



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Proposed Final Audit Report on Friends for Menor (LRA 732)

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Final Audit Report ("FAR") on Friends for Menor ("the Committee"). Our comments address: (1) Apparent Impermissible Loans; and (2) Receipt of a Contribution that Exceeds Limits. If you have any questions, please contact Allison T. Steinle, the attorney assigned to this audit.

II. FINDING 1 – APPARENT IMPERMISSIBLE LOANS

The candidate reported making a total of \$110,000 in loans to the Committee. Finding 1 involves \$75,000 of these loans, which were drawn from the candidate's business account,¹ that had not been verified as coming from the candidate's personal funds. The proposed FAR concludes that two legal services agreements and a loan agreement are sufficient to establish that \$60,000 of the \$75,000 in loans were from the candidate's personal funds. However, the proposed FAR concludes that the remaining \$15,000 in loans were not the candidate's personal funds, but rather excessive contributions resulting from a \$10,000 personal loan from the Committee's treasurer and his spouse and a \$5,000 personal loan from an individual.

We begin our analysis of this finding with the law that governs candidates who finance their own campaigns. Candidates may make unlimited expenditures from their own personal funds to finance their own campaigns. 11 C.F.R. §§ 100.33, 110.10. Personal funds include any income earned during the election cycle, including any salary or income from bona fide employment, investments, bequests, or customarily received gifts. 11 C.F.R. § 100.33. However, funds that do not qualify as the candidate's personal funds are regarded as coming from a source other than the candidate. For example, candidates who receive contributions or obtain loans from others for use in connection with their campaigns are considered to be acting as agents of their authorized committees, and the individual or entity that is the source of the funds is considered to have made a contribution to the committee. 2 U.S.C. § 432(e)(2); 11 C.F.R. § 101.2(a). This includes instances where the candidate receives funds from others and uses the funds to make loans to the campaign, or directly pay for certain campaign or living expenses. *See* 11 C.F.R. §§ 101.2(a), 113.1(g). The central issue in this finding is whether the funds that flowed into the business account were the personal funds of the candidate that he could use in connection with the campaign in an unlimited amount, or were contributions from others that the candidate accepted as an agent of his campaign.

The proposed FAR does not explain what legal standard the Audit Division has applied to determine whether certain funds in the business account were contributions from others that the candidate accepted as an agent of his campaign. Therefore, for each source of funds deposited into the business account, we suggest that the FAR provide a more detailed explanation of why the Audit Division has concluded those funds were or were not the personal funds of the candidate, consistent with the legal standard set forth above.

Of the \$75,000 in loans the candidate made to the Committee, \$15,000 of these loans were made using funds from a \$10,000 personal loan to the candidate from the Committee's treasurer and his spouse and a \$5,000 personal loan to the candidate from an individual. Both of these loans were deposited into the business account. We understand that the proposed FAR concludes that the proceeds from the two personal loans were not the candidate's personal funds

¹ The Committee has stated and the Audit Division has confirmed that the candidate's business, a law practice, is a sole proprietorship. If the candidate's business was incorporated or an LLC treated as a corporation for tax purposes at the time it made the loans to the Committee and had not made a proper distribution to the candidate, the business would be the entity making the loans to the Committee in violation of 2 U.S.C. § 441b(a).

because there was nothing indicating that they were income earned from bona fide employment, investments, bequests, or customarily received gifts. See 11 C.F.R. § 100.33. If this is correct, then we concur with the Audit Division, but suggest that it clarify its analysis to explain why it has concluded that the proceeds from the loans were not the candidate's personal funds.

The remaining \$60,000 in loans at issue were made by the candidate to the Committee using funds received by the candidate's business account from two corporations. The proposed FAR concludes that the payments from the corporations to the Committee were bona fide income made in consideration for the candidate's provision of legal services and therefore the candidate's personal funds, which he could lend to the Committee in an unlimited amount. The deposits of funds from the two corporations to the business account were made on the same day or just prior to the candidate's loans of similar amounts to the Committee. We address these loans separately because they raise additional issues.

The candidate's business received \$30,000 from a mortgage lending company and \$36,000 from a housing construction company, for a total of \$66,000 from the two corporations. The Committee has provided legal services agreements establishing that \$60,500 received from the two corporations (\$24,500 from the mortgage lending company and the entire \$36,000 from the housing construction company) was bona fide income made in consideration for legal services and therefore the personal funds of the candidate.

The legal services agreement between the mortgage lending company and the candidate's law practice provided for the mortgage lending company to pay a flat fee of \$24,500. The remaining \$5,500 the candidate received from the mortgage lending company appears to be the proceeds of a \$5,500 loan to the candidate's law practice from the mortgage lending company. The Committee has provided a loan agreement for \$5,500 that appears to be between the law practice and the president and CEO of the mortgage lending company personally. However, the loan amount was actually paid by the incorporated mortgage lending company, which made three \$10,000 payments for a total of \$30,000 in payments to the candidate's business.

The Committee asserts that the proceeds of the \$5,500 loan also were the candidate's personal funds because the loan agreement was "negotiated . . . as part of discussions for the provision of legal services by the candidate to the company." See Committee Response at 2. However, we have no documentation, other than the Committee's unsworn statement in its response to the IAR, that the loan was actually negotiated in exchange for the provision of legal services. The legal services agreement between the mortgage lending company and the candidate did not mention this, or any, loan. In addition, the promissory note provided by the Committee does not mention the legal services agreement or the provision of legal services. Thus, we believe that, if this \$5,500 loan is considered to be part of the \$60,000 the candidate lent to the Committee, the Committee has not adequately documented that the loan was made in exchange for the provision of legal services, and therefore has not adequately documented that this amount was the candidate's personal funds. Because the Committee has not adequately documented that the proceeds of the loan were the candidate's personal funds, if the candidate then made those proceeds available to the Committee in connection with the campaign, the loan should be treated as a prohibited corporate contribution from the mortgage lending company.

