidate has the burden of proving that disbursements by the candidate or any authorized committee(s) or agents thereof are qualified campaign expenses as defined in 11 CFR 9032.9.

Section 9038.2(c)(1) of Title 11 of the Code of Federal Regulations states in relevant part, that the Commission will provide the candidate with a written notice of its repayment determination. This notice will be included in the Commission's audit report prepared pursuant to 11 CFR 9038.1(d). The candidate shall repay to the United States Treasury in accordance with paragraph (d) of this section, the amount which the Commission has determined to be repayable.

Section 9038.2(b)(2) of Title 11 of the Code of Federal Regulations states in relevant part, that the Commission may determine that amount(s) of any payments made to a candidate from the matching payment account were used for purposes other than those set forth in paragraphs (b)(2)(i) (A)-(C) of this section: (A) defrayal of qualified campaign expenses, (B) repayment of loans which were used to defray qualified

campaign expenses, and (C) restoration of funds which were used to defray qualified campaign expenses.

Section 9038.2(b)(3) of Title 11 of the Code of Federal Regulations explains that the Commission may determine that amounts expended by the candidate, the candidate's authorized committees, or agent were not documented in accordance with 11 CFR 9033.11. Such amounts are subject to repayment.

Section 441a(a)(1)(A) of Title 2 of the United States Code states that no person shall make contributions to any candidate and his authorized political committees with respect to any election for Federal office that, in the aggregate, exceed \$1,000.

Section 441b(a) of Title 2 of the United States Code states, in part, that it is unlawful for any corporation to make a contribution in connection with any election for Federal office.

Section 116.3(a) of Title 11 of the Code of Federal Regulations states that a commercial vendor that is not a corporation may extend credit to a candidate, a political committee or another person on behalf of a candidate or political committee. An extension of credit will not be considered a contribution to the candidate or political committee provided that the credit is extended in the ordinary course of the commercial vendor's business and the terms are substantially similar to extensions of credit to nonpolitical debtors that are of similar risk and size of obligation.

Section 116.3(b) of Title 11 of the Code of Federal Regulations states that a corporation in its capacity as a commercial vendor may extend credit to a candidate, a political committee or another person on behalf of a candidate or political committee provided that the credit is extended in the ordinary course of the corporation's business and the terms are substantially similar to extensions of credit to nonpolitical debtors that are of similar risk and size of obligation.

Section 116.3(c) of Title 11 of the Code of Federal Regulations states that in determining whether credit was extended in the ordinary course of business, the Commission will consider: (1) whether the commercial vendor followed its established procedures and its past practice in approving the extension of credit; (2) whether the commercial vendor received prompt payment in full if it previously extended credit to the same candidate or political committee; and (3) whether the extension of credit conformed to the usual and normal practice in the commercial vendor's trade or industry.

Background and Historical Activity of Vendors

LCNBW entered into contractual agreements in 1999 with seven regional vendors, which operated offices in various states for LCNBW. According to LCNBW's response to the Preliminary Audit Report (PAR) five of the vendors (American System Publications, Inc. (ASP), Southeast Literature Sales, Inc. (SELS), Mid-West Circulation

Corp. (MCC), Eastern States Distributors, Inc. (ESDI), and Southwest Literature Distributors, Inc. (SWLD)) were incorporated in 1987 as not for profit corporations. "EIR News Services, Inc. (EIRNS), and Hamilton System Distributors, Inc. (HSDI) were incorporated as for profit entities although they do not operate to generate a commercial profit." The response to the PAR further explains that EIRNS is a publishing corporation and was incorporated in 1985 and HSDI was incorporated in 1987. The response to the PAR goes on to state that the regional vendors have as their primary purpose the dissemination of political, philosophical, and scientific literature and ideas originated by Lyndon LaRouche and his political associates.

The seven regional vendors have worked for the LaRouche presidential committees in 1988, 1992, 1996¹, 2000, and are working on the 2004 campaign. The PAR response suggests that the reason that the activity levels apparent in the 2000 campaign are much greater than in previous campaigns is a change in campaign strategy. According to the PAR response, the three prior presidential campaigns had as a substantial focus national television and other major media addresses by the candidate with direct literature distribution activities serving to amplify the media addresses. The 2000 Presidential campaign adopted a strategy emphasizing grassroots political organizing which substantially increased the literature distribution services and facilities use provided to the campaign by the regional vendors.

The response also explained that over the 15 years or more of their existence the regional vendors' incomes have been derived from subscription and single-issue sales of books, videotapes, periodicals and other publications, and from contributions and donations by the general public. The literature distributors purchase wholesale literature from four publishing entities² and sell it retail to the general public. A management company for the publishers, Publication and General Management, Inc. (PGM), provides uniform computer reporting services by which subscription and other sales and contribution items are entered and reported at the point of sale or contribution and at PGM in Leesburg, Virginia.

The contracts were for services performed commencing July 1997 through "close of business of the day on which the Democratic Party nominates its candidate for President at its Year 2000 nominating convention, except for such activities as may be necessary for winding down the campaign." The vendor services prior to April 1999 were included in each contract as a lump sum amount. Fees for services were calculated monthly starting in April 1999. LCNBW invoices were grouped in two broad categories: facilities contract expenses and other expenses. The facilities contract expenses were those expenses covered under the contract such as public relations, literature distribution, access to company existing networks, lists of customers and contacts, and office space and facilities. The other expenses were reimbursable items such as costs of room rentals

¹ The amounts paid to the seven regional vendors in the 1996 election were substantially less than in the 2000 election.

² The publishing entities are EIRNS (publisher of a weekly print and web-based national and international news magazine, *EIR*), KMW Publishing Company (publisher of the weekly newspaper, the *New Federalist*), the Schiller Institute (publisher of *Fidelio* magazine), and 21st Century Associates (publisher of *21st Century Science and Technology* magazine).

and incidentals for public campaign meetings and press conferences, automobile rentals, mailings, and rentals of office space or accommodations retained for the exclusive use of LCNBW campaign activities.

Cost Allocation

The regional vendors allocated a portion of their costs to LCNBW based on an activity ratio, defined by LCNBW as "the number of contributions raised for the Committee through use of the facilities [divided] by the total of all sales and contribution transactions for the distribution company." Records used to derive the activity ratio and the calculations of the ratios were handled by PGM.

Markup

The LCNBW allocable amount was then marked up. The markup percentages were 80% for July 1997 through September 1999, 50% for October through December 1999, and no markup for January through December 2000. According to LCNBW representatives, the markup was based on an agreement between the vendor and LCNBW to provide sharply increased activities on behalf of LCNBW to ensure adequate payment during the startup of the active phase of the campaign. It was further agreed that the markup would be reduced and then eliminated once LCNBW was well established. In the response to the PAR, LCNBW discussed and enumerated the purpose for the markup:

The purpose of the 80% (September 1997 – September 1999) and 50% (October – December 1999) markups to the allocable charge was three-fold. First, it was assumed that not all costs which should be part of the base-line projections forward or back from April, 1999 would be captured in the initial reticulation of baseline charges and that some highly variable costs, such as automobiles (gasoline and repairs), and field, travel and meeting costs would be underestimated. Second, the markups assured that certain one-time start up costs, such as the use of company lists and contributor data for fund-raising and intangible costs were adequately compensated. Finally, the markups served as a method of advance payment on services to be rendered, a bad debt reserve in the circumstances of this political campaign, and a potential means to generate a small profit.

In its response to the PAR, LCNBW also discussed the markup in relation to the extension of credit by the vendors. Referencing section 116.3(a) of Title 11 of the Code of Federal Regulations and various Commission Advisory Opinions³, LCNBW noted that if an entity was not in the business of providing the services it is providing to a campaign and cannot demonstrate a program of offering similar services on similar terms to others, then it must seek sufficient payment in advance of the services rendered to

³ LCNBW referred to Advisory Opinions, 1991-32, 1994-37 and 1997-15, in its response to the PAR.

insure against any possible shortfall. LCNBW recognized that these vendors did not provide services to others but noted that the 80% and 50% markups utilized to arrive at the fees charged met the requirements set forth in the Advisory Opinions for advance payments.

