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BEFORE THE FEDERAL ELECTION COMMISSION

In the Matter of

Gordon Smith for Senate, Inc. (96) and Stan Huckaby,
in his official capacity as treasurer

GENERAL COUNSEL'S REPORT #2

I. ACTIONS RECOMMENDED

Find reason to believe that Gordon Smith for Senate, Inc. (96) and Stan Huckaby, in his official capacity as treasurer ("Committee"), violated 2 U.S.C. § 434(b)(3)(E); enter into pre-probable cause conciliation with the Committee and approve the attached conciliation agreement.

II. BACKGROUND

This matter involves the repayment of a \$2 million line of credit from U.S. Bank of Oregon ("U.S. Bank") to Senator Gordon Smith. The proceeds of the line of credit were loaned to, and used primarily for, Senator Smith's 1995 special election committee. The line of credit was repaid by Senator Smith, with the Committee assuming the obligation to repay Senator Smith the funds loaned by him.¹

Originally, the Committee did not report all of the repayments of the outstanding balance to U.S. Bank. In 2002, it amended its 2000 and 2001 disclosure reports to reflect \$1,634,427 in repayments. The complaint challenged these amendments which state Senator Smith repaid the line of credit from "personal funds" in May 2000. Rather, the

¹ In an assumption agreement effective May 21, 1996, the Committee expressly assumed the debt of Senator Smith's 1995 special election committee relating to the \$2 million U.S. Bank line of credit. The assumption agreement stated that Senator Smith "agrees to no longer look to [the 1995 special election committee] for payment . . . and, instead, to look solely to [Gordon Smith for Senate Inc. (96)] for payment."

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1 complaint alleged, the repayment came from a \$1.7 million home equity loan obtained by
2 Gordon and Sharon Smith in April 2000, and Senator Smith therefore accepted an
3 excessive contribution from his wife because the repayment amount exceeded his share
4 of the home's equity.

5 As set forth in the First General Counsel's Report dated October 22, 2004
6 ("FGCR") at 14-15, the complaint's premise was completely understandable, even if
7 wrong. The 2002 amendments make it appear as though the line of credit balance from
8 1995 was repaid on a single day, May 2, 2000, soon after the Smiths obtained the \$1.7
9 million home equity loan. However, the Committee was able to establish through a
10 partial bank statement showing repayments of the line of credit that, at the time the home
11 equity loan was made, the unpaid balance on the line of credit was \$589,321, and that
12 only this amount from the home equity loan was used to pay off the line of credit. The
13 rest of the proceeds from the home equity loan, according to the Committee, were used
14 by Senator and Mrs. Smith for purely personal purposes. Since the Senator's share of the
15 equity in his home exceeded the \$589,321 he used to payoff the old line of credit, the
16 Commission found no reason to believe that Senator Smith's wife made an excessive
17 contribution to the Committee.

18 In its response to the complaint, the Committee acknowledged that it had
19 originally failed to report many payments made to pay off the 1995 line of credit,
20 including the last payment of \$589,321. It stated that it had attempted to correct this
21 problem by filing the 2002 amendments. The Committee also acknowledged that the line
22 of credit balance actually had not been repaid *on* May 2, 2000 as indicated in the
23 amendments, but had been repaid to U.S. Bank over time *as of* that date, although this

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1 information could not be found anywhere in the amendments or in the cover letter
2 accompanying them. Moreover, the Committee acknowledged that it had not reported
3 that a portion of the 2000 home equity loan had been used to make the final repayment on
4 the line of credit. The Committee reasoned that since "less than a third" of the home
5 equity loan had been used to pay off the 1995 line of credit, the home equity loan had not
6 been received "in connection with the campaign. . . and did not need to be designated as
7 such in Committee reports." *See* FGCR at 8-9.

8 Thus, at the reason to believe stage, it was evident that the Committee's reporting
9 of the repayments on the line of credit had been seriously flawed dating back to the
10 1990's, and that the 2002 amendments had served only to further confuse the picture.²
11 Accordingly, the Commission found reason to believe that the Committee violated
12 2 U.S.C. § 434(b)(4)(D) and 434(b)(8) by failing to report loan repayments on the 1995
13 U.S. Bank loan and by failing to accurately and consistently report the Committee's
14 outstanding debt to Senator Smith and the balance of the debt to U.S. Bank.

