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March 19, 2012

Mr. Tom Hintermister
Assistant Staff Director
Audit Division
Federal Election Commission
999 E Street, NW
Washington, DC 20543

Re: Audit of 2007-2008 Election Cycle for California Republican Party, C#000014590

Dear Mr. Hintermister:

The California Republican Party (CRP) responds further to the FEC Audit Division's Interim Audit Report of the 2007-2008 election cycle. This response is primarily to Finding No. 3.

Responses to Findings Nos. 1 & 2

The CRP has amended and thus complied with the FEC's audit division's request in regards to Findings No. 1 and 2. With respect to Finding No. 2, the CRP has amended its campaign statements to reflect adjustments of the period-end itemized debts and obligations totals. It should be noted that Finding No. 2 does not conclude that the CRP failed to report debts and obligations; rather that the reported debts and obligations by period were inaccurate. Some of these debts and obligations were reported on a later monthly report than the one the FEC auditor found it should have been reported. In fact at the end of the cycle in 2008 the auditor only had 12,439 of additional debt that CRP failed to disclose on its year end 2008 report. We would also like to point out that CRP's largest vendor (Strategic Fundraising, Inc. ("SFI")) was disclosed properly every month.

Response to Finding No. 3
Extension of Credit by a Commercial Vendor

With respect to Finding No. 3, the CRP disputes the FEC Audit Division's contention that its corporate vendor, SFI, ever made, or intended to make, a corporate contribution by extending credit in a manner that was not in the ordinary course of business or that SFI failed to make commercially reasonable efforts to collect the debt of the CRP to SFI.

Background

The Interim Audit Report correctly notes that the CRP incurred, and was unable to pay, its obligations to SFI, on what would commonly be thought to be a "timely" basis during the audit period. The Interim Audit Report also correctly notes that the CRP paid off its outstanding obligations to SFI in early 2009, following the end of the 2007-2008 audit period.

The facts and circumstances that led to the CRP incurring the debt to SFI were discussed but apparently not given much credence by the Audit Division. This is not much different than noting that the national economy declined in 2008 and 2009 without mentioning either the undisputed or disputed causes of the stock market decline and the mortgage credit collapse.

A. Fundraising is Cyclical – Off Year Fundraising Declined Before Federal 2008 Campaign Year and SFI Debt Repayment Reduced CRP's 2008 Capability to Support Federal Campaigns

Much of the CRP's debt to SFI occurred in 2007, an off-election year. Traditionally, the CRP and other political party committees raise little money in the months following a major statewide gubernatorial election or a Presidential election. Moreover, the CRP and other political parties committees do not spend money on federal campaigns or federal election activity during such periods. The CRP incurred the largest part of its SFI debt during the 2007 off-year due to this traditional fundraising drought period as well as due to some special political factors discussed below that exacerbated that drought.

Then, the CRP and SFI negotiated the SFI debt pay down during the height of the CRP's fundraising in the third and fourth quarters of 2008, during the active part of the 2008 Presidential campaign and the time when CRP would be best able to help Congressional candidates. At just this period, the CRP was devoting large sums of federal dollars to pay down its SFI debt.

Thus, the CRP's traditional fundraising cycle has peaks and valleys, and the valley in 2007 after the big California gubernatorial election of 2006 and the decline of national Republican fortunes in the 2006 Congressional elections, was especially large and problematic. However, when the CRP resumed better fundraising during the 2008 Presidential election year, it was using federally - qualified dollars to repay debt, not to maximize its assistance to federal candidates. In 2007, it cannot be said that the CRP was utilizing SFI's "extension of credit" to benefit federal campaigns or federal elections in a practical sense. When the CRP received federally- qualified dollars in mid to late 2008, the CRP directed those federal dollars to pay down its SFI debt, which affected the CRP's ability to support federal candidates and in no sense resulted in SFI's corporate debt being used to support federal campaigns.