However, there is an accounting question as to whether the candidate in fact made this \$5,500 available to the Committee in connection with the campaign. The three \$10,000 payments made by the mortgage lending company, along with a \$15,000 payment from the housing construction company, funded a \$9,000 loan and a \$30,000 loan to the Committee.² In other words, the candidate made a total of \$39,000 in loans to the Committee using \$45,000 in funds derived from the corporations, leaving \$6,000 in the business account. While this \$6,000 was not used by the candidate in connection with the campaign, it would be impossible to determine the source of the funds left in the business account.³ The source may have been the \$5,500 loan from the mortgage lending company, the fees from the mortgage lending company or housing construction company that were the personal funds of the candidate, or some combination thereof.

To assist the Commission in resolving this issue, we suggest that the Audit Division raise and consider the following points. On the one hand, if the Commission adopts an accounting rule that gives the Committee the benefit of the doubt and assumes that only permissible personal funds of the candidate were transferred to the Committee, then in future cases candidates could circumvent the contribution prohibitions and limitations simply by depositing a minimum amount of personal funds in the account alongside prohibited or excessive contributions and never loaning their committees more funds than the minimum amount in the account. For example, a candidate with \$2,000,000 in personal funds in an account could easily launder a \$1,500 prohibited contribution through that account to his or her committee by claiming the source was the \$2,000,000 in personal funds rather than the \$1,500 prohibited contribution. On the other hand, if the Commission concludes that it will assume the source of the funds was at least partially from a prohibited or excessive source, this may inadvertently limit the ability of candidates to use legitimate personal funds from their business accounts to make loans on behalf of their campaigns. While either of these options has significant drawbacks, there appear to be no other courses of action available. Consequently, we generally recommend that the Audit Division adopt one of these rules and raise the issue with the Commission in its cover memorandum to the FAR, noting that the Commission will have to choose between the competing interests discussed above. We also note that if the candidate had already committed some of the funds in the business account, then they were not available as personal funds for him to loan to the Committee. Moreover, if some of the funds were already committed, the candidate could not use the additional \$5,500 to "free up [the \$24,500] for campaign purposes" Cf. Advisory Opinion 1982-64 (Ron Hein for Congress) (applying the same analysis for funds received by a candidate for living expenses while campaigning).

² On September 5, 2006, the candidate deposited a \$10,000 check from the mortgage lending company, and made a \$9,000 loan to the Committee on the same day. On September 8, 2006, the candidate deposited the other two \$10,000 checks from the mortgage lending company and a \$15,000 check from the housing construction company, and made a \$30,000 loan to the Committee on the same day.

³ Specifically, it is our understanding that in this case it would be impossible for the Audit Division to apply generally accepted accounting principles such as LIFO or FIFO to accurately determine the source of the \$6,000 left in the business account. LIFO and FIFO are based on the chronology of transactions, and because it is not possible to know the exact chronology of the transactions here, the Audit Division cannot pinpoint which transaction was the source of the cash balance left in the business account on September 8, 2006.

If the Commission concludes that the candidate in fact made the \$5,500 loan from the mortgage lending company available to the Committee in connection with the campaign, we conclude that the loan was a prohibited corporate contribution that was accepted by the candidate on behalf of the Committee. If the Commission concludes that the source of the funds loaned to the Committee was entirely personal funds and not the \$5,500 loan, we concur with the Audit Division that \$60,000 of the \$75,000 in loans were from the candidate's personal funds. However, we note that even if the Commission concludes that the \$5,500 loan was not the source of funds loaned to the Committee, the \$5,500 loan could still become an excessive contribution if the candidate used these funds to pay for certain campaign or living expenses while he was campaigning. *See* 11 C.F.R. §§ 101.2(a), 113.1(g).

III. FINDING 2 – RECEIPT OF A CONTRIBUTION THAT EXCEEDS LIMITS

Finding 2 involves a \$9,000 loan from a joint checking account held by the candidate and his spouse that had not been verified as coming from the candidate's personal funds. The loan was made with a check signed only by the candidate's spouse with a notation in the memo line reading "loan to campaign," using funds deposited into the joint checking account from an unknown trust account. The proposed FAR concludes that the candidate's spouse made an excessive contribution to the Committee.

When one party signs a check from a joint account, the Commission generally will consider the contribution to be made from the contributor who signed the check. *See* 11 C.F.R. §§ 100.51(b), 110.1(k). Because the spouse signed the check drawn from the joint checking account, the presumption is that the contribution from the joint checking account was made by the spouse. *Id.* The Committee could rebut this presumption by showing that candidate intended to make the contribution. However, the Committee explicitly states that the spouse intended to use her own funds to make the loan to the campaign for purposes of supporting her husband's candidacy. *See* Committee Response at 4. Therefore, we concur that the candidate's spouse made an excessive contribution to the Committee.⁴

⁴ Because the Audit Division initially was unable to determine the source of the funds deposited in the joint checking account, there remained a possibility that the \$10,000 contribution from the candidate's spouse had been a contribution in the name of another. *See* 2 U.S.C. § 441f. The Committee, however, now states that the source of the funds deposited in the joint checking account was proceeds from the sale of stock by the candidate's spouse, and submitted tax returns indicating that the candidate and his spouse had reported and paid capital gains tax on this payment. *See* Committee Response at 4. Accordingly, we conclude that there is no indication that the \$10,000 contribution from the candidate's spouse was a contribution in the name of another.