15 This Office conducted a limited investigation to obtain documentation of the
16 course of the loan repayments. Our goal was to reconstruct when and in what amounts
17 the payments occurred in order to ascertain the amount in violation and to ensure that the
18 Respondents have the information needed to correct the public record. The investigation
19 was delayed in part due to Respondent's difficulty in finding some of the specific

² Among other things, until the 2002 amendments, the Committee had failed to report any principal repayments on the 1995 line of credit made after January 7, 1999. Moreover, some payments prior to that date were also not reported, and those that were reported, were variously described in the Committee's disclosure reports. For example, Schedules B filed with some reports had the notation "Loan Repayment/In-kind principal payment" by Gordon Smith, with corresponding in-kind receipts from Gordon Smith reported on Schedules A; Schedules B filed with other reports had the notation "Principal Payment Paid by Candidate" and corresponding receipts from Gordon Smith on the same dates on Schedules A; and in still other reports, the payments were described as "loan payment" or "loan repayment," without any obviously corresponding in-kind receipts from Gordon Smith. *See* the FGCR at note 11.

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1 information we requested and because they sought review and confirmation of certain
2 information from their accountants.

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4 **III. DISCUSSION**

5 The Committee provided a chronology of transactions, obtained from U.S. Bank,
6 on the line of credit from 1996 to 2000, as well as copies of checks showing Senator
7 Smith's payments to U.S. Bank in 1999 and 2000 after the Committee ceased reporting
8 principal payments on the line of credit. This Office confirmed that Senator Smith
9 directly paid off the line of credit entirely with his own funds or funds obtained from the
10 2000 home equity loan, and that disclosures showing contributions from Senator Smith to
11 the Committee in connection with these payments were disclosures of in-kind
12 contributions. We also compared the bank transaction chronology from 1996 to 2000
13 with the loan balances shown on each of the Committee's disclosure reports during this
14 time period. We determined that the Committee failed to report some payments on the
15 U.S. Bank line of credit beginning as early as 1996 and that the disparity between the
16 decreasing amount of the loan balance listed on the bank transaction chronology and the
17 debt balance reported on the Committee's disclosure reports, which remained largely
18 stagnant, increased over time. For example, the Committee's 1999 Year-End Report
19 showed a loan balance of \$1,634,427, when the bank statement shows the loan balance
20 was actually \$935,452, a difference of nearly \$700,000, reflecting the Committee's
21 failure to correctly report principal payments on the line of credit since its 1996 Year-End
22 Report.

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In the original 2000 Mid-Year Report, the Committee:

- Failed to report eight separate principal payments from January 2000 to May 2000, totaling \$935,452, in violation of 2 U.S.C. § 434(b)(4)(D);
- Failed to report that the receipt of \$589,321 in proceeds that was used to pay off the 1995 line of credit from U.S. Bank was derived from a home equity loan, in violation of 2 U.S.C. § 434(b)(3)(E);
- Erroneously continued to report an outstanding balance owed to U.S. Bank of \$1,634,427 instead of a zero balance showing the line of credit had been fully repaid, in violation of 2 U.S.C. § 434(b)(8). The Committee repeated this violation on its original 2000 Year-End Report, and 2001 Mid-Year and Year-End Reports; and
- Failed to report the accurate amount of debt owing to Senator Smith in connection with his repayment of the line of credit, when, according to the 2002 amendments and the 1996 assumption agreement, *see* note 1, *supra*, the Committee's apparent intent was to regard each payment of principal (and interest) by Senator Smith on the line of credit as creating new debt from the Committee to Senator Smith.

As noted previously, while the 2002 amendments correctly indicated that the line of credit had been paid off and now had a zero balance, those amendments made it appear as if all the payments took place on a single day in May 2000, rather than

1 over time.⁴ This error violated 2 U.S.C. § 434(b)(8).