B. CRP Organizational Changes and Decline in Direct Mail & Tele-fundraising Response Rates

The CRP, like many organizations that engage in direct mail and tele-fundraising, suffered a decline in fundraising receipts from these activities. This decline coupled with the fact that the CRP lacked sufficient funds to devote to enhancing or maintaining its fundraising donor base by prospecting for new donors, compounded the CRP's fundraising problems.

Further, as SFI notes, CRP began 2007 with a new Chairman and a new Chief Operating Officer. The new Chief Operating Officer served only a few months and was replaced by an interim Chief Operating Officer in July 2007. The interim Chief Operating Officer had to deal with the debt issue immediately and in circumstances described above that were less than ideal. Between July 2007 and January 2008, the CRP interim Chief Operating Officer, the Finance Director and the Controller attempted to resolve outstanding issues by discussion and partial payments. At SFI's and CRP's agreement, SFI's representatives appeared before the CRP's Board of Directors to discuss the state of the debt, SFI's services, and the necessity for both to continue the CRP fundraising and prospecting efforts. The CRP Board directed the Treasurer, the interim Chief Operating Officer and the Finance Director to evaluate billings and billing issues and to negotiate a payment arrangement with SFI to retire the debt.

C. National and State Decline in Republican Fortunes Had a Major Effect on the CRP's Fundraising Capability

Like other Republican organizations that engage in direct mail and tele-fundraising, the CRP also suffered a loss of brand identification and support that was related to the declining popularity of the national administration and special conditions in California, where in 2006, Republicans had suffered a loss of all but two statewide Republican officeholders. For the CRP, that related in part to the declining popularity of the Bush Administration from 2005–2008. The most obvious results of this declining popularity were (1) the loss of control of Republican majorities in the U.S. Senate and House of Representatives in 2006 and (2) the loss of the Presidency in 2008 to Democrat President Obama.

Moreover, the CRP suffered a loss of larger dollar donors in part because its major statewide officeholder, Governor Schwarzenegger, had declared after his re-election in 2006 that he no longer considered himself as a partisan Republican governor, and he described his party as a damaged brand. Beginning in early 2007, Governor Schwarzenegger ceased to assist the CRP in fundraising, which had two practical consequences: (1) it discouraged donations by small donors, particularly the small donors who typically constitute the bulk of hard federal dollar contributors for which SFI raised funds for the CRP from tele-fundraising efforts, and (2) severely precipitated an even larger loss or larger, hard dollar major donor dollars. Moreover the CRP's non-federal campaign reports showed substantial non-federal debt arising in 2006 from a $3,000,000 loan that had been raised to help re-elect Governor Schwarzenegger which the

Governor ceased to help retire, and its federal campaign reports reflected a growing, unpaid debt to SFI and several other vendors that began to arise at the start of the 2007 off-election year and only grew larger as the CRP attempted to keep its doors open and to attempt to rebuild its donor base, as SFI had repeatedly urged the CRP to do.

<u>SFI Made Commercially Reasonable Efforts To Collect the CRP Debt</u>

The CRP and SFI engaged in good faith discussions and negotiations to resolve the CRP's debt to SFI. These good faith efforts resulted in the extinguishment of the debt by early 2009. The CRP's officers and key employees, particularly its Treasurer, Chief Operating Officer and Finance Director, were in constant, regular communications with SFI during the 2007-2008 period. The CRP's Board of Directors received regular briefings at each Board meeting by these individuals of the growing campaign debt to SFI, and about CRP's efforts to deal with this problem. SFI's key staff visited California in January 2008 as noted above and in SFI's letter, and in 2008, CRP's key staff also visited SFI's offices in Minnesota to discuss, review, and following that meeting in Minneapolis, to negotiate a mutually - satisfactory method to pay off the debt. This led to the solution that eliminated the debt in early 2009.

SFI made commercially reasonable efforts to collect this CRP debt, as its correspondence submitted herewith details. SFI billed CRP monthly on all telemarketing and direct mail matters, regularly was in contact with the CRP's Chief Operating Officer, Controller and Finance Director about these bills and made regular inquiries about payment.

The CRP estimates that it had hundreds of separate communications by telephone, email and face-to-face with SFI's representatives during the period that related to addressing the debt issue. The CRP on its part also proactively communicated with SFI representatives about the obligation, the CRP's current and prospective capability to pay, its overall fundraising progress and status. SFI's invoices included finance charges.

In July 2008, the CRP and SFI negotiated an agreement that (1) resolved disputes about billing items; (2) negotiated a set aside of SFI-generated tele-fundraising receipts that were dedicated and credited to pay-down of the CRP debt; and (3) extended the SFI-CRP fundraising agreement into 2009-2010. SFI continues to this day as the CRP's tele-fundraising vendor.

Thus, the CRP along with SFI strongly disagrees that SFI failed to make commercially–reasonable efforts to collect the CRP debt, or that CRP considered the SFI's extension of debt to be a contribution by the corporation.

<u>The SFI-CRP Fundraising Agreement</u>
<u>Was an Ordinary Course of Business Agreement</u>

The Audit Division contends that CRP and SFI had not sufficiently documented why the SFI-CRP Fundraising Agreement was an "ordinary course of business" agreement, and sought documentation and justification of it. SFI has separately responded to the specific questions raised by the Audit Division to why the "break even guarantee" was reasonable in light of the potentially significant risk.

The Audit Division report seems to indicate that any CRP/SFI agreement that did not provide for SFI to cage and sequester funds necessary to pay its bills to CRP was not in the ordinary course of business. This position ignores two crucial facts: (1) CRP was one of the largest, if not the largest, of SFI's political accounts, and CRP had other direct mail fundraising, event fundraising and special fundraising contracts during the audit period. CRP chose to separate caging functions from all of its fundraising vendors, and had a separate caging agreement and vendor, better to ensure compliance with FEC and non-federal campaign reporting requirements; (2) CRP's financial situation in 2007 and 2008 resulted in a number of vendors and others receiving delayed payments. CRP of necessity had to try to balance the payment of its obligations with continuing to keep its doors open, the only means by which it could practically continue to pay its debts to vendors.

From the CRP's standpoint, the CRP faced a dilemma -- if it failed to prospect, its active donor base would decline and lose its value, but if it did prospect, such prospecting generally doesn't cover its costs, at least in the short run. In the long run, a new donor acquired is a valuable asset. The SFI-CRP agreement was designed with this dilemma in mind. By establishing an exclusive right to CRP's fundraising projects for a year or more, SFI was enabled to benefit from both direct mail and telemarketing, which have performed differently over the years.

Moreover, the long term CRP/SFI relationship (which had commenced in the mid-1990s) demonstrates that neither party intended to engage in non-ordinary course business arrangements. The CRP's fundraising goals are to maximize "contributions" from its tele-fundraising, direct mail fundraising and other donor fundraising programs as well as to acquire donors who will contribute to the CRP to advance its goals of elected Republicans to federal, state and local offices.

The CRP did not and does not expect to maximize contributions by failing to pay its bills or extracting contributions via lengthy extensions of credit from vendors. The CRP is not in the political business to break even in electing candidates, to stand by while its donor base erodes, or to just get by paying its vendors.

That this situation occurred in 2007-2008 is fully explaining by the perfect storm of adversity described above, and should not result in an adverse audit finding by the FEC, particularly where, as here, the CRP extinguished the SFI debt shortly after the close of the audit period.

The FEC has in the past taken into account the problem of candidates' and committees' permanent or temporary inability to pay their debts and obligations. The FEC's debt settlement procedures which are required for the termination of committees acknowledge that some debts simply cannot be paid timely, if at all. Moreover, the FEC's Advisory Opinions that are cited in the Interim Audit Report contemplate advance methods for corporate vendors and committees to use to avoid debt that might be viewed at some point as an illegal extension of credit. However, none of these advisory opinions address the distress situation, when a regular business relationship of long standing cannot be maintained accordingly to the strictures of a theoretical, arms' length, and ordinary course-of- business contract provision.

The Interim Audit Report seems to suggest that when strong winds blow in the course of a long standing business relationship, the parties should adjust their business relationships to utilize the approaches described in the advisory opinions, whether those affect the continued opportunity for the debtor to continue in business and work out those debts in a manner that is satisfactory to a particular creditor or all creditors. The most salient fact of the CRP and SFI relationship is that the parties worked out a payment plan and set aside arrangement that resulted in the extinguishment of the CRP's debt to SFI shortly after the end of the audit period. This demonstrates, rather than condemns, the course of business process and relationship that obtained between the two parties in the 2007-2008 audit period.

CONCLUSION

For the forgoing reasons, and on the basis of the information submitted by CRP and SFI, CRP respectfully requests the Commission to amend Finding No. 2 and not to adopt Finding No. 3.

Very truly yours,

Charles H. Bell, Jr.
General Counsel
California Republican Party

strategic
FUNDRAISING

Tom Hintermister, Assistant Staff Director, Audit Division
Federal Election Commission
999 E Street, NW
Washington, DC 20543
Re: Audit of 2007-2008 Election Cycle for California Republican Party, C#000014590

Dear Mr. Hintermister:

On behalf of Strategic Fundraising, Inc. ("Strategic") of St. Paul, Minnesota, this letter is in regard to an Interim Audit Report of the FEC concerning the extension of credit by Strategic to the California Republican Party ("CRP").

Strategic has been a primary industry vendor to political parties, campaigns, PACs and non-profit organizations since its founding in the early 1990's. Strategic provides telefundraising/telemarketing/donor list development and caging services to its clients, including the CRP. The CRP has been a major, valued client since 1995-1996. CRP is among Strategic's largest political telefundraising clients. Strategic currently employs more than 700 people in five locations (St. Paul, Minnesota; Eau Claire, Wisconsin; Oshkosh, Wisconsin; Springfield, Missouri and Fargo, North Dakota.)

In the 2007-2008 cycle, Strategic provided telefundraising services to the CRP. During that time period, Strategic raised primarily hard federal dollars for the Party. During this time, the CRP developed and maintained a substantial account receivable, largely due to circumstances related to the external political atmosphere (something that affected most of Strategic's Republican Party clients at that time). Due to this unanticipated negative impact on its financial situation, the CRP did not enable it to engage in sustainable new donor acquisition, membership renewal and reactivation of old donors.

The Audit staff specifically is seeking to answer two separate and distinct issues (p8): 1) Whether or not the extension of credit was in SFI's ordinary course of business, and 2) Whether or not, commercially reasonable attempts to collect the debts were made by SFI. Demonstrating the efforts pertaining to question two, will also help show why the extension of credit was in our ordinary but not desired course of business.

Going back several years prior to the 2007-08 cycle, the CRP was always current on their account. SFI recognized this history so when their accounts receivable started to get behind in mid-2007, and we immediately escalated the issue to key CRP staff (executive director and controller).

Unfortunately there were some staff changes made in the midst the summer of 2007, and the new staff inherited an undesirable situation. Besides our normal weekly invoices, SFI also sends out via an e-mail link bi-weekly billing summaries and open invoice reports which contain the 'aging' for each client (not just the CRP – all clients – political and non-profit). In addition to this regular communication to the accounting staff at the CRP, SFI's account management staff also communicated via phone and e-mail every two weeks during the period in which the balance was growing. SFI requested and was presented with several informal payment plans in the fall/winter of 2007. They would be adhered to for a while, and then the CRP would be unable to keep up with payments, most likely due to cash flow constraints.

In December 2007, SFI had internal discussions regarding suspending fundraising on behalf of the CRP until we could get a better understanding of when the balance would be paid down. This led to a meeting with the CRP Board of Directors in January 2008, in which SFI demonstrated the value of service we provide to the CRP and the need to continue the fundraising program. Both SFI and the CRP realized that by stopping fundraising activity completely, the CRP would have even less money to operate on. This helps explain why an extension of credit was in SFI's best interest ordinary course of business.