Monthly Fee

In addition, a monthly fee was charged. From July 1997 through December 1998 the fee was \$150 per month. For calendar year 1999 a \$750 per month fee was charged. The information provided does not explain how the monthly fee relates to the enumerated reasons for the markup such as "a potential means to generate a small profit", underestimated startup costs, or intangibles.

Total Invoices

LCNBW was invoiced a total of \$2,456,680 by the regional vendors; \$2,049,972 were facilities contract expenses; and \$406,708⁴ were other expenses.⁵ LCNBW paid the seven regional vendors approximately \$2,051,364 in total as of August 16, 2000; \$1,657,057 in facilities contract expenses; and \$394,307 in other expenses.

Prior to the exit conference, the Audit staff concluded that the broadly worded contracts and nonspecific invoices did not satisfy the candidate's "burden of proving that disbursements by the candidate or any authorized committee(s) or agents thereof are qualified campaign expenses, especially given the less than arm's length nature of the relationship between LCNBW and the vendors⁶. At the exit conference, the Audit staff informed and presented LCNBW with a schedule listing the total amount for each of the seven regional vendors, that would be considered non-qualified campaign expense due to lack of documentation, unless upon review of vendor documentation, the Audit staff could be confident that these facilities contract expenses were in fact qualified campaign expenses. The Audit staff also discussed the Section 116.3, extension of credit, issue with LCNBW. LCNBW representatives made no comment on this issue at that time. The Audit staff requested and LCNBW provided additional records for two regional vendors, SELS and ESDI. The Audit staff determined that the vendors had over billed LCNBW and information and documentation provided was not sufficient to establish the payments to these vendors as qualified campaign expenses.

⁴ Of the \$406,708 in other expenses, \$302,105 was billed by EIR News Services, Inc., most of this was for advertising and editorial services.

⁵ LCNBW did not prepare a spreadsheet with the breakdown of facilities contract and other expense for American System Publications, Inc. The Audit staff used the actual facilities contract invoices to determine which invoices were other expenses.

⁶ The response to the PAR noted that some of the billing adjustments that LCNBW agreed with were the result of errors made by the LCNBW Assistant Treasurer when calculating the amounts due to three of the vendors at March 31, 1999. It therefore appeared that the Assistant Treasurer also had responsibilities associated with the at least some of the vendors.

PAR Recommendation

In the PAR, the Audit staff recommended that, within 60 calendar days of service of the report:

- LCNBW provide documentation supporting amounts billed by the seven regional vendors. The documentation was to be similar to what was requested for ESDI and SELS.
- For the mark up percentages, provide additional explanation and documentation to demonstrate the derivation and changes to the percentage used.
- For the activity ratios used by the regional vendors, documentation should be provided to substantiate the figures used in the calculation of the ratios. The documentation should include samples of the literature distributed, and documentation for the numbers listed. PGM should be contacted to provide the worksheets for each billing period, itemizing the number of campaign transactions versus other transactions used by the regional vendors to calculate the activity ratio. Further an explanation and justification should be provided for weighting of factors in the calculation and for any activity that was excluded from the calculation.

Absent such documentation, the Audit staff stated that it would recommend that the Commission make a determination that \$438,285 [$\$1,626,290 \times .2695^7$] was repayable to the United States Treasury pursuant to 11 CFR 9038.2(b)(2).

Further, the Audit staff recommended that LCNBW provide additional documentation, to include statements from the vendors, which demonstrated that the credit extended was in the normal course of the vendor's business and did not represent a prohibited contribution by the vendor. The information provided was to include examples of other nonpolitical customers and clients of similar size and risk for which similar services have been provided and similar billing arrangements have been used. Also, provide information concerning billing policies for similar nonpolitical clients and work, advance payment policies, debt collection policies, and billing cycles.

Response to the PAR-Production of Regional Vendor Records

LCNBW responded to the PAR on October 4, 2002 by supplying selected records for all seven regional vendors. The records were made available for review in Leesburg, Virginia prior to the response deadline. The materials presented included more documentation than had been provided by SELS and ESDI before the PAR, however less than requested in the PAR. LCNBW provided bank statements for all seven vendors. According to LCNBW these were the only bank accounts of the seven regional vendors.

⁷ This figure (.2695) represented LCNBW's repayment ratio as calculated at the time of the PAR.

They also provided cancelled checks and additional documentation such as receipts, invoices, and memoranda to support the expenditures allocated to LCNBW. They did not submit any documentation except the bank statements for the disbursements that were not allocated to LCNBW. LCNBW did acknowledge a shortfall in documentation for baseline expenses for SELS and ESDI. According to the response LCNBW received \$80,472 in refunds from SELS.

The Audit staff calculated billable amounts using the records provided for each of the vendors. Based on these calculations, the Audit staff used the amounts documented by LCNBW for five vendors; for the remaining two vendors Audit staff figures were used.⁸ The vendors did not provide documentation for expenses outside those expenses used in their billing process. Therefore, no comment can be made concerning vendor expenses outside the transactions involving LCNBW. Further, some vendors had made disbursements in cash, primarily for field worker expenses, that cannot be verified. In some cases those expenses were apparently paid from daily cash receipts and therefore, did not pass through the regional vendor's account.

Mark-Up Percentages

As LCNBW stated, part of the mark-up served as a method of advance payments, "a bad debt reserve". LCNBW did not specify what part of the 80% and 50% mark up was for this purpose. As discussed above, LCNBW listed a number of purposes served by the markup. However, there is no support for the assumption that "not all costs which should have been part of the base-line projections forward or back from April, 1999 would be captured in the initial reticulation of baseline charges and that some highly variable costs, such as automobiles (gasoline and repairs), field, travel, and meeting costs would be underestimated". As for the compensation for one-time startup costs and intangibles, no accounting of those costs was provided. The vendors had been providing services since 1997 at a very low level and were billed and paid for those services as a lump sum expense. Thereafter, specific expenses were included in the calculation of the monthly billings. As for a profit, the response points out that five of the vendors were non-profit corporations and the other two do not operate to generate a commercial profit. Thus little or none of the markup appears to relate to a profit. Further, in 1999 each vendor was paid a \$750 per month fee and it is not clear how those payments may relate to the listed justifications for the mark up. Given the above and the lack of any allocation of the mark up among the various enumerated purposes that it served, in the Audit staff's opinion, the mark up should be considered primarily advance payment that should have been applied to the billings later in the campaign. Based on these advance payments, the Audit staff is in agreement that LCNBW would not have large outstanding debts to these vendors over long periods of time and therefore LCNBW did not receive extensions of credit outside the normal course of business. However as advance billings or advance payments, it is necessary to adjust those amounts out of the total amount billed to avoid overpayments. When these adjustments are made LCNBW would have an accounts receivable from five of the vendors as of the date of ineligibility.

⁸ Audit staff figures were used for ASP and SELS due to irreconcilable differences between the Audit calculated figures and the figures documented by LCNBW.

The total amount of the mark-up resulting from the application of the 80% and 50% to the documented expenses of the regional vendors amounts to \$413,883.

Activity Ratio

LCNBW also submitted an Activity Ratio Detail Report showing each transaction on a daily basis to support how the activity ratio was calculated. Although LCNBW did submit the minimum amount requested in the PAR, it did not submit any documentation to support the accuracy of the daily entries on the Activity Ratio Detail Reports. The Assistant Treasurer for LCNBW stated there was no way to tie this activity into the bank statements of the vendors, since the activity reports did not have a relationship to the actual receipts deposited in the vendors account. According to LCNBW's response to the PAR "The PGM computer reporting system was then utilized to determine, for any given month, the number of financial transactions for a distributor which were campaign transactions and contributions and the number of financial transactions which constituted non-campaign sales, subscriptions, and contribution activities". The activity ratios for the seven vendors varied from 64% during the campaign to .7% for periods after the date of ineligibility.

After reviewing the material submitted by LCNBW the Audit Staff arrived at the following conclusions. LCNBW did submit a substantial amount of additional information to support the activity ratio. Each type of transaction is counted for each day; however, no source documentation is available to support the individual and daily entries. The Audit Staff acknowledges that it was necessary for LCNBW and the vendors to devise some method for allocating expenses that related, in part, to the campaign. Though source documentation for the daily entries would be desirable, the method the vendors' used does appear to be reasonable and is supported by a large volume of detailed information. Finally, the ratios appear to be mathematically correct.

