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FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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April 29, 2003

MEMORANDUM

AGENDA ITEM

For Meeting of: 05-07-03

TO: The Commission

THROUGH: James Perhkon
Staff Director

FROM: Lawrence H. Norton *LHN (by JAC)*
General Counsel

Gregory R. Baker *GRB*
Acting Associate General Counsel

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SUBJECT: Oral Hearing – Buchanan/Foster, Inc.
May 7, 2003 (LRA #596)

I. INTRODUCTION

On December 23, 2002, the Commission approved the Report of the Audit Division for Buchanan/Foster, Inc. ("General Committee") and determined that the General Committee must repay \$58,033 to the United States Treasury. Attachment 1. On February 26, 2003, the General Committee submitted legal and factual materials in an effort to demonstrate that a lesser repayment is required to be paid to the United States Treasury. Attachment 2; *see also* 11 C.F.R. § 9007.2(c)(2)(i). On March 28, 2003, the Commission granted the General Committee's request to address the Commission in an open session pursuant to 11 C.F.R. § 9007.2(c)(2)(ii).

There are two bases for repayment in this matter. The first is a surplus of funds that remained unspent after the General Committee's qualified campaign expenses were paid. 11 C.F.R. § 9007.2(b)(3). The pro-rata repayment for the General Committee's surplus is \$33,479. The second is a pro-rata repayment, totaling \$24,554, for income earned on the investment of public funds. 11 C.F.R. § 9007.2(b)(4).

II. REPAYMENT DETERMINATIONS

A publicly-financed candidate must submit a Statement of Net Outstanding Qualified Campaign Expenses ("NOQCE Statement") no later than 30 days after the end of the expenditure report period. The NOQCE Statement includes the Committee's assets, all outstanding obligations for qualified campaign expenses, and the estimated necessary winding down costs. 11 C.F.R. § 9004.9(b). The NOQCE Statement ensures that unspent public funds are repaid to the United States Treasury and that public funds are used only for qualified campaign expenses. *See Explanation and Justification* for 11 C.F.R. § 9004.9, 60 *Fed. Reg.* 31860, 31861 (June 16, 1995).

A qualified campaign expense means any expenditure, including a purchase, payment, distribution, loan, advance, deposit, or gift of money or anything of value: (1) incurred to further a candidate's election to the office of President of the United States; (2) incurred within the expenditure report period; and (3) neither the incurrence nor payment of which constitutes a violation of any law. 11 C.F.R. § 9002.11(a)(1), (a)(2) and (a)(3). A publicly-financed committee has the burden of demonstrating, with supporting documentation, that its disbursements are qualified campaign expenses. 11 C.F.R. § 9003.5(a). However, if a committee makes an overpayment for a purchase, the excessive amount paid constitutes a non-qualified campaign expense. *See Lenora Fulani for President Statement of Reasons in Support of Repayment Determination*, page 17-18 (March 6, 1997).

In the Audit Report, the Commission found that the General Committee overpaid Buchanan Reform, Inc. ("Primary Committee") for a mailing list. The General Committee paid the Primary Committee \$197,496 for the mailing list. However, the Commission found that the General Committee's payment exceeded the fair market value for the list. The Commission valued the mailing list at \$50,000. Therefore, the assets, on the General Committee's NOQCE Statement, include a reimbursement of \$147,496 (\$197,496 - \$50,000) from the Primary Committee. Attachment 1 at 11. The Commission determined that the amount the General Committee overpaid for the mailing list was a non-qualified campaign expense.

As a non-qualified campaign expense, the Commission could have sought a repayment by the General Committee to the United States Treasury as a remedy or utilized the Primary Committee's reimbursement to the Committee as a cure for its payment of the non-qualified campaign expense. 11 C.F.R. § 9007.2(b)(2). *See Bush-Quayle '92 Primary Committee v. FEC*, 104 F.3d 448, 451 (D.C. Cir. 1997) (General election committee and compliance fund have standing with primary election committee to challenge a repayment determination although compliance fund could reimburse the general election committee to eliminate a repayment.) The Commission chose the latter option. Therefore, the Primary Committee's reimbursement is included as an asset on the General Committee's NOQCE Statement.

The General Committee's total assets are \$1,123,807 and its total liabilities are \$1,089,069. Attachment 1 at 11. Therefore, the General Committee has a surplus of \$34,738 (\$1,123,807 - \$1,089,069). The General Committee's repayment ratio is 96.3751%. *Id.* Thus, the Commission determined that the General Committee must repay \$33,479 (\$34,738 x 0.963751) to the United States Treasury for surplus funds.

In addition, the General Committee earned interest on the investment of public funds totaling \$25,478. Therefore, the Commission determined that the General Committee must make a pro-rata repayment of \$24,554 (\$25,478 x .0963751) for income received on the investment of public funds. 11 C.F.R. § 9007.2(b)(4).

III. ADMINISTRATIVE REVIEW OF THE REPAYMENT DETERMINATIONS

A. Purchase of Mailing List

The General Committee contends that "nothing in the Presidential Election Campaign Fund Act or the Commission's regulations supports the Audit Division's conclusion that an otherwise qualified campaign expense becomes an unqualified campaign expense if the Committee pays more than the 'fair market value' for the goods or services."¹ Attachment 2. In the alternative, the General Committee argues that the written appraisal obtained from the Richard Norman Company, an expert in the valuation of mailing lists, establishes that the General Committee paid the fair market value for the mailing list.² *Id.*

The Committee's first contention was addressed by the Commission in the *Fulani Statement of Reasons*. The Commission recognized that:

a qualified campaign expense does not include any payments that are in excess of the amount that would ordinarily be paid to a vendor to provide goods or services. In determining whether a committee paid the amount that would ordinarily be paid to vendors, the Commission will examine the transaction to ensure that the committee paid the commercially reasonable rate or the normal and usual

¹ The General Committee proposes that the surplus repayment would be eliminated should the Commission conclude that the mailing list is at least worth \$84,738 versus the Commission's current fair market value estimate of \$50,000. Attachment 2. It is our understanding from the Audit Division that this statement is accurate.

² The General Committee included this written appraisal with the legal and factual materials submitted with its request for administrative review and oral hearing. The written appraisal states that the \$197,496 paid was a fair market value for the list.

charge.³ (*footnote omitted*) (*citation omitted*). If a committee makes payments to vendors that are not commercially reasonable or exceed the normal and usual charge for the goods or services, the excessive amount has no connection with the candidate's campaign for the nomination. (*citation omitted*). Therefore, the excessive amount is a non-qualified campaign expense that must be repaid to the United States Treasury. (*citation omitted*).

See Id., pages 17-18 (March 6, 1997).⁴

During the audit fieldwork, the General Committee submitted two valuations for the mailing list. The first valuation was provided by Phil Alexander on September 15, 2000, and the second valuation was provided by Precision Lists on January 5, 2001. In addition, on May 10, 2002, Phil Alexander provided additional documentation to support its September 15, 2000 valuation.

The Audit Report concluded that the documentation provided by Phil Alexander was insufficient to "assess the reasonableness of this valuation" for the mailing list. Attachment 1 at 7. The Audit Report also questioned the independence of the Precision List valuation because the General Committee subsequently utilized the services of the vendor. *Id.* at 7.

With regard to the Committee's second contention, the Audit Division reviewed the General Committee's administrative review request, including the more recent written appraisal provided by the Norman Company.⁵ Attachment 3. The Audit Division notes that there were no payments made to the Primary and General Committees by the 1996 and 2000 Buchanan presidential campaign committees to the Norman Company, or any contributions received from the Norman Company to the General Committee for the 1996 and 2000 Buchanan presidential campaign committees. *Id.* However, the Audit Division states that the company was "part of a group that purchased a mailing list from a 1996 Buchanan presidential campaign." *Id.* As a result, the Audit Division has some

³ The terms "fair market value" and "usual and normal charge" are interchangeable. 11 C.F.R. § 100.7(a)(1)(iii)(B).

⁴ *Fulani* involved a primary election committee whose definition of a "qualified campaign expense" for a primary election committee is governed by 11 C.F.R. § 9032.9. Section 9032.9 states that expenses incurred by a primary election committee must be "made in connection with the candidate's campaign for nomination." 11 C.F.R. § 9032.9. However, the definition for "qualified campaign expense" for a general election committee, pursuant to 11 C.F.R. § 9002.11(a)(1), states that expenses incurred by a general election committee must be "incurred to further a candidate's campaign for election." The Office of General Counsel has found nothing in the legislative history to suggest that the standard enunciated in *Fulani* would not equally apply to general election committees merely because these regulatory provisions utilize slightly different language in defining a qualified campaign expense.

