FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

Cleta Mitchell, Esq.
Foley & Lardner LLP
Washington Harbour
3000 K Street, NW, Suite 500
Washington, DC 20007

MAY 1 9 2005

RE: MUR 5496
Lawrence D. Huffman

Dear Ms. Mitchell:

On August 6 and August 11, 2004, the Federal Election Commission notified your client of complaints alleging violations of certain sections of the Federal Election Campaign Act of 1971, as amended ("the Act"). Copies of the complaints were forwarded to your client at that time. Further, on August 9, 2004, you made a *sua sponte* submission concerning the above named Respondent. Please note that the Commission has merged the matter generated by the second complaint, MUR 5507, and your clients' *sua sponte* submission into the matter generated by the first complaint, MUR 5496. All further correspondence in this matter will refer to MUR 5496.

Upon further review of the allegations contained in the complaint, and information supplied by your client, the Commission, on May 5, 2005, found that there is reason to believe that Lawrence D. Huffman knowingly and willfully violated 2 U.S.C. §§ 441a(f) and 441f, provisions of the Act. The Commission also found reason to believe that your client violated 2 U.S.C. § 441b concerning a bank loan. The Factual and Legal Analysis, which formed a basis for the Commission's findings, is attached for your information. Further, the Commission found no reason to believe that your client violated 2 U.S.C. § 441b concerning a Ford Explorer purchased from Dale Jarrett Ford, Inc. and found no reason to believe that he violated 2 U.S.C. § 441i(e)(1)(A).

You may submit any factual or legal materials that you believe are relevant to the Commission's consideration of this matter. Please submit such materials to the General Counsel's Office within 15 days of receipt of this letter. Where appropriate, statements should be submitted under oath. In the absence of additional information, the Commission may find probable cause to believe that a violation has occurred [redacted]

[redacted]

[redacted]

[redacted]

Requests for extensions of time will not be routinely granted. Requests must be made in writing at least five days prior to the due date of the response and specific good cause must be demonstrated. In addition, the Office of the General Counsel ordinarily will not give extensions beyond 20 days.

This matter will remain confidential in accordance with 2 U.S.C. §§ 437g(a)(4)(B) and 437g(a)(12)(A) unless you notify the Commission in writing that you wish the matter to be made public.

If you have any questions, please contact Ana Peña-Wallace, the attorney assigned to this matter, at (202) 694-1650.

Sincerely,

Scott E. Thomas
Chairman

Enclosure
Factual and Legal Analysis

FEDERAL ELECTION COMMISSION
999 E Street, N.W.
Washington, D.C. 20463

FACTUAL AND LEGAL ANALYSIS

MUR 5496

RESPONDENT: Lawrence David Huffman

I. INTRODUCTION

The Commission received two complaints questioning the source and legality of a number of loans the candidate, Lawrence David Huffman, made to the Huffman for Congress committee ("the Committee") during the 2004 election cycle.[1] According to the complaints, the candidate obtained over $250,000 in bank loans and reported the source of the money as personal funds. However, according to the allegations, the candidate did not possess enough assets to make those loans.

At about the same time the complaints were submitted, the Committee, through its counsel, made a *sua sponte* submission disclosing the details of a $100,000 loan the candidate obtained through Dean Proctor, the campaign's Finance Chairman.[2] The *sua sponte* documents also address some of the other loans the candidate made to the Committee. