



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

March 12, 2008

MEMORANDUM

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

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Interim Audit Report ("IAR") on Friends for Menor ("the Committee"). We generally concur with the findings in the IAR, but have comments and suggested changes. First, we believe that the lack of proper documentation relating to \$75,000 of the \$101,000 that the candidate transferred to the

Committee from the candidate's law firm business account supports a finding that the candidate's loans were not from his personal funds, and suggest that the Audit Division revise the IAR to account for new documentation received after it sent the IAR to the Office of the General Counsel. Second, we suggest that the Audit Division include additional information and analysis to support its conclusions regarding the total funds received from the candidate's law firm business account and his joint personal account. Third, we concur with the IAR's recommendation that the Committee provide further documentation showing that the funds in the law firm business account and joint personal account were for specific services rendered, but suggest that the Audit Division further emphasize that it is seeking any evidence that the candidate was legally entitled to the funds received. If you have any questions, please contact Allison T. Steinhilber, the attorney assigned to this audit.

II. FINDING OF APPARENT IMPERMISSIBLE LOANS

A. Law Firm Business Account

The Committee disclosed loans from the candidate totaling \$110,000 that initially could not be verified as coming from the candidate's personal funds. Of this amount, \$101,000 was transferred to the Committee from the candidate's law firm business account. The Committee provided documentation identifying three sources for \$80,000 of the \$101,000 transferred to the Committee from the law firm business account. The three sources are two corporations and one individual. To date, the Committee has been unable to document the sources for the remaining \$21,000, aside from determining that \$6,000 of the \$21,000 was from a cash deposit. In a letter to the Audit Division, the candidate denied depositing any campaign contributions in the law firm business account. Several deposits to the account were made on the same day or just prior to the candidate's loans to the Committee, and the average daily balance in the account during this time period was only \$2,700. Based on the above documentation related to the \$80,000 and the timing of the deposits into the law firm business account, the Audit Division found that the entire \$101,000 may not have been from the candidate's personal funds. To address this finding, the Audit Division recommends that the Committee demonstrate that the loans were from the candidate's personal funds. Absent such a demonstration, the Audit Division recommends that the Committee refund the funds to the original source and amend its reports to properly disclose the source of the loans.

We suggest that the Audit Division remove its finding regarding \$26,000 of the \$80,000 originating from the two corporations and individual and transferred to the Committee from the law firm business account because the candidate has submitted proper documentation to establish legal entitlement to the \$26,000. We believe that the lack of proper documentation relating to \$54,000 of the \$80,000 originating from the two corporations and individual and transferred to the Committee from the law firm business account supports a finding that the funds in the law firm business account may not have been the personal funds of the candidate. We also believe that the lack of proper documentation relating to the remaining \$21,000 originating from an unknown source and transferred to the Committee from the law firm business account supports a finding that the funds in the law firm business account may not have been the personal funds of

the candidate. Finally, we suggest that the Audit Division revise its analysis and recommendation to further emphasize that it is seeking information regarding whether the funds received were personal funds.

We begin our analysis of this finding with the law that governs candidates who finance their own campaigns. Candidates may make unlimited expenditures from personal funds to finance their own campaigns. 11 C.F.R. §§ 100.33, 110.10. Personal funds are broadly defined as the sum of: (1) any income earned during the election cycle, including any salary or income from bona fide employment, investments, bequests, or customarily received gifts; and (2) any assets held at the time the individual becomes a candidate that the candidate had legal and rightful title over and legal right of access to or control over. *Id.* § 100.33. The central issue in this personal funds analysis is whether the candidate was legally entitled to the funds the Committee received from the law firm as his assets or income, as defined above, or whether a corporation or individual intended a contribution to pass through the candidate to his committee. *See id.* For example, assuming the law firm was a sole proprietorship,¹ the candidate would have been legally entitled to any assets or income legitimately deposited in the law firm business account, including, but not limited to, attorney's fees from clients,² the candidate's legislative salary,³ or loan repayments.⁴

To establish legal entitlement, the Committee must provide documentation regarding *why* the candidate was entitled to the funds deposited in the law firm business account. Specifically, to the extent that the funds at issue came from two corporations and an individual, the Committee must provide documentation that the funds were paid in exchange for bona fide services to the corporations or individual pursuant to a bona fide retainer agreement, salary, repayment of a preexisting loan, or the like. At the time the Audit Division sent the IAR to the Office of the General Counsel, the candidate only had provided a spreadsheet summarizing the law firm's income and expenses, which does not establish legal entitlement. The candidate subsequently submitted a fee sharing agreement, which, assuming the candidate's law firm was a sole proprietorship, establishes that the candidate was legally entitled to a \$30,000 payment from the

¹ We understand that the Audit Division has inquired as to the form of business organization of the candidate's law firm and has received tentative confirmation that the candidate is practicing law as a sole proprietor. We suggest, however, that the Audit Division take additional steps if necessary to confirm that the law firm is a sole proprietorship. Specifically, it should request official documentation from the candidate and verify tax records and business filings with the Hawaii Department of Commerce and Consumer Affairs. If it turned out that the candidate's law firm 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 law firm would be the entity making the loans to the Committee in violation of 2 U.S.C. § 441b(a), and the IAR should be revised to address the prohibited corporate contribution accordingly. *See* 2 U.S.C. § 441b(a); 11 C.F.R. §§ 100.134(f), 110.1(g), 114.2(a); First Gen. Counsel's Rep. on MURs 5283 and 5285 (Feb. 12, 2003).

² The candidate states that he earned attorney's fees during the period in question.

³ The candidate states that his "legislative salary for 2006 [as a Hawaiian Senator] was deposited into the law account."

⁴ The candidate states that the documentation he submitted does "not include the loan repayments that were made to me by the campaign committee, a portion of which were already deposited into the law account."

individual as a bona fide contract right.⁵ A \$30,000 check from the individual was deposited in the law firm business account on August 11, 2006. Therefore, we suggest that the Audit Division remove its finding regarding the \$26,000 transferred to the Committee from the law firm business account that was funded by the individual's \$30,000 payment.

By contrast, the Committee has failed to provide adequate documentation regarding \$54,000 of the \$80,000 originating from the two corporations and the remaining \$21,000 originating from an unknown source. Therefore, we concur with the Audit Division's recommendation that the Committee provide "copies of contracts, agreements, specific terms of service, and/or billing statements illustrating that the [\$75,000 was] received for services."

B. Joint Personal Account

Of the \$110,000 that initially could not be verified as coming from the candidate's personal funds, \$9,000 was transferred from a joint personal account held by the candidate and his spouse. The Committee provided documentation identifying the source for this \$9,000 as being a \$10,000 deposit from a check written to the candidate's spouse from an unspecified joint trustee account. The candidate's spouse deposited the \$10,000 in the joint personal account. The Committee received the contribution from this joint personal account in the form of a check signed by the candidate's spouse with a notation in the memo line reading "loan to campaign." The deposit to the joint personal account was made on the same day as the \$9,000 loan to the Committee. The balance in the account prior to this transaction was only \$1,302. Based on this documentation, the IAR appeared to conclude, but did not explicitly state, that the \$9,000 may not have come from the candidate's personal funds. The Audit Division recommends that the Committee further clarify and demonstrate that the loans were from the candidate's personal funds. Absent such a demonstration, the Audit Division recommends that the Committee refund the funds to the original source and amend its reports to properly disclose the source of the loans.

1. The Audit Division Should First Address and Analyze the Loan from the Joint Personal Account

We suggest that the Audit Division first analyze the \$9,000 loan as a possible contribution by the candidate's spouse. Specifically, the Audit Division should revise the IAR to address the fact that it was the candidate's spouse who signed the check to the Committee from the joint personal account. When one party signs a check from a joint account, the Commission generally will consider the contribution made from the contributor who signed the check. 11 C.F.R. § 110.1(k)(1). Therefore, the Audit Division should address whether the spouse directly made an excessive contribution to the Committee by signing the loan check to the Committee. *See Explanation and Justification for Joint Contributions and Reattribution, 52 Fed.*

⁵ Under the terms of the fee sharing agreement, the individual, who also is an attorney, agreed to pay the candidate \$45,000 in consideration for the opportunity to work on a specific case with the candidate and receive 20 percent of any attorney's fees earned on the case. The agreement specifies that the individual will make a \$30,000 payment to the candidate within five months of the agreement date of May 8, 2006.

Reg. 766 (Jan. 9, 1987). In doing so, it should consider any other evidence regarding both the candidate and spouse's intent to contribute the \$9,000 loan to the Committee. See Gen. Counsel's Mem. on Interim Audit Report on Bill Spadea for Congress (LRA 702) (Sept. 8, 2006) (concluding that the attribution of a contribution from a jointly held account is based on donative intent, and that the signature method is not the sole method for establishing donative intent).

Assuming that the candidate and not his spouse intended to contribute the \$9,000 loan, we also suggest that the Audit Division revise the IAR to analyze the \$9,000 loan as a possible contribution by the candidate using the candidate's spouse's assets. When a candidate uses a jointly held asset to make a contribution to a committee, the candidate may contribute up to his or her full share of the asset. 11 C.F.R. § 100.33(c). The instrument of conveyance or ownership determines the candidate's share of the asset. *Id.* § 100.33(c)(1). If the instrument of conveyance or ownership does not indicate the share, then the candidate's share is one-half the value of the assets. *Id.* § 100.33(c)(2). The proposed IAR does not address whether the candidate properly made the contribution from only his assets in the joint account. Since the candidate and his spouse appear to be the only account holders and we are not aware of an instrument of conveyance or ownership specifying the candidate's share of the account, we assume that the candidate could only contribute half of the funds in the account. According to the IAR, at the time the candidate made loan to the Committee, the joint account had a balance of \$11,302. Because the candidate and his spouse owned these funds equally and therefore were entitled to \$5,651 each, the candidate may not have been able to properly contribute \$9,000 in personal funds from the jointly held account. In this event, the difference between the \$9,000 that the candidate contributed and the \$5,651 that the candidate was entitled to would be the amount of the spouse's contribution.

2. The Audit Division Should Then Address and Analyze the Spouse's Check from the Joint Trustee Account in Order to Determine Whether the Funds in the Joint Personal Account Were Personal Funds

Even if the entire \$9,000 contribution is attributable to the candidate, we believe that the lack of proper documentation regarding the \$9,000 supports a finding that the funds in the jointly held account may not have been the personal funds of the candidate and were instead an excessive contribution from the holders of the joint trustee account. Specifically, the Committee has failed to provide adequate documentation regarding whose money was in the joint trustee account or why that money was paid to the candidate's spouse. Therefore, we concur with the Audit Division's recommendation that the Committee provide "documentation to support that these funds are personal funds of the candidate." We suggest, however, that the Audit Division use broader language to emphasize that it is seeking to determine whether the candidate was legally entitled to the funds received from the joint trustee account. The recommendation should specifically request information regarding the joint trustee account and the purpose of the \$10,000 check issued to the candidate's spouse from the joint trustee account. The recommendation also should request information regarding who holds the joint trustee account and in what shares of ownership.