⁵ The written appraisal submitted by the General Committee was provided by a different company than the entities who provided the previous two valuations during the Audit stage.

concern regarding the independence of Mr. Norman's appraisal.⁶ *Id.* Therefore, the Commission must decide whether Mr. Norman's appraisal is credible given the concerns raised about his independence.⁷

B. Income Received

The General Committee contends that, as a minor party candidate who does not receive full federal funding, "no reason exists, therefore, to prohibit a minor party candidate from 'keeping' and 'spending' the interest it received from the financial institutions in which it deposits its 'partial' federal payment". Attachment 2 at 6. The General Committee analogizes its situation to a publicly-financed primary committee. In the primary public financing system, a primary committee may be required by the Commission to repay the net income derived from an investment of public funds after the candidate's date of ineligibility. 11 C.F.R. § 9038.2(b)(4). Therefore, a primary committee is entitled to retain interest that is earned on the account during the candidate's period of eligibility. The retention of this interest is a logical extension of the concept that the primary committee may receive financing from private sources.

In the general election context, major party candidates who are eligible for general election financing receive all of their funding from the government. 26 U.S.C. § 9003(b)(2). Minor party general election candidates do not enjoy the same level of public financing as major party candidates. These candidates only receive partial financing from the federal government. 26 U.S.C. § 9004(a)(3). These candidates may receive the remainder of their financing from private contributions. 26 U.S.C. § 9003(c)(3). Therefore, the General Committee maintains that minor party candidates who receive federal funding in the general election are in a similar situation to publicly-financed primary election candidates. However, the regulations do not distinguish between a fully funded and partially funded general election campaigns regarding the repayment of interest income. 11 C.F.R. § 9007.2(b)(4).

The Commission must make the policy determination of whether the retention-of-interest concept should be extended to minor party candidates who receive partial public financing in the general election. However, in deciding this issue, the Commission must assess whether the repayment of gains received from the investment of public funds "ensures that any income received through the use of public funds benefits the public financing system." *Explanation and Justification* for 11 C.F.R. § 9007.2 at 60 Fed. Reg. 31864 (June 16, 1995).

⁶ The Office of General Counsel notes that possibility of obtaining the services of an expert in the valuation of mailing lists in order to objectively determine the credibility of the Norman Company valuation.

⁷ It is our understanding that Mr. Norman will not be available during the Committee's oral hearing.

Attachments

1. Report of the Audit Division on Buchanan/Foster, Inc. approved December 23, 2002
2. Dispute of Repayment Determination Finding for Buchanan/Foster, Inc. dated February 26, 2003
3. Audit Division Comments on the General Committee's Response to the Repayment Determination dated March 18, 2003

REPORT OF THE AUDIT DIVISION
ON
BUCHANAN FOSTER, INC.

Approved December 23, 2002



FEDERAL ELECTION COMMISSION
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TABLE OF CONTENTS
BUCHANAN FOSTER, INC.

	Page
Executive Summary	1
Final Audit Report	3
Background	3
Findings	5
Legal Analysis	15
Transmittal to Committee	21
Chronology	23



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

**REPORT OF THE AUDIT DIVISION
ON
BUCHANAN FOSTER, INC.**

EXECUTIVE SUMMARY

The Committee to Elect Patrick J. Buchanan registered with the Federal Election Commission on August 31, 2000, as the principal campaign committee for Patrick J. Buchanan, candidate for the Reform Party's nomination for the office of President of the United States.¹

The audit is mandated by Section 9007(a) of Title 26 of the United States Code, which requires the Commission to audit committees authorized by candidates of each political party for President and Vice President.

The findings of the audit were presented to BFI at the exit conference held on April 23, 2002, and in the preliminary audit report. BFI's responses to the findings are contained in the audit report.

The following is an overview of the findings contained in the audit report.

ITEMIZATION OF RECEIPTS – 2 U.S.C. §434(b)(3)(A) and 11 CFR §104.18(f). BFI did not itemize 76 contributions from individuals, totaling \$34,230, as required. BFI filed amended electronic reports itemizing the contributions as requested.

APPARENT NON-QUALIFIED CAMPAIGN EXPENSES – 11 CFR §§9002.11(a)(1); 9003.5(a); 9007.2(b)(2)(i) and (iii); and 9004.4(a)(5).

- **DONOR LIST** – BFI purchased a mailing list from Buchanan Reform, Inc. for \$197,496 but did not provide sufficient documentation demonstrating that the amount paid represented the fair market value of the list. The Audit staff determined the fair market value to be \$50,000 and the overpayment (\$147,496) has been included in the Statement of Net Outstanding Qualified Campaign Expenses as a receivable due from Buchanan Reform, Inc. As such, no repayment is warranted.

¹ The Committee to Elect Patrick J. Buchanan amended its Statement of Organization on November 29, 2000 changing its name to Buchanan Foster, Inc. (BFI).

- **BONUSES** – BFI paid \$70,000 in bonuses and was unable to document that they were provided for pursuant to a written contract with the recipients made prior to the date of the election. The Commission decided that, although BFI's documentation was not a written contract, it offered sufficient documentary evidence of BFI's attempt to comply with the "written contract" provision at 11 CFR §9004.4(a)(5). As such, no repayment is warranted.

NOQCE SURPLUS REPAYMENT – 11 CFR §§9004.4(b)(9); 9007.2(b)(2)(iii); and 9007.2(b)(3). A Statement of Net Outstanding Qualified Campaign Expenses (NOQCE) was prepared to determine BFI's financial position as of the end of the expenditure report period, December 7, 2000. The NOQCE Statement reflects a surplus of \$34,738 of which \$33,479 is repayable to the United States Treasury.

INCOME RECEIVED – 11 CFR §§9004.5; 9007.2(b)(2)(iii); 9007.2(b)(4). BFI earned interest (net of taxes) of \$25,478. Since BFI received funding from the Presidential Election Campaign Fund, a pro-rata portion of any income earned is repayable to the United States Treasury. As a result, BFI is required to repay \$24,554.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20461

**REPORT OF THE AUDIT DIVISION
ON
BUCHANAN FOSTER, INC.**

I. BACKGROUND

A. AUDIT AUTHORITY

This report is based on an audit of Buchanan Foster, Inc. (BFI). The audit is mandated by Section 9007(a) of Title 26 of the United States Code. That section states "after each presidential election, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of the candidates of each political party for President and Vice President." Also, Section 9009(b) of Title 26 of the United States Code states, in part, that the Commission may conduct other examinations and audits as it deems necessary to carry out the functions and duties imposed on it by this chapter.

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 covered the period from BFI's first financial transaction, August 14, 2000, through December 31, 2001. BFI reported an opening cash balance of \$-0-; total receipts of \$13,496,168; total disbursements of \$13,475,936; and a closing cash balance of \$20,178. In addition, the Audit staff conducted limited reviews of reported activity through September 30, 2002.

C. CAMPAIGN ORGANIZATION

The Committee to Elect Patrick J. Buchanan registered with the Federal Election Commission (the Commission) on August 31, 2000, as the principal campaign committee for Patrick J. Buchanan. On November 29, 2000, an amended statement of organization was filed which indicated a name change to Buchanan Foster, Inc. Patrick J. Buchanan was a candidate for the Reform Party's nomination for the office of President of the United States. The Treasurer was, and continues to be, Angela M. Buchanan.

During the audit period, BFI maintained its headquarters in Vienna, Virginia and moved to McLean, Virginia in February of 2001. BFI maintained depositories in Vienna,

Virginia and Washington, D.C. To handle its financial activity, BFI used nine bank accounts. From these accounts, BFI made approximately 1,300 disbursements.

On September 13, 2000, the Commission determined that, based on the votes received by the Reform Party in the 1996 general election, Mr. Buchanan was eligible to receive pre-election funding from the Presidential Election Campaign Fund; BFI received \$12,613,452 from the United States Treasury on September 14, 2000. Additional receipts received through December 31, 2001, included \$535,675 in contributions from individuals; \$220,819 from vendor refunds and rebates; \$73,036 from interest and other income; and \$53,132 in transfers received from Buchanan Reform, Inc., the Candidate's primary campaign committee.

D. AUDIT SCOPE AND PROCEDURES

In addition to a review of expenditures made by BFI 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 (see Finding II.);
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 debts and obligations;
6. the accuracy of total reported receipts, disbursements and cash balances as compared to campaign bank records;
7. adequate recordkeeping for transactions (see Finding III.A.);
8. accuracy of the Statement of Net Outstanding Qualified Campaign Expenses (NOQCE Statement) disclosing its financial position (see Finding III.B.);¹
9. compliance with spending limitations; and,

¹ BFI did not file a Statement of Net Outstanding Qualified Campaign Expenses. The Audit staff generated the Statement of Net Outstanding Qualified Campaign Expenses presented at Finding III.B.

10. other audit procedures that were deemed necessary in the situation (see Findings III.C. & III.D.).

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

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 this report in an enforcement action.

II. AUDIT FINDING AND RECOMMENDATION – NON-REPAYMENT MATTER

ITEMIZATION OF RECEIPTS

Section 434(b)(3)(A) of Title 2 of the United States Code states, in part, that each report under this section shall disclose the identification of each person (other than a political committee) who makes a contribution to the reporting committee in an aggregate amount or value in excess of \$200 within the calendar year,² together with the date and amount of such contribution.