The review of documentation resulted in differences between LCNBW's and the Audit staff's amounts of \$507,890. Of this amount \$413,883 results from the disallowance of the 80% and 50% mark-ups on vendor billings, as discussed above. The remaining difference of \$94,007 stems primarily from a lack of documentation from the regional vendors or the disallowance of some of the expenditures. Listed below are the regional vendor amounts as calculated by both LCNBW and the Audit staff, and the resulting differences.

Company	Committee Numbers	Audit Numbers	Difference
ASP	291,430	211,159	80,271
ESDI	229,062	179,369	49,693
EIRNS	344,342	239,245	105,097
HSDI	282,613	207,219	75,394
MCC	291,854	232,786	59,068
SELS	299,484	200,262	99,222
SWLD	186,960	147,815	39,145
Total	\$1,925,745	\$1,417,855	\$507,890

The differences for EIR, aside from the differences resulting from the disallowance of the mark-ups, consist of the rejection of expenses for rent (\$31,070) paid on a farm in Round Hill, VA. The connection between the campaign and those expenses is not clear.

The differences for ASP, aside from differences arising from mark-ups, result from a lack of documentation to justify LCNBW's submitted numbers (\$28,110). Of this difference, \$18,538 relates to billings from documentation supplied for periods prior to April 1, 1999 that the Audit staff did not accept, LCNBW submitted amounts prior to this date in lump-sum amounts. The Audit staff had already included those lump-sum amounts in its calculations.

In addition, with its response to the PAR, LCNBW submitted adjusted numbers for SELS that significantly lowered the billable amounts, however, the reviewed documentation was still insufficient to support the figures. LCNBW has admitted that there is still a shortage of documentation for this company (\$34,828)⁹.

Summary - Non-qualified Amount and Repayment Calculation

LCNBW paid the regional vendors a total of \$1,656,048 in facilities contract costs through August 16, 2000 (Mr. LaRouche's date of ineligibility). As of that date, the Audit staff calculated that LCNBW over-paid five of the regional vendors a total of \$301,669, \$214,544 after netting the refunded amount of \$80,472 received from SELS, and a total of \$6,653 in other amounts due for the regional vendors. In addition, LCNBW made payments to EIRNS, HSDI, and SELS totaling \$39,209 between August 17 and September 6, 2000, the period when LCNBW's accounts contained public funds. This amount is added to the over-payments to determine the total amount subject to a ratio repayment¹⁰.

⁹ LCNBW response acknowledges a remaining shortage of \$33,650, a difference of \$1,178 from Audit staff numbers.

¹⁰ If all or a portion of the overpayments are recovered from the vendors, the repayment will be reduced accordingly.

Recommendation #1

Based on the above, the Audit staff recommends that the Commission make a determination that \$70,139 [(\$214,544 + \$39,209) x .2764¹¹] is repayable to the United States Treasury pursuant to 11 CFR 9038.2(b)(2).

B. DETERMINATION OF NET OUTSTANDING CAMPAIGN OBLIGATIONS

Section 9034.5(a) of Title 11 of the Code of Federal Regulations requires that within 15 calendar days after the candidate's date of ineligibility, the candidate shall submit a statement of net outstanding campaign obligations which reflects the total of all net outstanding obligations for qualified campaign expenses plus estimated necessary winding down costs.

In addition, Section 9034.1(b) of Title 11 of the Code of Federal Regulations states, in part, that if on the date of ineligibility a candidate has net outstanding campaign obligations as defined under 11 CFR 9034.5, that candidate may continue to receive matching payments provided that on the date of payment there are remaining net outstanding campaign obligations.

The Candidate's date of ineligibility was August 16, 2000. The Audit staff reviewed LCNBW's financial activity through September 30, 2000, analyzed and estimated winding down costs (through December 31, 2003), and prepared the Statement of Net Outstanding Campaign Obligations (NOCO statement) that appears below. The deficit on the NOCO statement presented below is substantially less than the deficit on the NOCO statement provided by LCNBW. The majority of the difference is due to the reduction in accounts payable to the seven regional vendors discussed in section A above.

¹¹ This figure (.2764) represents LCNBW's repayment ratio as calculated pursuant to 11 CFR 9038.2(b)(2)(iii).

LAROCHE'S COMMITTEE FOR A NEW BRETTON WOODS
STATEMENT OF NET OUTSTANDING CAMPAIGN OBLIGATIONS

As of August 16, 2000

As Determined at December 31, 2002

Assets

Cash in Bank	\$24,038 a	
Accounts Receivable		
Vendor Deposits	\$23,866	
Vendor Refunds-Regional Vendors	\$214,544	
Capital Assets	<u>\$5,823</u>	
Total Assets		\$268,271

Obligations

Accounts Payable for Qualified Campaign Expenses	\$322,883	
Actual Winding Down Expenses	\$25,875 b	
Estimated through 12/31/03	\$10,100	
Due to the U.S. Treasury - Stale-dated Checks	<u>\$3,281</u>	
Total Obligations		<u>\$362,139</u>
Net Outstanding Campaign Obligations		<u>(\$93,868)</u>

FOOTNOTES TO THE NOCO

- a. This figure includes the amount of stale-dated checks, (\$3,281).
- b. The inclusion of estimated fundraising costs (\$39,082) is not included in the Audit staff's NOCO since sufficient moneys had been raised to eliminate the deficit.

C. MATCHING FUNDS RECEIVED IN EXCESS OF ENTITLEMENT

Section 9034.1(b) of Title 11 of the Code of Federal Regulations states that if on the date of ineligibility a candidate has net outstanding campaign obligations as defined under 11 CFR 9034.5, that candidate may continue to receive matching payments for matchable contributions received and deposited on or before December 31 of the Presidential election year provided that on the date of payment there are remaining net outstanding campaign obligations, i.e., the sum of the contributions received on or after the date of ineligibility plus matching funds received on or after the date of ineligibility is less than the candidate's net outstanding campaign obligations. This entitlement will be equal to the lesser of: (1) the amount of contributions submitted for matching; or (2) the remaining net outstanding campaign obligations.

Section 9038.2(b)(1) of Title 11 of the Code of Federal Regulations entitled *Bases for repayment - payments in excess of candidate's entitlement* states, in part, that the Commission may determine that certain portions of the payments made to a candidate from the matching payment account were in excess of the aggregate amount of payments to which such candidate was entitled. One example of such excessive payments is payments made to the candidate after the candidate's date of ineligibility where it is later determined that the candidate had no net outstanding campaign obligations as defined in 11 CFR 9034.5.

The Audit staff's NOCO statement as presented above, indicated a deficit of \$93,868 as of August 16, 2000, the Candidate's date of ineligibility. The calculation of matching funds received in excess of the Candidate's entitlement follows:

Net Outstanding Campaign Obligations (deficit) as of 8/16/00 per the Audit staff's calculation		(\$93,868)
Net Private Contributions Received 8/17/00 to 9/1/00		<u>36,412</u>
Remaining Entitlement on 9/1/00		(57,456)
Matching Funds received on 9/1/00		<u>50,968</u>
Remaining Entitlement on 9/1/00		(6,488)
Net Private Contributions Received 9/2/00 to 10/1/00		<u>29,631</u>
Remaining Entitlement on 10/1/00		-0-
Matching Funds received on 10/1/00 to 4/2/01		163,272
Amount in Excess of Entitlement		<u>(\$163,272)</u>

In the PAR, the Audit staff recommended that LCBNW provide documentation demonstrating that it was entitled to the matching funds it received. LCBNW did supply additional documentation and additional work was performed as stated in the previous finding. In addition, in its written response to the PAR, LCBNW stated that after reviewing the additional documentation, the Audit staff should determine

that no repayment is required other than that arising from the stale dated checks. This was not the case.

Recommendation #2

The Audit staff recommends that the Commission determine that LCNBW has received matching funds in excess of entitlement in the amount of \$163,272 and that an equal amount is repayable to the U.S. Treasury.