Unfortunately, the CRP continued to use funds raised from SFIs activities to pay other bills which increased the overall debt substantially in the first quarter of 2008. Repeated extraordinary attempts were made to obtain payments throughout February, March and April besides the normal billing reminder process. The high balance eventually caused the executive director to cease all prospecting in early April in an effort to stop the balance from growing further. What was not understood at that time is it also meant the income from said prospecting would also cease. Over the next several weeks, SFI worked diligently to show the importance of prospecting and its direct impact on future fundraising, which funds the CRP with federal dollars.

At SFI's urging in late June 2008, the CRP financial and fundraising staff took another unprecedented step and flew to SFI's St. Paul, Minnesota office to discuss the situation in person – much more than the normal course of business but necessary for a long-time, valued partner like the CRP. At that meeting, SFI presented a detailed house file analysis which included details on historical fundraising trends and renewal rates as well as a look back at how the balance got to be as large as it was at that time.

This meeting led to a better understanding of the need to prospect and fundraise to help the CRP out of the situation it found itself in. Following this meeting, serious discussions began about developing a formal payment plan (unlike the informal ones from 2007) to clear up the balance. To that end, SFI's CEO, CFO and Account Director flew to California to work out the details. The plan was mutually agreed to and the debt was paid off.

As one can clearly see, Strategic believed at all times that this extension of credit would further the CRP's receipt of new funding from new donor acquisition, and the renewal and reactivation of old donors. The long term relationship we enjoy with the CRP was worth the extra effort to work out a mutually beneficial payment plan that allowed SFI to continue raising funds for the CRP. At no time has Strategic intended to make a contribution to the CRP's federal account by virtue of its extension of credit.

One can also clearly see that Strategic extended credit to the CRP in the ordinary course of business. In doing so, Strategic followed its established procedures and its past practice as with other telefundraising clients in the political and non-profit arena in approving the extension of credit. Many of Strategic's other clients have experienced similar fundraising problems at one time or another, and Strategic has worked with them in their mutual interests by providing flexible payment plans. During the time period in question, the CRP and Strategic negotiated a resolution of disputed billing items, a payment plan which involved Strategic's continuing telefundraising for the CRP and a retention against the outstanding but unpaid balances of receipts until the obligation was satisfied in 2009.

Strategic received as reasonably prompt payment in full from the CRP based on this extension of credit. During the subsequent time periods, the CRP has continued to make regular payments for ongoing services provided by Strategic. Strategic's extension of credit to the CRP conformed to a usual and normal practice in the political and non-profit fundraising industry. Over our long history it has not been uncommon for a few clients to fall behind in any given year, and moving forward we work with them to continue fundraising while simultaneously bringing their accounts back to current status.

Due to confidentiality clauses in our contracts with our non-profit clients that do not fall under the purview of the Federal Election Commission, we cannot list them in a public forum. There is currently one very large, national non-profit 501(c)3 that SFI recently worked out a similar payment plan for. As one can imagine it is not in anyone's best interest to cease fundraising and make the situation worse, while at Strategic we could run the risk of never receiving payment. As far as SFI's other political clients that have fallen into similar circumstances, we believe all have been duly reported on their Schedule Ds.

The Audit staff also recommended that SFI 'provide evidence' (p10) on; 1) The 'break-even guarantee' as a common industry practice; 2) The value of the exclusivity clause to SFI; 3) Confirmation that the terms of the credit are similar to a non-political client of similar risk.

Without disclosing too much of the details of our business model or explaining how fundraising works, SFI will stress that our standard fundraising agreements with all political clients call for exclusivity. As a company, we understand the need to acquire new donors for the long-term health of our partners like the CRP and we have a 20 year history which allows us to mitigate our internal 'risk'. All other telefundraising firms offer the exact or similar 'break-even guarantee'. As pointed out above, we issue credit to non-political clients as well in the exact same fashion.

Sincerely,

Mark Dixon

Mark Dixon

Chief Financial Officer

Strategic Fundraising, Inc.