Section 104.18(f) of Title 11 of the Code of Federal Regulations states, in part, if a committee files an amendment to a report that was filed electronically, it shall also submit the amendment in an electronic format. The committee shall submit a complete version of the report as amended, rather than just those portions of the report that are being amended.

The Audit staff reviewed all contributions from individuals requiring itemization. Based upon this review, it was determined that 76 contributions from individuals totaling \$34,230 were not itemized on Schedule A-P (Itemized Receipts) as required. Forty-three of the errors totaling \$30,834 (90%) involved contributions in amounts greater than \$200. The Audit staff could not determine, nor could BFI representatives explain, why these contributions were not itemized.

At an exit conference held at the close of fieldwork, the Audit staff discussed this matter with BFI representatives and provided them with a schedule of those contributions from individuals that had not been itemized. BFI representatives indicated amended disclosure reports would be filed.

In the preliminary audit report, the Audit staff recommended that BFI file complete amended reports itemizing the contributions from individuals discussed above.

² This was changed to "election cycle" in the case of an authorized committee of a candidate for Federal office, effective for reporting periods beginning after December 31, 2000 (amended by section 641 of the Treasury and General Government Appropriations Act, 2000, Pub. Law No. 106-58, signed into law on September 29, 1999).

In response to the preliminary audit report, BFI filed complete amended reports as requested.

III. AUDIT FINDINGS AND RECOMMENDATIONS — AMOUNTS DUE TO THE UNITED STATES TREASURY

A. APPARENT NON-QUALIFIED CAMPAIGN EXPENSES

Section 9002.11(a)(1) of Title 11 of the Code of Federal Regulations states, in part, that *qualified campaign expense* means any expenditure incurred to further a candidate's campaign for election to the office of President or Vice President of the United States.

Section 9003.5(a) of Title 11 of the Code of Federal Regulations states, in part, that each candidate shall have the burden of proving that disbursements made by the candidate or his authorized committee(s) are qualified campaign expenses as defined in 11 CFR 9002.11.

Section 9007.2(b)(2)(i) of Title 11 of the Code of Federal Regulations states, in part, that if the Commission determines that any amount of any payment to an eligible candidate from the Fund was used for purposes other than to defray qualified campaign expenses, it will notify the candidate of the amount so used, and such candidate shall pay to the United States Treasury an amount equal to such amount.

Section 9007.2(b)(2)(iii) of Title 11 of the Code of Federal Regulations states, in part, that in the case of a candidate who has received contributions pursuant to 11 CFR 9003.3 (b) or (c), the amount of any repayment shall bear the same ratio to the total amount determined to have been used for non-qualified campaign expenses as the amount of payments certified to the candidate from the Fund bears to the total deposits, as of December 31 of the Presidential election year.

Section 9004.4(a)(5) of Title 11 of the Code of Federal Regulations states, in part, that monetary bonuses for committee employees and consultants in recognition for campaign-related activities or services shall be considered qualified campaign expenses, if provided for pursuant to a written contract made prior to the date of the election and are paid during the expenditure report period. Further Section 9002.12 of Title 11 of the Code of Federal Regulations states that the expenditure report period, in the case of a minor or new party, will be the same as that of the major party with the shortest expenditure report period. Therefore, BFI's expenditure report period would be August 16, 2000 through December 7, 2000.

The Audit staff conducted various reviews of BFI disbursements that resulted in the identification of the apparent non-qualified campaign expenses categorized below.

1. Purchase of Mailing List

The Audit staff noted that BFI purchased a mailing list (71,784 names) from the Primary Committee by check dated September 21, 2000, in the amount of \$197,496. To document this disbursement, BFI provided a memorandum from one of its direct mail vendors valuing the names on this list at \$2.75 per name. In a May 10, 2002, memorandum, the vendor states that:

"My recollection is that my recommendation of a \$2.75 per name purchase price by Buchanan Foster from Buchanan Reform of the latter's donor list was based on the 1997 purchase, at \$3.00 per name, of the 1996 Buchanan campaign donor list by a private group of investors, headed by Richard Norman.

I believed that the private group, a disinterested group of businessmen intending to turn a profit on the list by renting it, had set a fair market price for the purchase of a donor list three years before the Buchanan Reform Buchanan Foster transaction. Wanting to make sure that this was a transparent transaction, I recommended a purchase price that was 25 cents per name less than the 1997 purchase."

Absent additional details such as the size of that list and the basis for the \$3.00 valuation for each name by the private investors, the Audit staff is unable to assess the reasonableness of this valuation as a basis for pricing the list purchased from the Primary Committee. BFI also provided a written estimate dated January 5, 2001 from another direct mail vendor. The estimate addressed the potential rental income that could be derived from use of the list and estimated that income of \$156,780 could be earned over a period of 12 months. BFI later entered into an agreement with this vendor to market its mailing list. However, total income received by BFI from rental of the mailing list during 2001 was only about \$14,402. Prior to the estimate, both BFI and the Primary Committee utilized the services of this vendor bringing to question the independence of the valuation.

Reference materials are readily available to determine the market value for the use of a mailing list by another entity. For example, the Buchanan list is available for \$135 per thousand names.³ The sale of all rights to a mailing list is more difficult, such sales are not common among campaigns. Neither the publisher of the rental guide nor two firms who market mailing lists were able to suggest a source for such a valuation. Further, the Audit staff was unable to locate reference materials to independently calculate a value for the sale versus rental of the mailing list. However, an analogous situation was found with the

³ Rate is according to SRDS Street Marketing List Source, December 2001, Volume 35, Number 6 for a list offered by Precision Marketing entitled Buchanan Campaign 2000 Donors. Since there are several Buchanan lists, the Audit staff cannot state with certainty that this is the same list as the one purchased.

Quayle 2000, Inc. Primary committee (Quayle 2000) where it purchased a mailing list from a political action committee. In order to establish fair market value, that committee obtained two independent valuations that valued the list at \$40,000 and \$50,000. The Audit staff notes that Quayle 2000 purchased the mailing list, which was of comparable size, for \$45,000; in this case, the apparent average of the two valuations.

As noted above, one valuation proffered to BFI was equivalent to 12 months rental. The Audit staff calculated the present value of the list based on an anticipated stream of rental income payments. The first month's rental income received by BFI was \$3,222, which was the largest monthly rental income payment received during 2001. The present value of monthly rental income payments of \$3,222 received for 12 months with an interest rate of 6%⁴ is \$27,000. Considering that BFI is not an ongoing entity and could be expected to terminate in about two years, increasing the time period during which rental payments would be received to 24 months results in an increased present value for the list of \$40,437.⁵ This present value analysis may be relevant, if BFI's intent was to market the list to recover the cost to purchase the list.

Therefore, it is the opinion of the Audit staff that BFI paid more than fair market value for the mailing list. Based upon the available information, we feel \$50,000, the highest appraisal value of a similar list, is a reasonable value for the list.

In the preliminary audit report, the Audit staff recommended that BFI provide documentation (such as appraisals from independent and qualified sources) or comments relative to the purchase of the mailing list. Absent such evidence, the Audit staff included an overpayment of \$147,496 in the NOQCE Statement as a receivable from the Primary Committee.

In response to the preliminary audit report, Counsel reiterates many of the facts already detailed above. Counsel offers additional information from BFI's Treasurer regarding the value of the list. Counsel states "Ms. Buchanan estimates that the Committee raised a net of almost \$400,000 from direct mail, more than defraying the cost of the list and further supporting the Committee's estimate of the list's value to the Committee."

In addition, Counsel contends that since the Audit staff conceded that it was unable to "locate reference materials" to calculate a fair market value, it is unreasonable for the Audit staff to substitute their valuation of \$50,000 for the Committee's valuation. Counsel states that as a general rule, the Commission has not examined the prices paid by a committee for goods and services, unless the price paid by the committee appeared to be too low. However, Counsel did not provide any documentation or examples to support this statement.

⁴ The average monthly prime interest rate for the period January 2001 through July 2002, the same time frame the mailing list was available for rent.

⁵ Increasing the expected number of monthly payments or the monthly rental rate would result in an increased present valuation, as would a decrease in the interest rate.

The Audit staff, however, contends that the burden of proof regarding the value paid for goods or services rests with BFI. BFI is responsible for documenting that expenditures meet the definition of a "usual and normal charge" for goods and services, i.e., meaning the price of those goods in the market from which they ordinarily would have been purchased. As discussed above, Quayle 2000 purchased a comparable size mailing list for \$45,000. That campaign established fair market value by obtaining two independent valuations that valued the list at \$40,000 and \$50,000. The Audit staff agreed that Quayle 2000 had provided sufficient documentation to support the value paid for the list.