D. STALE-DATED CHECKS

Section 9038.6 of Title 11 of the Code of Federal Regulations states that if the committee has checks outstanding to creditors or contributors that have not been cashed, the committee shall notify the Commission. The committee shall inform the Commission of its efforts to locate the payees, if such efforts have been necessary, and its efforts to encourage the payees to cash the outstanding checks. The committee shall also submit a check for the total amount of such outstanding checks, payable to the United States Treasury.

The Audit staff identified 47 stale-dated checks totaling \$4,370. The checks were dated between April 22, 1999 and August 10, 2000 and had not cleared the bank as of September 30, 2001.

This matter was discussed at the exit conference and LCNBW was provided with a detailed schedule of stale-dated checks. LCNBW representatives had no response.

The Audit staff recommended in the PAR, that LCNBW provide evidence that the checks were not outstanding (i.e., copies of the front and back of the negotiated checks), or that the outstanding checks were voided and that no LCNBW obligation existed. Absent such evidence, the Audit staff recommended that LCNBW repay \$4,370 in stale-dated checks to the United States Treasury.

Subsequent to the receipt of the PAR, LCNBW submitted additional information with respect to some of the outstanding checks. The Audit staff updated the list of outstanding checks and determined that the revised amount was \$3,281.

Recommendation #3

The Audit staff recommends that the Commission determine that a payment of \$3,281 is due the United States Treasury.

IV. SUMMARY OF AMOUNTS DUE TO THE U.S. TREASURY

Finding II.A.	Apparent Non-Qualified Campaign Expenses	\$ 70,139
Finding II.C.	Matching Funds Received in Excess of Entitlement	\$ 163,272
Finding II.D.	Stale-Dated Checks	<u>\$ 3,281</u>
	Total	<u>\$ 236,692</u>



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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2003 APR 17 P 3:22

April 17, 2003

MEMORANDUM

TO: Robert J. Costa
Deputy Staff Director

THROUGH: James A. Pehrkon *JAP*
Staff Director

FROM: Lawrence H. Norton *LHN*
General Counsel

Gregory R. Baker *GRB*
Acting Associate General Counsel

Lorenzo Holloway *LH*
Assistant General Counsel

Michelle E. Abellera *mea*
Attorney

SUBJECT: Report of the Audit Division on LaRouche's Committee for a New Bretton Woods (LRA #565)

I. INTRODUCTION

The Office of General Counsel reviewed the proposed Report of the Audit Division ("Proposed Report") on LaRouche's Committee for a New Bretton Woods ("the Committee") submitted to this Office on February 11, 2003. This memorandum summarizes our comments on the Proposed Report.¹ Our comments address two procedural issues and a repayment finding. We concur with any findings not specifically discussed in this memorandum. If you have any questions, please contact Michelle E. Abellera, the attorney assigned to this audit.

¹ The Office of General Counsel recommends that the Commission consider this document in open session. See 11 C.F.R. § 9038.1(e)(1).

II. FACTUAL BACKGROUND

The Committee, which sought to reach voters through grassroots organizing, operated a massive outreach campaign of policy broadsides and leaflets, pamphlets, books, and discussions. The Committee entered into contracts with seven regional vendors to distribute the literature.² The Committee estimates that the vendors distributed at least 8,502,500 leaflets (18 separate titles and topics), 4,674,00 pamphlets (17 separate titles), 76,976 videos (14 separate programs), 185,000 books and 80,000 releases and posters. The vendors also solicited and collected contributions for the Committee.

According to the Committee, the vendors have as their primary purpose the dissemination of political, philosophical and scientific literature and ideas originated by Lyndon LaRouche and his political associates. At the same time that the vendors were distributing literature on behalf of the campaign and generating/collecting campaign contributions, the vendors were also conducting non-campaign-related business activities for the Candidate.³ These business activities also involved literature distribution and sales. Furthermore, some of the same literature distributed in the vendors' normal course of Lyndon LaRouche business was also distributed for the campaign. The Committee indicates that the income of the vendors, for the 15 years or more of their existence, has been derived from subscription and single issue sales of books, videotapes, periodical and other publications, and contributions and donations by the general public.

Given that the vendors were involved in two activities at the same time, the Committee had to allocate the vendors' expenses to determine the amount the vendors should charge to the Committee for campaign-related activity. To properly allocate campaign-related expenses to the Committee, the vendors applied an activity ratio. The activity ratio represented the number of disbursement and contribution transactions for a vendor which were campaign transactions compared to the number of financial transactions which constituted non-campaign sales, subscription and contribution activities ("other transactions").

The vendors also charged the Committee a markup percentage. The Committee claims the markup percentage represented payment for underestimated and highly variable vendor costs, startup and intangible costs and advance payment/bad debt reserve. The vendors applied the markup percentage to their baseline monthly operational expenses for the months of April through September 1999 (80% markup) and October through December 1999 (50% markup).

² In addition to literature distribution, the vendors performed other services. See *infra* note 9.

³ This Office notes that five of the vendors are incorporated as not-for-profit corporations; the two remaining vendors, although incorporated as for-profit entities, "do not operate to generate a commercial profit." Proposed Report at 5.

The Preliminary Audit Report ("PAR") concluded that the Committee incurred \$1,651,951 in non-qualified campaign expenses for services performed by the seven regional vendors. The PAR requested that the Committee provide documentation supporting the amounts billed by the vendors. The Committee was asked to validate the number of reported campaign transactions included in the activity ratio and to provide an explanation for the variable markup percentages.⁴ In addition, the Audit Division concluded that two vendors overbilled the Committee and that all seven vendors improperly extended credit to the campaign by allowing large debts to accumulate under the contract. The Audit staff requested that the Committee provide additional vendor documentation demonstrating that the vendors did not overbill and that credit was extended in the normal course of business. As a part of its response to the PAR, the Committee provided only selected records for all seven vendors, consisting of bank statements, canceled checks and additional documentation such as receipts, invoices and memoranda to support the expenditures allocated to the Committee.

III. PROCEDURAL ISSUES

The Committee's PAR response raises two procedural issues. First, the Committee argues that it sufficiently documented the vendor expenses with the materials supplied at the start of the audit fieldwork. The Committee argues that "vendors who are not agents of the campaign are not required under 11 C.F.R. § 9033.11 to keep the type of detailed records which are required of the campaign or its agents."⁵ The Committee argues that the documentation provided during the audit—the vendor contracts and the invoices and cancelled checks showing payment to the vendors—met all the specificity requirements of 11 C.F.R. § 9033.11. *See* 11 C.F.R. § 9033.11. Hence, it was unnecessary and unlawful for the Commission to request further documentation from third party vendors.⁶ Second, the Committee argues that because it provided new information which may be included in the proposed Audit Report, the Committee has a

⁴ The Audit Division requested "bank statements, deposit slips, canceled checks, debit and credit memoranda for all accounts; workpapers showing the computation of the activity ratio including but not limited to an explanation of how receipts were tracked; computerized records; documentation or explanation for the markup percentage charged; source documents and other related materials for all contract and lease agreements; audit reports or financial statements prepared by an external accounting firm; tax returns; invoices and receipts for all expenses; and documentation demonstrating the derivation of staff billing hours." PAR Attachment 1.

⁵ As the Committee explains, "an agent must hold express or implied authority to make expenditures on behalf of the campaign. Here, the contract specifies that the vendors are being reimbursed for use of their facilities and specific organizing services. Under the contract, only the Treasurer can authorize expenditures by the campaign."

⁶ The voluminous documentation required the Audit staff to travel to the Committee's headquarters in Leesburg, Virginia to review the materials. This additional fieldwork continued for three weeks. The Committee argues that, by conducting this "endless audit," the Commission has abused its statutory and regulatory authority. *See* 11 C.F.R. § 9033.1.

right to respond to all issues—including changes from the PAR and any new findings—prior to the Commission's consideration of the Audit Report.