2 In considering the Committee's violations in this matter, the Commission should
3 view them in the context of the reporting rules applicable at the time. When a candidate
4 receives a loan for use in connection with his campaign, he does so as an agent of his
5 committee. 2 U.S.C. § 432(e)(2). Prior to 2002, however, the reporting rules applied this
6 principle strictly, requiring committees to itemize such loans as loans from the financial
7 institution to the committee rather than from the candidate to the committee. *See*
8 11 C.F.R. § 104.3(a)(3)(vii)(B) (2001). In 2002, the Commission adopted new
9 regulations regarding the reporting and repayment of brokerage loans and other lines of
10 credit, which "allow the candidates and their authorized committees the flexibility to
11 structure and manage these loans in a manner that fits their needs and circumstances."
12 Explanation and Justification for Regulations on Brokerage Loans and Lines of Credit,
13 67 Fed. Reg. 38,353, 38,355 (June 4, 2002). The current regulations allow committees to
14 report these loans as contributions or loans from the candidate to the committee, *see*
15 11 C.F.R. § 104.3(a)(3)(vii)(B) (2005), provided that the financial institution is reported
16 as a secondary source of the loan and that, on the report where the transaction first
17 appears (and on subsequent reports where there are draws on lines of credit), a Schedule
18 C-1 is filed reflecting the terms of the loan from the financial institution to the candidate.
19 The committee is no longer required to report repayments by the candidate to the lending
20 institution.

⁴ The amendments were prompted by an inquiry from the Reports Analysis Division ("RAD") with respect to the Committee's failure to report interest payments on the U.S. Bank loan. As noted in the FGCR at 7-8 and note 7, although the Committee claimed in its response to the complaint that the 2002 amendments had been made in conjunction with RAD, this Office could not find any evidence of RAD's involvement. The Committee did not renew this claim in writing in response to the Commission's reason to believe findings.

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At the reason to believe stage, the Committee's inconsistent reporting made it impossible to determine whether Senator Smith and the Committee consistently intended that the loan transaction would be structured as one in which Senator Smith relent the loan proceeds to the Committee. Our investigation established that Senator Smith personally made all of the principal and interest payments on the 1995 line of credit. Had Senator Smith obtained the line of credit today, his committee could have simply reported the transaction as a loan from himself to his committee, so long as the bank was reported as a secondary source and appropriate Schedules C-1 were filed for the draws on the line of credit. Most of the violations, therefore, would not have occurred today, because the Committee would not have been obligated to report Senator Smith's payments to U.S. Bank.

With respect to the Committee's reporting of the proceeds of the home equity loan as derived from "personal funds," rather than from a lending institution, the Committee should have reported the source and amount used to pay off the Committee's remaining debt from the 1995 line of credit, but would not be required to report the portion of the proceeds used for non-campaign purposes. *See* FGCR at 13-14; *cf.* Advisory Opinion 1994-26 (where candidate obtained line of credit years prior to candidacy, his committee only needed to report the line of credit starting with the reporting period when the line of credit was first drawn on for campaign purposes); *accord*, 11 C.F.R. § 104.8(g)(2003); Brokerage Loans and Lines of Credit, Explanation and Justification, 67 Fed. Reg. 38, 353, 38, 354 (June 4, 2002) ("[I]f a loan or advance . . . is used for the purpose of influencing the candidate's election for Federal office and for other purposes . . . then the portion that is used for the purpose of influencing the

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1 candidate's election for Federal office must be reported . . ."). In connection with the
2 Committee's failure to report that a portion of the home equity loan proceeds was used
3 for campaign purposes, this Office recommends that the Commission find reason to
4 believe that Gordon Smith for Senate, Inc. (96) and Stan Huckaby, in his official capacity
5 as treasurer, violated 2 U.S.C. § 434(b)(3)(E), the provision requiring the reporting of
6 each person who makes a loan to the committee, together with the date and amount of
7 such loan.

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13 Having completed its investigation, this Office now recommends that the
14 Commission offer to enter pre-probable cause conciliation with the Committee.

15 **IV. PROPOSED CONCILIATION AGREEMENT**
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V. RECOMMENDATIONS

1. Find reason to believe that Gordon Smith for Senate, Inc. (96) and Stan Huckaby, in his official capacity as treasurer, violated 2 U.S.C. § 434(b)(3)(E).
2. Enter into pre-probable cause with Gordon Smith for Senate, Inc. (96) and Stan Huckaby, in his official capacity as treasurer, and approve the attached conciliation agreement.
3. Approve the appropriate letter.

Lawrence H. Norton
General Counsel

7/28/05
Date

BY: Susan L. Lebeaux
Susan L. Lebeaux
Assistant General Counsel

Delbert K. Rigsby
Delbert K. Rigsby
Attorney

- 1 Attachment
- 2 Conciliation Agreement

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