The Audit staff does not support the view that a value for a list should be established based upon how much income was raised using that list. Thus far, BFI has not provided sufficient documentation to support the value paid for its list. As such, the Audit staff's position remains unchanged and \$50,000, the highest appraisal value of a similar list, is a reasonable value for the list.

As noted above, the Audit staff included an overpayment of \$147,496 in the NOQCE Statement as a receivable from the Primary Committee. Therefore, no pro-rata repayment to the United States Treasury is warranted.

2. Bonuses

BFI paid \$70,000 in bonuses to six employees on November 2, 2000. An internal memorandum dated October 20, 2000, which listed the six recipients and the amounts they were to receive, refers to these payments as "general election bonuses." However, BFI was unable to document that the bonuses were provided for pursuant to a written contract with the recipients made prior to the date of the election (November 7, 2000).

The Audit staff discussed this matter with BFI representatives at the exit conference. BFI representatives indicated they would provide additional documentation.

In the preliminary audit report, the Audit staff recommended that BFI submit documentation to demonstrate that the bonuses were provided for in written contracts with the recipients made prior to the date of the election. Absent such evidence, the Audit staff would recommend that the Commission make a determination that BFI make a pro-rata repayment of \$67,463 ($\$70,000 \times .963751^6$) to the United States Treasury.

In response to the preliminary audit report, Counsel for BFI (Counsel) refers to these payments as "salary adjustments" and not bonuses. Counsel offers the explanation that BFI decided to continue its six top employees at their Buchanan Reform, Inc. (the Primary Committee) salary levels rather than raise their salaries to a level commensurate with their increased responsibilities in the general election campaign. He further explains that BFI promised these employees an increase in their compensation through a lump sum payment if federal funds became available and provides a written declaration from BFI's

⁶ This figure (.963751) represents BFI's repayment ratio as calculated pursuant to 11 CFR §9007.2(b)(2)(iii).

Treasurer to support this statement. Counsel also references the October 20th internal memorandum (as mentioned above) as support for the compensation adjustments.

Counsel contends that the Audit staff's reliance on 11 CFR §9004.4(a)(5) is misplaced. Counsel states "The Commission created 9004.4(a)(5) to ensure that committees do not give out, simply because they have surplus, public funds at the end of the campaign. Section 9004.4(a)(5) does not apply to adjustments to salary that are paid before the date of the election. Payments made prior to the date of the election are not subject to this provision. Only payments made after the date of the election. Campaign committees are free to adjust the salaries of their employees prior to the election."

The Audit staff concluded that the information provided in response to the preliminary audit report did not establish that the bonuses had been paid in accordance with 11 CFR §9004.4(a)(5) and recommended that a pro-rata repayment of \$67,463 be required. At its December 12, 2002 meeting, the Commission decided that, although the memorandum discussed above was not a written contract, it offered sufficient documentary evidence of BFI's attempt to comply with the "written contract" provision at 11 CFR §9004.4(a)(5) cited above.

B. DETERMINATION OF NET OUTSTANDING QUALIFIED CAMPAIGN EXPENSES

Section 9004.9(b) of Title 11 of the Code of Federal Regulations requires that, within 30 calendar days after the end of the expenditure reporting period, the candidate shall submit a statement of net outstanding qualified campaign expenses. The statement shall contain all outstanding obligations for qualified campaign expenses as of the date of the election; an estimate of the winding down costs and any campaign expenses that will be incurred by the end of the expenditure report period; and, the amount of cash on hand, assets and receivables as of the last day of the expenditure report period.

BFI did not file a Statement of Net Outstanding Qualified Campaign Expenses. As a result, the Audit staff prepared the NOQCE Statement presented below. The NOQCE Statement is as of December 7, 2000, the end of the expenditure report period, and is based on a review of BFI's financial activity through December 31, 2001, and a limited review of reported activity through September 30, 2002.

BUCHANAN FOSTER, INC.
STATEMENT OF NET OUTSTANDING QUALIFIED CAMPAIGN EXPENSES
As of December 7, 2000
As Determined at September 30, 2002

ASSETS

Cash in Bank	\$587,298	
Accounts Receivable	174,209	
Amounts Due from Buchanan Reform, Inc.	350,097 (a)	
Capital Assets	<u>12,203</u>	
Total Assets		\$1,123,807

OBLIGATIONS

Accounts Payable	\$378,449 (b)	
Amounts Due to Buchanan Reform, Inc.	261,968 (c)	
Interest Payable to U.S. Treasury (see Finding III.D.)	24,554	
Winding Down Costs:		
Dec. 8, 2000 to September 30, 2002: Actual	393,298	
Oct. 1, 2002 to Dec. 31, 2004: Estimated	<u>30,800</u>	
Total Obligations		<u>1,089,069</u>
Net Outstanding Qualified Campaign Expenses – SURPLUS		<u>\$ 34,738</u>

FOOTNOTES TO NOOCE

- (a) This amount includes \$196,178 for half of the winding down costs paid by BFI for the period December 8, 2000, through September 30, 2002. In addition, the Audit staff has included an apparent overpayment (\$147,496) for the purchase of a mailing list, as discussed in Finding III.A.1 above, and an overpayment (\$6,423) for equipment and health insurance.
- (b) This figure represents disbursements paid during the period December 8, 2000, through September 30, 2002, for goods and/or services received prior to December 8, 2000. This figure also includes \$60 for estimated taxes on net income earned in 2002.
- (c) This amount includes half of the winding down costs paid by the Primary Committee for the period December 8, 2000, through September 30, 2002, or \$15,410, and all of the winding down costs (\$95,281) paid by the Primary Committee for the period August 12, 2000, through December 7, 2000. In addition, this amount includes \$151,277 for general election expenses paid by the Primary Committee after August 11, 2000.

C. NOQCE SURPLUS REPAYMENT

Section 9007.2(b)(3) of Title 11 of the Code of Federal Regulations states, in part, that if the Commission determines that a portion of payments from the Fund remains unspent after all qualified campaign expenses have been paid, the candidate shall pay the United States Treasury that portion of surplus funds.

Section 9007.2(b)(2)(iii) of Title 11 of the Code of Federal Regulations states, in part, that in the case of a candidate who has received contributions pursuant to 11 CFR 9003.3 (b) or (c), the amount of any repayment shall bear the same ratio to the total amount determined to have been used for non-qualified campaign expenses as the amount of payments certified to the candidate from the Fund bears to the total deposits, as of December 31 of the Presidential election year. In the preliminary audit report, the Audit staff calculated that BFI had a surplus of \$239,171 and recommended that BFI provide evidence that it was not in a surplus position.

In response to the preliminary audit report, BFI provided documentation supporting that expenses totaling \$38,658 related to payables as of December 7, 2000, not winding down costs. Winding down costs are allocated equally between BFI and the Primary Committee while accounts payable are solely obligations of BFI. The Audit staff reviewed the documentation, agreed with this assessment and the NOQCE Statement was adjusted accordingly. In addition, the Audit staff reviewed reported activity through September 30, 2002, in order to update the NOQCE Statement. Finally, as a result of the Primary Committee's response to its audit report, the Amounts Due to Buchanan Reform, Inc. figure on the NOQCE Statement increased \$151,277 for general election expenses (primarily ballot access payments) paid by the Primary Committee and by \$47,837 for additional wind down expenses the Primary Committee could not incur during the expenditure report period. As a result, the NOQCE Statement reflects a surplus of \$34,738 of which \$33,479 ($\$34,738 \times .963751$) is repayable to the United States Treasury.

Recommendation #1

The Audit staff recommends that the Commission determine that a pro-rata repayment of \$33,479 ($\$34,738 \times .963751$) is due the United States Treasury.

D. INCOME RECEIVED

Section 9004.5 of Title 11 of the Code of Federal Regulations states, in part, that investment of public funds or any use of public funds that results in income is permissible, provided that an amount equal to all net income derived from such use, less Federal, State and local taxes paid on such income, shall be paid to the United States Treasury.

Section 9007.2(b)(4) of Title 11 of the Code of Federal Regulations states that if the Commission determines a candidate received any income as a result of an investment or other use of payments from the fund pursuant to 11 CFR 9004.5, it shall so notify the

candidate, and such candidate shall pay to the United States Treasury an amount equal to the amount determined to be income, less any Federal, State or local taxes on such income.

Section 9007.2(b)(2)(iii) of Title 11 of the Code of Federal Regulations states, in part, that in the case of a candidate who has received contributions pursuant to 11 CFR 9003.3 (b) or (c), the amount of any repayment shall bear the same ratio to the total amount determined to have been used for non-qualified campaign expenses as the amount of payments certified to the candidate from the Fund bears to the total deposits, as of December 31 of the Presidential election year.

From its inception through December 31, 2001, BFI earned interest totaling \$41,638 from funds deposited into its bank and investment accounts. Documentation was provided indicating that federal and state taxes of \$16,332 had been paid. Therefore, BFI earned net income of \$25,306 (\$41,638 - \$16,332).