The documentation regulation is concerned with both ensuring that a payment actually was disbursed and that it was used for an appropriate purpose. *Fulani for President v. FEC*, 147 F.3d 924, 928 (D.C. Cir. 1998). The documentation requirement also satisfies the "public's right to know how tax monies are distributed." *Reagan-Bush Committee v. FEC*, 525 F. Supp. 1330, 1340 (D.D.C. 1981). Although the vendor contracts and invoices, taken as whole, may have met the minimum documentation requirements of 11 C.F.R. § 9033.11, the Commission may ask the Committee for additional information when there are remaining questions about the Committee's disbursements.⁷ 11 C.F.R. § 9033.1(b)(3). Furthermore, candidates are required to obtain and furnish to the Commission upon request all documentation relating to funds received and disbursements made on the candidate's behalf by other political committees and organizations associated with the candidate. 11 C.F.R. § 9033.1(b)(6).

Given the close relationship of the vendors and the Committee, as well as other LaRouche entities, the Commission had the authority to treat the vendors as "organizations associated with the candidate" and ask the Committee for additional vendor documentation. Thus, a review of vendor documentation was not only lawful but necessary to determine whether the vendors' expenses allocated to the campaign were for the purpose of seeking the nomination. See 11 C.F.R. § 9032.9(a)(2); *Fulani*, 147 F.3d at 928.

In addition, the Committee does not have a right to respond to the proposed Audit Report prior to the Commission's consideration. There are no provisions contained in the regulations that permit a committee to submit additional comments or responses prior to the Commission's consideration of the proposed Audit Report. See 11 C.F.R. § 9038.1(c)(2). The Committee is concerned that the additional vendor information will give rise to new findings that were not covered by its original response to the PAR. However, the regulations specifically state that "the Commission-approved audit report may address issues other than those contained in the [PAR]." 11 C.F.R. § 9038.1(d)(1).⁸

⁷ According to the Audit staff, all requests for additional documentation and information regarding vendor expenses were made through the Committee.

⁸ See also *Financial Control and Compliance Manual for Presidential Primary Candidates Receiving Public Financing* (April 2000), Chapter 10, Section D.2.h. ("Occasionally the audit report may contain one or more findings that were not discussed at the exit conference or in the Preliminary Audit Report... These findings are generally the result of additional information that comes to light after the audit field work or information provided by the campaign in its response to the Preliminary Audit Report.") If the Committee disputes any repayment determination arising out of the Audit Report, it may request an administrative review pursuant to 11 C.F.R. § 9038.2(c)(2).

IV. NON-QUALIFIED CAMPAIGN EXPENSES

In the PAR, the Audit Division concluded that the Committee incurred \$1,651,951⁹ in non-qualified campaign expenses for services performed by the seven regional vendors. After reviewing the response to the PAR, the Audit Division now accepts all but \$484,033 of the vendor expenses as qualified campaign expenses. The Audit staff disallowed all markup charges, totaling \$390,026, and disallowed vendor expenses totaling \$94,007¹⁰ (\$390,026 + \$94,007=\$484,033).

A. Activity Ratio

In response to the PAR, the Committee submitted Detailed Summary Reports showing individual and daily entries of campaign-related transactions and sales for all seven vendors. The Audit Division accepts the majority of vendor costs calculated under the activity ratio as qualified campaign expenses. The Committee submitted a substantial amount of additional information to support the activity ratio. The information was extremely detailed with respect to the date and type of each purported campaign-related transaction. The Audit staff concluded that the activity ratio was a reasonable method of allocating expenses and also noted the mathematical accuracy of the reported activity ratios.

While it is true that the Committee provided very detailed information related to the activity ratio calculation, the documentation is not complete: the missing piece to the equation is the information that would demonstrate that the vendors were justified in classifying any particular expenditure as campaign-related. For example, the Detailed Summary Report shows the vendor Eastern States Distributor, Inc. ("ESDP") conducted approximately 930 contribution and subscription transactions in the period December 17 through December 31, 1999. Of this amount, the Committee claims that approximately 207 transactions were campaign-related. Therefore, the Committee used these 207 transactions to calculate the activity ratio for the ESDI expenses charged to the Committee. Unfortunately, there is no information to support the vendor's conclusion that it made 207 campaign-related transactions from December 17 through December 31, 1999. This problem is exacerbated by the fact that we know that the vendors were engaged in similar, but non-campaign-related activity, at the same time.

⁹ The Committee was invoiced a total of \$2,450,531 by the regional vendors. The \$1,651,951 figure represents the portion of non-qualified campaign expenses paid while the Committee's bank account still contained federal funds. See 11 C.F.R. § 9038.2(b)(2)(iv).

¹⁰ The \$94,007 figure includes expenses for rent paid on a farm in Leesburg, Virginia (\$31,070) and disbursements to two vendors, American Systems Publications (\$28,110) and Southeast Literature Sales (\$34,827), for which no documentation was provided to demonstrate the disbursements were in connection with seeking the nomination.

This Office acknowledges that portions of the amount that the vendors charged to the Committee are undoubtedly campaign-related.¹¹ However, since the vendors were engaged in similar and overlapping activities at the same time, the line between advocacy made in connection with the nomination and general political advocacy is blurred. Thus, we remain concerned that the Committee may have paid the vendors for items that were general political advocacy.

As an alternative to the Audit Division's approach, the Commission could conclude that the expenses at issue should remain nonqualified campaign expenses. The basis for the disallowance of vendor expenses is threefold. First, the close relationship between the Committee and the seven vendors raises questions as to whether the vendors' contracts were arm's length transactions. Second, the vendors performed similar, and arguably indistinguishable, services and activities in both their campaign and non-campaign-related functions. Last, the Committee has the legal burden of documenting its expenses as qualified campaign expenses. 11 C.F.R. § 9033.11(a). The Committee did not submit information demonstrating that any particular vendor expenditure used in calculating the activity ratio was for the purpose of seeking the nomination.¹² 11 C.F.R. § 9032.9(a).

The Office of General Counsel recognizes that there are numerous vendor transactions. As a result, the Committee may find it difficult and burdensome to document the transactions.¹³ Nevertheless, the Commission's request for documentation beyond the minimum amount required by the regulations is consistent with past Commission practice.¹⁴ Also, the request for additional information is justified, given the

¹¹ For example, this Office notes that some literature advocating the election of the Candidate was produced solely for the election. In such instances, vendor expenses associated with the distribution of these materials and all resulting contributions are clearly campaign-related. Therefore, no further documentation is required for those transactions.

¹² For example, Publication and General Management, Inc. ("PGM"), a management company for the literature publishers, provided the Committee with uniform computer reporting services by which subscription and other sales and contribution items were entered and reported at the point of sale or contribution. According to the Committee, campaign-related receipts were "identif[ied] vis-à-vis previously reported pledges (based on information submitted to PGM, electronically, by committee fundraising volunteers)." Thus, there exists some underlying documentation to support the Daily Summary Reports prepared by PGM. This documentation may provide additional information regarding the reporting, entry and calculation of campaign transactions, and therefore constitute sufficient evidence that the transactions were made in connection with seeking the nomination.

¹³ Should the Committee submit a request for review of the Commission's repayment determination, the Committee may submit this information as a part of its written materials. See 11 C.F.R. § 9038.2(c)(2)(i).

¹⁴ The request for additional documentation from the seven vendors is consistent with the Commission's past treatment of media vendors. According to the Audit staff, expenditures relating to the purchase of media airtime typically account for 50% of a campaign's disbursements. The media vendor invoices do not contain detailed information. Therefore, the Audit staff also requests and reviews additional

following factors: 1) the close relationship between the Committee and the vendors; 2) the vendors were engaged in campaign and non-campaign-related activity for the Committee at the same time; and 3) the transactions were characterized (campaign-related vs. non-campaign-related) at the vendor level.

B. Markup Charges

In its response to the PAR, the Committee stated that the purpose of the markup was threefold: 1) to cover costs not included in the vendors' baseline charges and highly variable costs that were underestimated; 2) to compensate for one-time start up costs; and 3) to serve as advance payment/bad debt reserve and to generate a small profit. However, the Committee did not provide any explanation or documentation demonstrating what portion of the 50% and 80% markups served each of the three purposes.