At an exit conference held at the close of fieldwork, the Audit staff discussed this matter with BFI representatives.

In the preliminary audit report, the Audit staff indicated that absent any additional documentation or comments submitted by BFI, the Audit staff would recommend that the Commission make a determination that BFI make a pro-rata repayment of \$24,389 ($\$25,306 \times .963751$) to the United States Treasury.

In response to the preliminary audit report, Counsel contends that the requirement that net interest earned on deposits be refunded to the Treasury was intended to apply only to the campaigns of the major parties, which are prohibited from spending more money than they receive from the Presidential Election Campaign Fund. Since Mr. Buchanan did not receive the full federal payment, Counsel argues that BFI has the right to raise funds from other sources, and should have the right to retain interest on funds deposited in financial institutions.

The Audit staff's position is that the Code of Federal Regulations as cited above related to investment of public funds does not distinguish between fully funded and partially funded general election campaigns. In addition, relative to 11 CFR §9007.2, the Explanations and Justifications for Federal Election Commission Regulations dated June 16, 1995, states in part, "This amendment clarifies that receiving income from investment or any other use of payments from the Fund is a basis for requiring payment to the Treasury. The Commission will require the committee to pay any such income received, less taxes paid, to the Treasury. The revisions to sections 9004.5 and 9007.2 ensure that any income received through the use of public funds benefits the public financing system." Based upon the regulations as cited above, the opinion of the Audit staff remains unchanged.

As a result of our review of reported activity through September 30, 2002, net income of \$171 (\$231 - \$60) was identified. Therefore, BFI earned net income of \$25,478 (\$41,870 - \$16,392).

Recommendation #2

The Audit staff recommends that the Commission determine that a pro-rata repayment of \$24,554 ($\$25,478 \times .963751$) is due the United States Treasury.

IV. SUMMARY OF AMOUNTS DUE TO THE UNITED STATES TREASURY

Finding III.C.	NOQCE Surplus Repayment	33,479
Finding III.D.	Income Received	<u>24,554</u>
	Total Due United States Treasury	<u>\$ 58,033</u>



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

RECEIVED
FEDERAL ELECTION
COMMISSION
AUDIT DIVISION

2002 NOV 22 A 11:42

November 21, 2002

MEMORANDUM

TO: Robert J. Costa
Assistant Staff Director
Audit Division

THROUGH: James Pehrkon
Staff Director

FROM: Lawrence H. Norton
General Counsel

Gregory R. Baker
Acting Associate General Counsel

Lorenzo Holloway
Assistant General Counsel

Kimberly D. Hart
Attorney

SUBJECT: Proposed Audit Report on Buchanan/Foster Inc. (LRA #596)

I. INTRODUCTION

The Office of the General Counsel reviewed the proposed Audit Report ("Proposed Report") on Buchanan/Foster, Inc. ("General Committee") submitted to this Office on October 23, 2002. The following memorandum summarizes our comments on the Proposed Report.¹ Generally, we concur with the findings in the Proposed Report, and have provided additional legal analysis on three of the findings contained in the Proposed Report. We concur with any finding not specifically discussed in this memorandum. If you have any questions concerning our comments, please contact Kimberly D. Hart, the attorney assigned to this audit.

¹ The Office of the General Counsel recommends that the Commission consider this document in open session since the Proposed Report does not include matters exempt from public disclosure. 11 C.F.R. § 9007.1(e); 11 C.F.R. § 2.4.

II. APPARENT NON-QUALIFIED CAMPAIGN EXPENSES (Finding III.A.)

Monetary bonuses for committee employees and consultants, given in recognition for campaign-related activities and services, are considered as qualified campaign expenses if they are provided for by written contract entered into prior to the date of the election and are paid during the expenditure report period. 11 C.F.R. § 9004.5(a)(5). The General Committee paid six employees a total of \$70,000 prior to the date of the election. However, the General Committee did not demonstrate that it entered into written contracts with the recipients of the bonuses prior to the date of the election.

The General Committee contends that the payments were not bonuses. Rather, the General Committee argues that the \$70,000 actually represents "salary adjustments" granted to those employees once the General Committee became eligible for funds for its general election campaign. The General Committee states that it hired many of the employees who worked for the Buchanan Reform, Inc. Primary Committee ("Primary Committee"). The General Committee made the decision to "continue its six top employees at the salary level they had while working with the Primary Committee because of the General Committee's uncertainty concerning the availability of federal funds for the general election campaign." The General Committee contends that these employees had increased responsibilities in working with the Committee and the General Committee "promised to increase their compensation through a lump sum payment if federal funds became available." The General Committee argues that the internal memorandum, drafted on October 20, 2000, was intended to memorialize the General Committee's intent to make the salary adjustments. The Committee also takes the position that 11 C.F.R. § 9004.4(a)(5) does not apply to salary adjustments.

We believe that the \$70,000 paid to six General Committee employees constitutes bonuses subject to the requirements of section 9004.5(a)(5). Although the General Committee contends that the payments were salary adjustments, it has not provided any documentation to demonstrate that these payments should be viewed as such, except for the internal memorandum. However, this is the same document that the General Committee argued, at the preliminary audit report stage, demonstrated that there were written contracts for bonuses entered into prior to the date of the election. In fact, the internal memorandum that purports to demonstrate that the payments were salary adjustments specifically designates the payments as bonuses and not salary adjustments. Furthermore, the General Committee did not submit any documentation to demonstrate that the duties and responsibilities of those staff employees increased when they went to work for the General Committee. Therefore, this Office concurs with the Audit staff's position that the payments constitute bonuses that are subject to the requirements of 11 C.F.R. § 9004.5(a)(5).

III. DETERMINATION OF NET OUTSTANDING QUALIFIED CAMPAIGN EXPENSES (Finding III.B.1.)

The Proposed Report recommends that the General Committee make a pro-rata repayment of \$218,059 for surplus funds. The surplus repayment is based on the Statement of

Net Outstanding Qualified Campaign Expenses ("NOQCE statement"). The NOQCE Statement includes an accounts receivable of \$147,496 from the Primary Committee. The Audit staff contends that the General Committee overpaid the Primary Committee \$147,496 when it purchased a mailing list from the Primary Committee. The Proposed Report concludes that the General Committee paid more than fair market value for the mailing list. The auditors believe the value of the list is \$50,000.

The General Committee states that its treasurer estimates that the "Committee raised a net of almost \$400,000 from direct mail, more than defraying the cost of the list and further supporting the Committee's estimate of the list's value to the Committee." The General Committee argues that it submitted two valuations from direct mail vendors to support its contention that the price paid for the mailing list was fair market value. The first valuation, dated May 10, 2002, valued the mailing list of 71,784 names at \$2.75 per name.² The second appraisal valuation, dated January 5, 2001, addresses the potential rental income that could be derived from the use of the mailing list and estimates that income of \$156,780 could be earned over a period of 12 months by the General Committee.

The Audit staff compared the General Committee's mailing list to another 2000 Presidential campaign mailing list of comparable size purchased from a political action committee.³ The Audit staff noted that the Quayle Committee obtained two independent valuations, valuing the mailing list respectively at \$40,000 and \$50,000. The Quayle Committee subsequently purchased the mailing list for \$45,000, the apparent average of the two valuations. Based on the General Committee's second appraisal, the Audit staff calculated the present value of the mailing list based on an anticipated stream of rental income payments for a 12 month time period.⁴ This rental calculation is relevant if the General Committee attempted to rent the list to recover the purchase price. The auditors use this information to conclude that a reasonable value for the General Committee's mailing list was \$50,000. Therefore, the Audit staff concluded that the General Committee paid more than fair market value for the mailing list. It is our

² The \$2.75 per name valuation was based on the 1996 Buchanan Committee's sale of its mailing list at \$3.00 per name. The vendor discounted the \$3.00 per name value to \$2.75 based on the differences in the time period. The General Committee also provided a valuation that was based on rental income from the mailing list.

³ The Proposed Report notes that the Audit staff compared the General Committee's mailing list to another 2000 Presidential campaign mailing list. However, the name of the committee is not specified. It is our understanding that a mailing list from the Quayle 2000 Primary Committee ("Quayle Committee") was used for comparison purposes. The Office of General Counsel recommends that the Audit staff specify the Quayle Committee mailing list as the mailing list used by the Audit staff for comparison purposes in its cover memorandum. This will ensure that the Commission is fully informed of the specific mailing list used for comparison purposes.