In the Proposed Report, the Audit Division rejects the markup percentage and all resulting charges.¹⁵ According to the Audit staff, the proffered reasons for the markup were not supported by the facts.¹⁶ This Office agrees with the Audit Division's disallowance of the markup percentages and corresponding charges, as the Committee has neither demonstrated nor explained how the markup charges correspond to their purported purposes. However, we recommend that the Audit Division revise the Proposed Report to include a full discussion of its reasons for rejecting the markup, addressing each purpose offered by the Committee.

media vendor records. These records consist of invoices from TV stations and invoices from subcontractors for production. *See* Bush-Cheney 2000, Inc. Audit (media vendor subcontracted approximately \$1.5 million of campaign work to other media vendors; Commission requested and reviewed subcontracts and underlying documentation).

¹⁵ According to the Audit staff, the total amount of markup charges resulting from application of the markup percentages to the vendors' documented expenses totals \$390,026. Taking into account the markup charges, the Audit staff recalculated the expenses billable to the Committee and concluded that the Committee over-paid five of the vendors a total of \$191,695.

¹⁶ For instance, the Committee included other charges (*i.e.*, the monthly fee and the lump-sum charge for services performed prior to April 1999) that appear to have covered any underestimated charges and start-up costs. Furthermore, although the funds were deemed advanced payments, they were neither applied to the total amounts billed by the seven vendors nor refunded to the Committee at the close of the election. Also, the Audit staff deemed it unlikely that the markup constituted a source of "small profit" for the vendors, given their status and/or operation as non-profit entities.

**Response by LaRouche's Committee for a New Bretton Woods
To the FEC Preliminary Audit Report Dated July 17, 2002**

LaRouche's Committee for a New Bretton Woods ("LBW"), by counsel, submits the following response to the Preliminary Audit Report dated July 17, 2002.

Procedural Status and Reservation of Rights

The primary issue presented by the Preliminary Audit Report concerns expenses billed to the campaign by seven vendors pursuant to a written contract between LBW and each of the seven vendors. Recommendation #1 of the Preliminary Audit Report states that LBW should provide additional specified documentation supporting the charges by the seven regional vendors within 60 days. Absent such documentation, the Audit Staff recommends that LBW repay the Treasury \$438,285 because LBW failed to demonstrate that payments to the seven vendors defrayed qualified campaign expenses.¹ 11 CFR 9038.2(b)(2).

By letter dated September 6, 2002, counsel for LBW requested an extension of the September 19, 2002 due date for LBW's response to the Preliminary Audit Report because September 16, 2002 was the earliest possible agreed date by which the FEC could begin its supplemental field audit of the voluminous documentation requested in the Preliminary Audit Report from the seven vendors. LBW proposed an alternative schedule under which the FEC would complete its field audit and provide specific notice to LBW of what issues remained, if any, after the audit, by supplementing and/or modifying the Preliminary Audit Report. LBW would then respond expeditiously to the Preliminary Audit Report as supplemented and/or modified. The Audit Division rejected LBW's proposal, stating that LBW was only entitled to one 15 day extension to October 4, 1999 pursuant to 11 CFR 9038.4(c).

The field audit of all of the documentation requested in Recommendation #1 of the Preliminary Audit Report commenced on September 16, 2002 and is ongoing as of this writing in Leesburg, Virginia. As a result, LBW does not know, at this critical stage of the repayment determination process, what issues remain from the Preliminary Audit Report, after the documents which were requested in that report, have been produced

¹Recommendation #2 of the Preliminary Report recommends repayment of \$211,674 based on a proposed finding that matching funds were received in excess of entitlement. However, this recommendation is based totally on Recommendation #1 and will be nullified if the seven vendors' expenses are found to be qualified campaign expenses. Recommendation #3 of the Preliminary Report concerns stale-dated checks and will be addressed below.

to the FEC. Under the circumstances presented here and on the entire record of this audit, anything less than a full opportunity to respond to any and all issues the Audit Division intends to raise in the Final Audit Report, well before any vote of that report is taken by the Commission, raises serious due process and fundamental fairness concerns about the constitutionality of 11 CFR 9038 as applied.

**1. The Expenses Incurred By the Seven Vendors
Were Qualified Campaign Expenses**

Five of the vendor literature distributors, American System Publications, Southwest Literature Distributors, Midwest Circulation Corporation, Eastern States Distributors, and Southeast Literature Distributors were incorporated in 1987 as not-for-profit corporations. EIR News Service and Hamilton Systems were incorporated as for-profit entities although they do not operate to generate a commercial profit. EIR is a publishing corporation and was incorporated in 1985. Hamilton Systems was incorporated in 1987. The vendors have as their primary purpose the dissemination of political, philosophical, and scientific literature and ideas originated by Lyndon LaRouche and his political associates. Like the advocacy organizations in Beaumont v. Federal Election Commission, 278 F.3d 261, 274 (4th Cir. 2002) each vendor "was formed to disseminate political ideas, not to amass capital."

The income of the vendors for the 15 years or more of their existence has been derived from subscription and single issue sales of books, videotapes, periodical and other publications, and contributions and donations by the general public. In addition to literature distribution activities in several states, EIR News Service publishes a weekly print and web-based national and international news magazine, *EIR*. The magazine has been continuously published since 1973. The literature distributors purchase wholesale, literature from four publishing entities, EIRNS, KMW Publishing Company (publisher of the weekly newspaper, the *New Federalist*), the Schiller Institute (publisher of *Fidelio* magazine), and 21st Century Science Associates (publisher of *21st Century Science and Technology* magazine), and sell it retail to the general public. A management company for the publishers, PGM, provides uniform computer reporting services by which subscription and other sales and contribution items are entered and reported at the point of sale or contribution and at PGM in Leesburg, Virginia.

In prior campaigns by Lyndon LaRouche for President in 1988, 1992, and 1996 literature distribution and other services and facilities were provided by these distributors and EIR to the respective campaign committees pursuant to contract. The three prior presidential campaigns had as a substantial focus national television and other major media addresses by the candidate with direct literature distribution activities serving to amplify the media addresses. The 2000 Presidential campaign adopted a strategy emphasizing grassroots political organizing which substantially increased the literature distribution services and facilities use provided to the campaign by the vendors.

As detailed below, the vendors billed LBW for these services and the use of their facilities in accordance with the FECA and the advisory opinions of the FEC. LBW documented these expenditures as required under 11 CFR Section 9033.11 by the invoices, detailed contracts with the vendors, and cancelled checks showing payment, which were provided to the Audit Staff two years ago. In response to the Audit Staff's requests, LBW obtained further documentation for these disbursements, over and above that required by 11 CFR Section 9033.11, from the vendors which has been provided to the Audit Staff. LBW believes that any question that these disbursements were qualified campaign expenses was settled with its supplemental submission to the FEC of October 10, 2001 and that the endless audit upon which the FEC appears now to be embarked is an abuse of the authority granted by 11 CFR 9033.1 and contravenes fundamental First Amendment due process and associational rights.

THE 2000 CAMPAIGN

Although LaRouche registered his principal campaign committee in September of 1997, there was not a great deal of activity by the campaign until April of 1999. Between September of 1997 and February of 1999, funds were primarily expended for printing three campaign programmatic pamphlets, and reprinting the program book from LaRouche's 1996 campaign, *To Save the Nation*. In February of 1999, the candidate's book *The Road to Recovery* was printed and released by the campaign and between February and May 1999, two campaign broadsides were produced and distributed, each with a print run of one million.

LaRouche's 2000 grass roots organizing campaign strategy was devised in the face of a concerted effort by then Vice-President Al Gore and the Democratic Leadership Council (DLC) to control the debate in the Democratic primaries and lock LaRouche out of the process. The Democratic National Committee, acting in concert with the Gore campaign and the DLC, sought to improperly use Democratic Party rules to keep LaRouche off Democratic Party primary ballots, denied LaRouche delegates to which he was entitled on the basis of the number of votes cast for him by Democratic voters in primaries and caucuses² and blocked LaRouche's participation in local and nationally broadcast debates. In August 1999, the FEC contributed to this interference in LaRouche's campaign when its press staff, acting officially, falsely stated to the national news media that LaRouche was not eligible to be on Democratic Party Primary ballots. (See, Appendix A).