⁴ The Proposed Report states that "reference materials are readily available to determine the market value for the use of a mailing list by another entity. For example, the Buchanan list is available for \$135 per thousand names." It is our understanding that the source of this information, SRDS Street Marketing List Source, contains several mailing lists and the one referred to in the Proposed Report is titled "Buchanan Campaign 2000 Donors." However, the Audit staff cannot state with certainty that this is the same mailing list as the one at issue in the Proposed Report without comparing the names on both lists. Therefore, the Office of General Counsel recommends that the Proposed Report be revised to include clarifying language on this point.

understanding that the Audit staff believes that the \$400,000 raised by the General Committee from direct mail solicitations at a later date is not necessarily indicative of the value of the mailing list at the time of purchase. The Proposed Report notes that the General Committee's two appraisal valuations do not demonstrate that fair market value was paid by the General Committee for the mailing list because of the Audit staff's inability to assess the reasonableness of the May 10, 2002 valuation and the lack of independence of the January 5, 2001 appraisal valuation.⁵

We agree that there are some problems with the General Committee's valuation. However, in the alternative, the auditors provide their own valuation of the list based on a suggestion that the General Committee's list is comparable to the Quayle Committee's list and based on the rental value supported by the assumption that the General Committee would market the list to recover the purchase price. We have some concerns with the Audit Division's valuation. It is our understanding that the Quayle Committee list is similar in size. However, the Audit Division's comparison assumes that the value for each name on the Committee's list is the same as the Quayle Committee list. Furthermore, there is no indication that the General Committee intended to market the list to recover the purchase price.

The value of the mailing list drives the surplus repayment determination. However, this repayment determination is subject to judicial review. 26 U.S.C. § 9011(a). Therefore, it is imperative that the Audit Division's valuation is not arbitrary and capricious. We believe that an opinion from a professional independent appraiser in the mailing list industry would show that the valuation is not arbitrary and capricious.⁶ As a condition to receiving public financing, the General Committee agreed to provide all documentation relating to receipts and disbursements and *other* information that the Commission may request. 11 C.F.R. § 9003.1(b)(3)(emphasis added). Therefore, upon the Commission's request, the General Committee is obligated to provide the information.

In the Preliminary Audit Report, the Commission requested an independent appraisal, and the General Committee failed to provide this information. However, since this is a repayment matter, the General Committee could still submit the information as a part of its written materials at the administrative review stage. 11 C.F.R. § 9007.2(c)(2)(i). Nevertheless, this approach requires the Commission to first use a specific amount on the NOQCE Statement for the value of the mailing list to actually notify the General Committee that there is a repayment. Given the limited options at this point, we believe that the Commission may use the Audit Division's valuation.

⁵ The Audit staff also questioned the independence of the appraisal valuation due to the fact that the General Committee and the Primary Committee had previously utilized services of the vendor and the General Committee later entered into an agreement with this vendor to market this particular mailing list.

⁶ The auditors attempted to obtain an independent appraisal prior to the issuance of the Preliminary Audit Report. However, the auditors were unsuccessful in obtaining the appraisal.

When a committee does not submit documentation in support of its expenditures, the Audit Division may estimate the expenditures. See *John Glenn Presidential Committee v. FEC*, 822 F.2d 1097, 1103 (D.C. Cir. 1987) (Commission may estimate allocation of expenses to state expenditure limitations in the absence of documentation of the exact allocation). However, the committee must have the burden of producing the documentation.⁷ A publicly-financed committee has the burden of demonstrating, with supporting documentation, that its disbursements are qualified campaign expenses. 11 C.F.R. § 9003.5(a).

The General Committee's disbursement for the mailing list is not addressed in the Proposed Report as an issue of whether it is a qualified campaign expense. The Proposed Report addresses the issue as a reimbursement from the Primary Committee to the General Committee. However, this issue is about a disbursement for a qualified campaign expense. Any amount that a committee overpays for goods and services is non-qualified campaign expense. See *Fulani v. FEC*, 147 F.3d 924 (D.C. Cir. 1998). The auditors contend that the General Committee overpaid the Primary Committee for the mailing list. Therefore, we recommend that the Audit Division revise the Proposed Report to address the mailing list payment as a General Committee's non-qualified campaign expense. If the Proposed Report is revised in this manner, the General Committee will have the burden of demonstrating that its disbursement to the Primary Committee for the mailing list was a qualified campaign expense.⁸ If the General Committee fails to submit documentation (independent appraisal) supporting this disbursement as a qualified campaign expense during the administrative review, then the Commission is justified in using the Audit Division's valuation. See *John Glenn Presidential Committee v. FEC*, 822 F.2d 1097, 1103 (D.C. Cir. 1987).

IV. INCOME RECEIVED (Finding III.B.2.)

The Preliminary Audit Report identified \$41,638 in interest earned by the General Committee from funds deposited into its bank and investment accounts. The General Committee provided documentation indicating that federal and state taxes of \$16,332 had been paid leaving a net income of \$25,306 (\$41,638 - \$16,332). The Preliminary Audit Report recommended that the Commission make a determination that the General Committee should make a pro-rata repayment of \$24,389 to the United States Treasury.

⁷ In *John Glenn Presidential Committee v. FEC*, the John Glenn Presidential Committee exceeded two state expenditure limitations. The court noted that the amount in excess of the state expenditure limitation was a non-qualified campaign expense. *John Glenn Presidential Committee* at 1099. Therefore, the John Glenn Presidential Committee had the burden of demonstrating that it had not incurred non-qualified campaign expenses in excess of the state expenditure limitations. 11 C.F.R. § 9033.11(a)(1984).

⁸ As a non-qualified campaign expense, the remedy is not necessarily a repayment to the United States Treasury. The Audit Division may maintain the Primary Committee's reimbursement to the General Committee as the General Committee's cure for its payment of a non-qualified campaign expense. See *Bush-Quayle '92 Primary Committee v. FEC*, 104 F.3d 448, 451 (D.C. Cir. 1997) (General election committee and compliance fund have standing with primary election committee to challenge repayment determination although compliance fund could reimburse the general election committee to eliminate a repayment).

In its response to the Preliminary Audit Report, the General Committee argues that:

the requirement that the net interest earned on deposits be refunded to the Treasury was intended to apply, however, only to the campaigns of the major parties which are prohibited by the Presidential Election Campaign Fund Act from spending more money than they receive from the Presidential Election Campaign Fund. ... As a candidate of a minor party, however, Mr. Buchanan did not receive full federal payment and, consequently, he had the right to raise funds from other sources, and should have the right to retain interest on funds deposited in financial institutions.

The Proposed Report concludes that 11 C.F.R. §§ 9004.5, 9007.2(b)(4), and 9007.2(b)(2)(iii) does not distinguish between fully funded and partially funded general election campaigns. The Office of General Counsel concurs with the Audit staff's conclusion that the applicable regulatory provisions on repayment of interest income received by committees does not distinguish between fully funded and partially funded general election campaigns. Furthermore, as a minor party candidate, Buchanan could accept contributions to defray qualified campaign expenses. 26 U.S.C. § 9003(c)(2). However, Buchanan's receipt of contributions as a minor party candidate does not entitle the candidate to the gains from the use of public funds. Requiring a repayment of gains on the investment of public funds "ensure that any income received through the use of public funds benefits the public financing system." Explanation and Justification for 11 C.F.R. § 9007.2 at 60 Fed. Reg. 31864 (June 16, 1995).



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

December 26, 2002

Angela Buchanan, Treasurer
Buchanan Foster, Inc.
115 Rowell Court
Falls Church, VA 22046

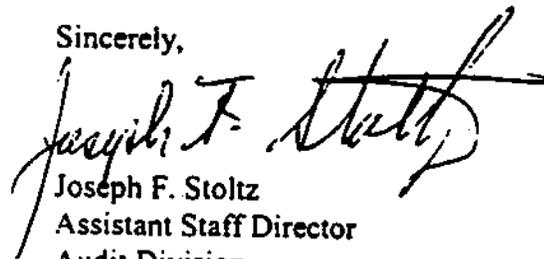
Dear Ms. Buchanan:

Attached please find the Report of the Audit Division on Buchanan Foster, Inc. The Commission approved the report on December 23, 2002. As noted in the report, the Commission may pursue any of the matters discussed in an enforcement action.

The Commission approved report will be placed on the public record on December 31, 2002. Should you have any questions regarding the public release of the report, please contact the Commission's Press Office at (202) 694-1220.

Any questions you have related to matters covered during the audit or in the report should be directed to Paula King or Alex Boniewicz of the Audit Division at (202) 694-1200 or toll free at (800) 424-9530.

Sincerely,


Joseph F. Stoltz
Assistant Staff Director
Audit Division

Attachment as stated

cc: John J. Duffy, Esq.

CHRONOLOGY
BUCHANAN FOSTER, INC.

Audit Fieldwork	07/15/01 – 4/19/02
Exit Conference	4/23/02
Preliminary Audit Report to the Committee	7/17/02
Response Received to the Preliminary Audit Report	9/19/02
Final Audit Report Approved	12/23/02

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jduffy@steptoel.com

February 26, 2002

Via Hand Delivery

Ms. Ellen Weintraub
Chairman
Federal Election Commission
999 E Street, N.W.
Washington, D.C. 20463

RECEIVED
FEDERAL ELECTION
COMMISSION
OFFICE OF GENERAL
COUNSEL
2002 FEB 26 P 4: 55

Re: Buchanan Foster, Inc.

Dear Ms. Weintraub:

Buchanan Foster, Inc. (the "Committee"), by its attorneys, hereby submits this response to the Report of the Audit Division (the "Final Audit Report").

We request an opportunity to address the Commission in open session to demonstrate that no repayment is required. We will address both the proper valuation of the mailing list purchased from Buchanan Reform, Inc. and its impact on the proposed surplus repayment, as well as the proposed repayment of interest.

The Purchase of the Mailing List From Buchanan Reform Was a Qualified Campaign Expense

Background

At the start of the general election campaign, Buchanan Foster, Inc. (the "Committee") purchased outright the mailing list of the candidate's primary committee, Buchanan Reform. The list contained 71,784 names, and the contract of sale transferred all of Buchanan Reform's rights to the mailing list to the Committee. Buchanan Reform did not retain, as is often the case, the right to mail the list itself. The Committee paid \$197,496 for the list, based on Ms. Buchanan's determination that the names had a value of \$2.75 each. In valuing the list, Ms.

ATTACHMENT
Page 2 of 4

Buchanan solicited, and relied upon, the opinion of Mr. Phil Alexander, the Committee's direct mail consultant, who had experience with the valuation of mailing lists.

In the Final Audit Report, the Audit Division asserts that the Committee's purchase of the mailing list was not a "qualified campaign expense" to the extent that the Committee paid more than \$50,000 for the list. Fifty thousand dollars was the amount that the Audit Division concluded represented the "fair market value" of the list. The Audit Division's method of determining the "fair market value" of the mailing list was, to say the least, unusual. The Audit Division conceded that that it could find no independent basis for determining the fair market value of the sale of a mailing list. The Audit Staff stated that

"Reference materials are readily available to determine the market value for the use of a mailing list by another entity. . . . The sale of all rights to a mailing list is more difficult, such sales are not common among campaigns. Neither the publisher of the rental guide nor two firms who market mailing lists were able to suggest a source for such a valuation. Further, the Audit Staff was unable to locate reference materials to independently calculate a value for the sale versus rental of the mailing list."

The Audit Staff observed, however, that the Quayle 2000 Inc. Primary Committee had purchased a mailing list from Campaign America, a multi-candidate political action committee, that contained approximately the same number of names as the Buchanan Reform mailing list, and that the Quayle Committee had paid Campaign America only \$45,000. According to the Audit Staff, the Quayle Committee had based the purchase price of the list on the average of two estimates -- \$40,000 and \$50,000 -- that the Quayle Committee had received from two "independent" direct mail consultants, who had been asked to give an opinion concerning the fair market value of the list. The Audit Division concluded -- without any evidence -- that the Campaign America list and the Buchanan Reform list were comparable and that the purchase price of the Campaign America list represented the approximate fair market value of the Buchanan Reform list as well. The Audit Staff assigned the Buchanan Reform list a fair market value of \$50,000.

In its comments on the Preliminary Audit Report, the General Counsel expressed its concern that the Audit Division's valuation of the mailing list would be considered "arbitrary and capricious" and, consequently, would not withstand judicial review. The General Counsel concluded that the best evidence would be "an opinion from a professional independent appraiser in the mailing list industry," but noted that the auditors had tried to locate such a person

without success. (p. 4, fn 6). The General Counsel recommended, therefore, that the "Audit Division revise the Proposed Report to address the mailing list payment as a General Committee non-qualified campaign expense." The General Counsel stated that the purpose of the suggested revision was to place on the Committee the burden of locating a "professional independent appraiser," a task that the Audit Staff had not been able to accomplish.

The General Counsel also stated that, in its opinion, only an "independent appraisal" would constitute acceptable documentation from the Committee.

"If the Proposed Report is revised in this manner, the General Committee will have the burden of demonstrating that its disbursement to the Primary Committee for the mailing list was a qualified campaign expense. If the General Committee fails to submit documentation (independent appraisal) supporting this disbursement as a qualified campaign expense during the administrative review, then the Commission is justified in using the Audit Division's valuation."

Finally, the General Counsel noted that "the value of the mailing list drives the [surplus] repayment determination." Without the account receivable from Buchanan Reform in the amount of the alleged overpayment, the Committee's NOQCE would show a deficit of \$112,758, and the Committee would have no repayment obligation. In addition, to reduce or eliminate the Committee's surplus repayment obligation, the Commission does not have to conclude that the mailing list had a fair market value equal to the full \$197,496 that the Committee paid for it. The Committee's surplus repayment would be reduced dollar for dollar by any upward adjustment that the Commission made in the fair market value of the mailing list over the \$50,000 estimate reached by the Audit Division, and the Committee's surplus repayment will be eliminated if the Commission concludes that the mailing list's fair market value was at least \$84,738, *i.e.*, the Audit Division's fair market value estimate (\$50,000) plus the present NOQCE surplus (\$34,738).

Discussion

1. **Qualified Campaign Expenses Are Not Rendered Unqualified Because The Committee Allegedly Paid More Than The "Fair Market Value" For The Goods Or Services Purchased.**

The Final Audit Report does not dispute that the purchase of a mailing list is the type of expenditure that would ordinarily constitute a qualified campaign expense, and, indeed, the Audit Report recognizes the Committee's payment to Buchanan Reform for the mailing list as a qualified campaign expense up to \$50,000. The Audit Division goes on to contend, however,

that the Committee paid more for the list than its "fair market value," as determined by the Audit Staff and that the amount above the "fair market value," as determined by the Audit Staff, is not a qualified campaign expense.

Nothing in the Presidential Election Campaign Fund Act or in the Commission's regulations supports the Audit Division's conclusion that an otherwise qualified expense becomes an unqualified expense if the Committee pays more than the "fair market value" for the goods or services. The Final Audit Report does not cite any statutory or regulatory support for this proposition, and we have found none. Neither the statutory nor the regulatory definitions of "qualified campaign expense" includes a requirement that the amount of the expense not exceed the "fair market value" of the goods or services purchased. The Final Audit Report does not cite any prior Commission application of a "fair market value" test to render unqualified a portion of an otherwise qualified campaign expenditure made within the expenditure report period, and we are aware of none. Moreover, constitutional and policy considerations militate against the Commission's adoption of the deviation from the plain language of the statutory and regulatory definition of "qualified campaign expense" that the Audit Staff advocates here.

The term "qualified campaign expense" is defined in section 9002.11 of the Act and the same section of the Commission's regulations. The Committee's purchase of the mailing list meets each of the requirements set forth in those sections. The purchase was: (1) incurred by the candidate's committee to further the candidate's campaign for President; (2) incurred during the expenditure period; and (3) not a violation of federal or state law. Neither section 9002.11 of the Act nor section 9002.11 of the Commission's regulations require that the amount of the expense not exceed the "fair market value" of the goods or services purchased.

The General Counsel cites (Rpt. at 19) section 9003.5(a) for the proposition that the Committee has the burden of proving that its disbursements are qualified campaign expenses, but 9003.5(a) actually mandates proof that the disbursements are "qualified campaign expenses as defined in 11 CFR 9002.11" (emphasis added).¹ As we have noted above, the definition of "qualified campaign expense" in section 9002.11 does not contain a requirement that the expense

¹ "Each candidate shall have the burden of proving that disbursements made by the candidate or his or her authorized committee(s) or persons authorized to make expenditures on behalf of the candidate or authorized committee(s) are qualified campaign expenses as defined in 11 CFR 9002.11." (emphasis added)

not exceed the "fair market value" of the goods or services purchased, and consequently, section 9003.5 does not obligate the Committee to demonstrate that it paid no more than the fair market value for the Buchanan Reform mailing list.

Similarly, the general language concerning the obligation to furnish evidence requested by the Commission regarding qualified campaign expenses is likewise limited specifically to the documentation set forth in paragraph (b).²

The General Counsel also cites section 9003.1(b)(3) for the proposition that the committee has agreed to provide all documentation relating to receipts and disbursements and other information that the Commission may request. The regulation actually states, however, that the Committee must provide an explanation of the connection between any disbursements and the campaign, which the Committee has done, and makes no mention of fair market value.

2. The Committee Paid The Fair Market Value Of The Mailing List

The Committee attaches a statement from Mr. Richard Norman, an expert in the valuation of mailing lists. Mr. Norman has been involved in the direct mail business for more than twenty years and has purchased and sold millions of conservative direct mail donor names. Mr. Norman concludes that the price paid by the Committee represented the fair market value of the list.

The Committee also incorporates by reference the arguments made on this point in its response to the Preliminary Audit Report.