² LaRouche received more than 53,000 votes, or 23% in the Arkansas Democratic Primary. This vote total re-qualified LaRouche for Federal Matching Funds and entitled him to 9 delegates to the Democratic National Convention. The Democratic National Committee, in violation of Arkansas state law, refused to allow LaRouche to appoint 9 members of the Arkansas delegation, allocating the entire Arkansas delegation to LaRouche's only opponent, Vice-President Al Gore.

Cut off from access to local and national media coverage and with prohibitive costs for paid political advertisements, LaRouche sought to reach the voters directly by old fashioned face to face, one-on-one organizing methods directed both at leaders of political constituencies and those Americans who had been abandoned by the political process. He decided to take on Gore and the DLC through a massive outreach campaign of policy broadsides and leaflets, pamphlets, books, and discussions aimed at the leaders and potential leaders of the Democratic party, specifically seeking to rebuild the coalition of labor, minorities, farmers and entrepreneurs which was Franklin Delano Roosevelt's legacy and thereby embolden other qualified potential candidates to step forward. Citing the world's economic depression and threatened war, LaRouche wrote in an April, 1999 broadside, "The world's needs cry out for a U.S. leader with the outlook and commitments of a Franklin Delano Roosevelt. U.S. candidates who are not committed to policies and outlooks like those of Roosevelt are of little use to the United States, or the world as a whole today. For the moment I am the only visible candidate who meets that standard. . . . I hope that qualified other candidates do appear. We shall then create a forum among such candidates, a forum in which what really should be discussed will be discussed. . . ."

LaRouche's strategy was premised on use of the Internet, specifically a campaign website and Internet webcasts, featuring the candidate in discussions with various constituency groups e.g., civil rights leaders, labor, state legislators and other elected representatives, about national and international issues and events. Audiences for the webcasts had to be built largely through personal contacts supplemented by E-mails and similar advertising. The strategy also depended upon massive dissemination of topical campaign literature and videotapes to leaders of political constituencies and concerned individuals throughout the United States, primarily through one-on-one contacts at meetings, public events, and public locations, such as post offices, DMV's, campuses, and downtown locations. A series of photographs of these activities is set forth at Appendix B. Additional photographs can be provided if the FEC so requests.

As a result of this strategy at least 8,502,500 leaflets (18 separate titles and topics) 4,674,000 pamphlets (17 separate titles), 76,976 videos (14 separate programs), 185,000 books and 80,000 releases and posters were disseminated through the vendors. In addition, LaRouche participated in 34 webcasts with various constituency groups. (See Appendix C). Reflecting the increased level of vendor activity inherent in this strategy is the fact that the month of May, 1999 the vendors distributed over 500,000 copies of a LaRouche broadside entitled "Time to Vote for a Change," 500,000 copies of a broadside outlining the candidate's Balkans reconstruction program, and 200,000 copies of his pamphlet on the economy which challenged citizens to test their Economics IQ. The literature distribution vendors' role increased dramatically from May 1999 forward and for the period between May, 1999 and the August, 2000 Democratic Convention was several orders of magnitude higher than previous campaigns. In addition, the literature distributors were responsible for coordinating petitioning drives for ballot access in the states in which they operated.

The Contract With the Vendors and Payments Made Pursuant To the Contract

In commenting on the audit of LaRouche's 1996 campaign, the FEC's General Counsel expressed concern about whether the vendor distribution companies were receiving adequate compensation from the campaign for the facilities and services they provided or whether, in fact, excessive in-kind and/or corporate contributions were being made based upon inadequate compensation by the campaign committee to the entities. Both the Audit Division and the General Counsel decided against any further investigation of this concern since the audit disclosed no wrongdoing by the 1996 campaign committee. See, June 20, 1997 Memorandum to Robert Costa from Lawrence M. Noble, et al.

In anticipation of the vastly increased activities proposed for these vendors in the 2000 campaign, the campaign and the vendors in April of 1999 signed and implemented a contract and reached an agreement concerning rates of reimbursement under that contract which they believed would insure that all campaign related costs incurred by the vendors would be captured and duly compensated.

There were two types of expenses specified in the contract between the campaign committee and the vendors, expenses reimbursed directly by the campaign to the vendor after being pre-approved by LBW's treasurer and "general organizing expenses." To LBW's knowledge the expenses pre-approved by the Treasurer and reimbursed directly under the contract are not at issue. The documentation issues in the continuing audit and the Preliminary Audit Report concern the "general organizing expenses" specified in the contract.

The contract specifies that "general organizing expenses" involve reimburseable expenses incurred by campaign volunteers engaged in campaign activity, and reasonable charges for use by campaign volunteers of the vendor's office space, equipment, telephones, and like expenses. In arriving at the fees which were to be charged to the campaign, each vendor first set forth baseline monthly operational charges for rents and utilities; office expenses including equipment, supplies, insurance, security and other costs; automobiles; telephones; meeting, travel and field costs; postage and shipping; and any relevant administrative costs, such as bank fees. Some vendors estimated these charges and projected them over the life of the contract. Other vendors provided their actual costs for operational expenses on a monthly basis over the life of the contract in computing the fees charged to the campaign.

The PGM computer reporting system was then utilized to determine, for any given month, the number of financial transactions for a distributor which were campaign transactions and contributions and the number of financial transactions which constituted non-campaign sales, subscription, and contribution activities. The vendor's baseline charges were then multiplied by the percentage of financial transactions which were campaign contribution transactions to determine the campaign's allocable portion

of the baseline charges, ("Allocable charge to LBW"). For the months of April through September, 1999, the allocable charge to LBW was marked up by 80%. It was marked up by 50% for October 1999 through December of 1999. For the months of January 2000 through December 2000 there was no markup.

To insure that the vendors were compensated for the volunteer campaign activity which occurred in the months prior to the implementation of the contract, the campaign was charged a flat fee by each vendor of \$150 per month for the months of July 1997 through December of 1998. Added to this was an additional amount consisting of the vendors' reported baseline operational costs multiplied by the ratio of campaign transactions to total transactions for the 6 month periods of 7/97 to 12/97, 1/98 to 6/98 and 7/98 to 12/98. This allocable charge to LBW was then marked up 80% for these three 6 month periods. Since activity increased from January 1999 forward, the flat fee was raised to \$750 a month starting in January of 1999. The total amount of all these charges, the \$150 a month and \$750 a month flat fees and the allocable charge as marked up, was the amount written into each contract as due and owing to the vendor as of March 31, 1999. (See Appendix D, Declaration of Richard Welsh).

The purpose of the 80% (September 1997- September 1999) and 50% (October-December 1999) markups to the allocable charge was three-fold. First, it was assumed that not all costs which should be part of the base-line projections forward or back from April, 1999 would be captured in the initial reticulation of baseline charges and that some highly variable costs, such as automobiles (gasoline and repairs), and field, travel, and meeting costs would be underestimated. Second, the markups assured that certain one-time start up costs, such as the use of company lists and contributor data for fund-raising and intangible costs were adequately compensated. Finally, the markups served as a method of advance payment on services to be rendered, a bad debt reserve in the circumstances of this political campaign, and a potential means to generate a small profit.

From the vendors' standpoint, if the campaign had worked in the way that the DLC and Al Gore planned it, LaRouche would have been disqualified from receiving further matching funds in April of 1999 as a result of losses in the Super Tuesday and other March primaries and out of public attention because Al Gore had been anointed and could now focus on the general election. It was to the vendors' business advantage to bill at a rate which served as insurance against the difficult financial circumstances this situation normally entails. As it happened, LaRouche was disqualified in the Super Tuesday and March primaries but he had built sufficient support through his campaign activities so that the Super Tuesday and March primary losses had little impact on his supporters' resolve and he was able to requalify for matching funds as a result of the vote for him in the Arkansas Democratic primary.

The Audit Staff's Expressed Concerns

In the Preliminary Audit Report the Audit Staff expressed concern about what it termed "overbilling" by two vendors, Southeast Literature and Eastern States. The fact that there were large apparent discrepancies in documentation of the baseline expenses charged by these vendors results, in part, from errors by campaign volunteers in administering this somewhat complex contractual arrangement and a \$15,000 error by the FEC auditors in auditing the documents provided by Eastern States. .