The Committee Should Not Be Required to Repay Interest on Federal Funds to the Treasury

The Report of the Audit Division ("Final Audit Report") requires the Committee to pay to the United States Treasury the amount of the net interest (interest minus taxes) earned on the monies received by the Committee from the Presidential Election Campaign Fund and deposited in interest bearing accounts. In requiring this repayment, the Audit Division relied upon section

² "The candidate and his or her authorized committee(s) shall obtain and furnish to the Commission on request any evidence regarding qualified campaign expenses made by the candidate, his or her authorized committees and agents or persons authorized to make expenditures on behalf of the candidate or committee(s) as provided in paragraph (b) of this section." (emphasis added)

9004.5 of the Commissions regulations, which provides that: "[I]nvestment of public funds or any other use of public funds that results in income is permissible, provided that an amount equal to all net income derived from such a use ... shall be paid to the [Treasury]."

In its response to the Preliminary Audit Report, the Committee argued that the requirement that a general election committee refund the net interest earned on the investment of public funds makes sense only when applied to the campaign committee of a major party candidate. Major party candidates cannot be allowed to "keep" and "spend" the income earned through the investment of the monies they receive, because to do so would result in a violation of the Presidential Election Campaign Fund Act's prohibition on fundraising and its limitation on qualified campaign expenses. A candidate of a minor party, however, does not receive the full federal payment and, consequently, has the right to raise and expend funds from other sources until the candidate has raised and expended an amount equal to the amount received and available for expenditure by the major party candidates. No reason exists, therefore, to prohibit a minor party candidate from "keeping" and "spending" the interest it receives from the financial institutions in which it deposits its "partial" federal payment.

The Commission's treatment of interest on public funds received by a primary committee from the Primary Matching Funds Payment Account provides an analogous precedent for permitting a minor party committee to retain and spend the interest on public funds. Like a minor party candidate in a general election, a primary candidate can raise and expend funds in addition to the funds it receives from the federal government. In the primary election cycle, a candidate's principal campaign committee deposits the federal and non-federal funds in the same interest bearing account, interest payments are made on all of the funds in the account, and the Commission allows the primary committee to use these interest payments in the same manner as other funds in the account. The Commission does not require any repayment of the interest earned on the federal funds.³ Since a minor party committee, like a primary committee, can raise

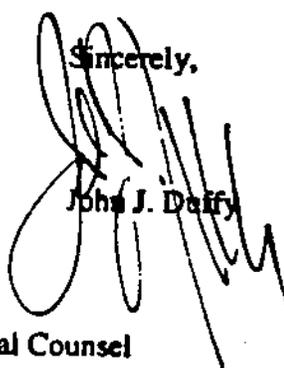
³ Section 9038.2 (b)(4) provides for repayment of interest only on "the net income derived from an investment or other use of surplus public funds after the candidate's date of ineligibility." Thus, in the event a candidate's committee has a "surplus" the income received on the investment of the federal portion of the surplus must be returned to the Treasury. On the other hand, the Committee can spend the interest received on the investment of federal funds received during the campaign without limitation. The Committee has no obligation to repay those funds to the Treasury.

and use non-federal funds for qualified campaign expenses, a minor party committee should be permitted, like a primary committee, to retain and spend the interest earned on federal and non-federal funds.

In the Final Audit Report, the Audit Division did not address directly the Committee's contention that the rationale that supports sections 9004.5 and 9007.2 does not support its extension to a minor party candidate. The Audit Staff states only that: "the Code of Federal Regulations ... related to investment of public funds does not distinguish between fully funded and partially funded general election campaigns." The Commission has broad authority, however, to interpret its regulations. Moreover, the Commission's present interpretation of sections 9004.5 and 9007.2 conflicts with those provisions of the Federal Election Campaign Act of 1971, as amended, that permit minor party candidates in the general election cycle to raise funds. Finally, the Commission's regulations treat minor party candidates in the general election differently from similarly situated candidates in the primary election. The Commission has an obligation to interpret its regulations with reference to the statutory and regulatory framework in which they operate, and to treat similar situations in a similar way.

If you have any questions concerning this matter, please don't hesitate to contact the undersigned.

Sincerely,


John J. Deify

cc: **Greg Baker, Office of the General Counsel**
Joseph F. Stoltz, Audit Division
Alex Boniewicz, Audit Division
Paula King, Audit Division
Angela M. Buchanan

TO: Angela Buchanan
 FROM: Richard Norman *Richard Norman*
 RE: Fair Market Value of the Buchanan Reform, Inc. Mailing List

You have asked me to give my professional opinion of the fair market value of the Buchanan Reform, Inc. mailing list as of September, 2000. Buchanan Reform was the campaign committee of Mr. Pat Buchanan, who was seeking the Reform Party's Presidential nomination. Upon receiving the nomination, the candidate's general election committee, Buchanan Foster, Inc., purchased all of the rights to the mailing list from Buchanan Reform for \$197,496. The mailing list contained 71,784 donor names. Buchanan Foster valued the list at \$2.75 per name.

I am the President of the Richard Norman Company. I have had extensive experience in the sale and purchase of mailing lists. I have purchased and sold literally millions of conservative, political direct mail donors over the past twenty years. I have, I believe, bought and sold more mailing lists than any other person in the country.

I have no hesitation in stating that \$2.75 per name was a reasonable fair market value for the names on the Buchanan Reform list, and that \$197,496 was a fair market value for the 71,784 names on the Buchanan Reform list.

Several factors entered into my decision, including the recency of the list, the nature of the candidate, and the totality of the sale of rights. The recency of the list is critical. These names were current names. The nature of the organization or candidate to which the contribution is made is also important. The more narrow the message or audience, the more valuable the list. In other words, donors to a candidate who only received a small percentage of the vote are more valuable than donors to a candidate who received the majority of votes. Also, donors to a

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Attachment 2
 Page 8 of 9

candidate who is more ideological are more valuable than donors to a candidate who is more moderate or "mainstream." Mr. Buchanan fits the candidate profile for a valuable list. Exclusivity is an important factor. Buchanan Reform sold all of its rights to the list. No other party had rights to the list, and Buchanan Reform did not itself retain the right to mail the list. This added to the list's value.

Some months after the 1996 election, myself and a group of investors purchased the Buchanan for President donor list for approximately \$2.00 per name. We purchased this list subject to the rights of another commercial user to rent the list to newsletter and magazine clients and to the right of Buchanan for President, and other organizations in which Mr. Buchanan was involved, to use the list for fundraising purposes. Since the Buchanan Reform list was sold without the reservation of any rights, and in light of the increase in the cost of donor names over the four years between 1996 and 2000, and our success with the 1996 Buchanan for President list, I believe that the fair market value of the Buchanan Reform list was at least \$197,496.

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Attachment 2
 Page 9 of 9



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

March 18, 2003

MEMORANDUM

TO: Lawrence H. Norton
General Counsel

THROUGH: James A. Pehrkon
Staff Director

Robert J. Costa
Deputy Staff Director

FROM: Joseph F. Stoltz
Assistant Staff Director
Audit Division

Alex R. Boniewicz
Audit Manager

Paula King
Lead Auditor

SUBJECT: Audit Division Analysis of Request for Administrative Review of Commission's Repayment Determination and Oral Hearing Buchanan/Foster, Inc. (LRA #596)

As requested in your memorandum dated March 10, 2003, our analysis of Buchanan/Foster, Inc.'s (BFI) request for an administrative review of the Commission's repayment determination and an oral hearing is presented below.

BFI's request discusses only two matters:

- the valuation of a mailing list purchased from the primary committee and its impact on the surplus repayment determination based on the NOQCE Statement presented in the FAR; and,
- the repayment of interest income. BFI reiterates its belief that the requirement that net interest earned on deposits be refunded to the United States Treasury was intended to apply only to the campaigns of the major parties, and not to minor parties receiving only partial funding from the Presidential Election Campaign Fund.

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With respect to the valuation of the mailing list, BFI provides an "independent" valuation of its list from the Richard Norman Company, which values the mailing list at its purchase price of \$197,496. At this value, BFI's NOQCE Statement would reflect a deficit position and no repayment would be required. In addition, this change would have no repayment impact relative to Buchanan's 2000 Presidential primary committee. The Audit staff reviewed records for Buchanan's Presidential campaign committees for 1996 and 2000 and found no payments to, or contributions from, Richard Norman or The Richard Norman Company. However, Richard Norman was part of a group that purchased a mailing list from a 1996 Buchanan presidential campaign committee. This presents some concern about his independence in this valuation and, therefore, whether BFI has met its obligation to demonstrate that the purchase is a qualified campaign expense.

As for the fair market value argument put forward by BFI, it is correct that generally the fair market value of the payment for goods and services is not often questioned. There is a presumption that an arm's length transaction between a willing seller and a willing buyer represents a fair market value transaction. In the instant case, there can be no presumption of an arm's length transaction. To argue that the fair market value of such a transaction cannot be questioned is to suggest that funds may be transferred in any amount on any pretense.

With respect to the repayment of interest income, the Audit staff's position is that the Code of Federal Regulations does not distinguish between fully funded and partially funded general election campaigns. This appears to be a legal question more appropriately addressed by your office.

Should you have any questions please contact Paula King or Alex Boniewicz at extension 1200.