The campaign's Assistant Treasurer, Richard Welsh, erred in computing the amount written into the contract as due and owing as of March 31, 1999. (This error is referred to at page 7 of the Preliminary Audit Report.) In computing what the charges should be for the period September, 1997-March 31, 1999, Welsh mistranscribed a decimal point in computing the allocation formula for three vendors, Hamilton Systems Distributors, Eastern States, and Southeast. The amount due at contract inception for Hamilton Systems should be \$11,673, not \$31,021. For Eastern States the amount should be \$13,135 rather than \$37,726 and for Southeast the amount should be \$7,526 rather than \$11,894. (See Declaration of Richard Welsh, Appendix D). The actual balances at contract inception were paid off in June of 1999 for Hamilton Systems and Eastern States and in May of 1999 for Southeast. (See, Appendix F below).

Through an apparent accounting error Southeast made charges of company expenses to the campaign which it could not document as falling under the contract. LBW requested and received \$80,472.50 in repayment from Southeast as a result of this error.

Additionally, the FEC auditor made a \$15,010 error in adding up the documentation of baseline expenses for Eastern States. The error arose from the auditor's treatment of a billing cycle that originally combined the documented expenses for two months, and divided the resulting total by two, but then only listed one of the two halves. (See Appendix E, FEC Audit Spreadsheet for ESDI and the same data recalculated to show the corrected amounts). This error has been acknowledged by the FEC auditor.

When these errors are taken into account, the shortfall in the documentation provided for contractual baseline expenses is \$156,607 for Eastern States and \$33,650 for Southeast.

The Audit Report also suggests that the vendors improperly extended credit to the campaign by allowing large debts to accumulate under the contract for which they were not timely paid. The auditors suggest that the vendors must provide statements to the effect that this is consistent with their business practices with other customers in order to avoid a finding of an improper corporate contribution. 11 CFR Section 116.3.

As outlined below, however, this suggestion is not supported by either the law or the facts of this case.

Applicable Law

Documentation Issues.

11 CFR Section 9033.11 sets forth what documents are required to establish that a disbursement is a qualified campaign expense. Under Section 9033.11, the detailed contract with the vendors, and the invoices and cancelled checks showing payment to the vendors, meet the campaign's burden for documenting that the disbursements to the vendors were qualified campaign expenses.

The Preliminary Audit Report asserts, however, that the contract is vague and that the invoices are non-specific, requiring a further audit. A review of the very detailed contract, the invoices, which refer back to that contract, and the cancelled checks to the vendors, reveals that these documents meet all of the specificity requirements of 11 CFR 9033.11. Further, on October 10, 2001 the campaign and the vendors provided supplemental spreadsheets as requested by the auditors, further detailing the purpose and each category of cost under the contract in full compliance with 11 CFR Section 9033.11.

As noted above, the Preliminary Audit Report also concludes that the records of two vendors, LBW previously provided to the FEC, Eastern States and Southeast, show that these vendors "overbilled" LBW because of a shortfall of documentation in baseline expenses charged to the campaign. The fact that there is a shortfall in documentation of baseline expenses does not necessarily suggest an intent to "overbill" the campaign by these two vendors as the Audit Division seems to conclude. A shortfall in documentation means just that, that some charges that Eastern States and Southeast billed to the campaign were not documented by them.

Further, vendors who are not agents of the campaign are not required under 11 CFR Section 9033.11 to keep the type of detailed records which are required of the campaign or its agents and the vendors in this case are not agents as that term is defined in 11 CFR 109.1(5). An agent must hold express or implied authority to make expenditures on behalf of the campaign. Here, the contract specifies that the vendors are being reimbursed for use of their facilities and specific organizing services. Under the contract, only the Treasurer can authorize expenditures by the campaign.

LBW set up a relatively complicated billing arrangement with the vendors in order to capture all costs being incurred by the vendors, to appropriately pay those costs, and to create a level of transparency as to the components of the bill between the vendors and the campaign. In various Advisory Opinions over the years the Commission has dealt with methods of reimbursement to corporations and other entities for the types of uses of their facilities by campaigns which are at issue here. The rule developed from

these Advisory Opinions is that any reasonable method of allocation which captures the benefit derived by the actual use by the campaign is allowable. (See e.g., Advisory Opinions 1977-12, 1978-34, 1978-34, 1991-37, 1994-37).

Under the theory that the Audit Staff is applying to LBW in this case however, any vendor whose bill is otherwise in compliance with 11 CFR Section 9033.11, who makes a profit over and above costs could be charged with "overbilling," and be required to produce all its financial records for the FEC's auditors. Any campaign committee which does not demand documentation and continuously audit its vendors charges throughout the course of a political campaign would face the consequence of paying its bills twice, once to the vendor and once to the U.S. Treasury as part of a repayment determination.

Under the Audit Staff's theory, if a vendor misestimates variable costs over the life of a contract, such as Eastern States did in this case with respect to telephone costs, the same consequences would ensue for the vendor and for the campaign. Any vendor adding undocumentable costs to a travel bill, such as the use of pay phones or parking meters, would provoke the same consequences. Any professional campaign consultant charging an exorbitant flat fee for consulting services who failed to document every minute spent consulting would find themselves in the same position as LBW's vendors, despite the fact that the consultant's and the political committee's payments of them met all of the requirements of 11 CFR 9033.11 for documenting qualified campaign expenses.

Allegations Concerning Improper Extensions of Credit.

11 CFR 116.3 deals with extensions of credit to political campaigns by commercial entities and the FEC's Advisory Opinions over the years have also dealt with this issue. Here the rule is that if a commercial entity extends credit to a campaign it must demonstrate that it extends credit to other non-political entities of similar size or risk on the same basis. If it is not in the business of providing the services it is providing to the campaign and cannot demonstrate a program of offering similar services on similar terms to others, *then it must seek sufficient payment in advance of the services rendered to insure against any possible shortfall.* (See, e.g. Advisory Opinions, 1991-32, 1994-37, 1997-15).

As noted above, the vendors here are organized to promote ideas not to amass capital in the marketplace and the provisos of 11 CFR 116.3 and the Advisory Opinions do not address their situation. Nonetheless, the 80% and 50% markups utilized to arrive at the fees charged to LBW, meet the requirements set forth in the cited Advisory Opinions for advance payments to insure against possible shortfalls.

Further, contrary to the impression left by the Preliminary Audit Report, there were not huge balances carried by the distributors throughout the term of the contract. As the attached chart demonstrates, payments were made on a regular basis to each of

the entities throughout the life of the contract, reducing balances during the life of the contract to negligible amounts at certain points for each vendor. (See Appendix F).

2. Stale Dated Checks

LBW has provided copies of the three checks it is contesting to the Audit Division. Otherwise, LBW concedes this finding.

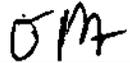
Conclusion

The FEC has had a long history of using its bureaucratic power excessively with regards to the Presidential campaigns of Lyndon LaRouche. As early as 1982 U.S. District Judge Charles Brieant in enjoining an FEC investigation of LaRouche stated that it would be "hard to imagine a more abusive visitation of bureaucratic power" and noted that "It is not a crime for someone such as LaRouche, clearly not part of the mainstream of the Democratic Party . . . to seek its nomination for the Presidency. Had Congress intended to exclude persons situated such as plaintiffs were, from the benefits, if any of matching funds, it could have established criteria that would have had that effect." Memorandum and Order, Dolbeare v. Federal Election Commission, 81 Civ. 4468-CLB, Southern District of New York, March 9, 1982.

This audit has already lasted two years and has resulted in the production of thousands and thousands of documents. LBW has cooperated fully with the Audit Staff in an effort to clarify and resolve all issues. Despite the fact that the disbursements to the literature distribution vendors were shown to be in compliance with the FECA well before the exit conference in August, 2001, in order to avoid unnecessary litigation and further costs to the campaign, LBW has continuously obtained additional documentation from its vendors and provided that documentation to the Audit Staff. This cooperation has included the ongoing audit in Leesburg, Virginia where seven auditors have spent three weeks pouring over vendor records which include thousands of petty cash receipts. The voluminous documentation provided by LBW more than meets the burden required under 11 CFR 9033.11 and all applicable law. The Final Audit Report should determine that no repayment is required other than that arising from the stale dated checks. (A)

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Respectfully submitted,



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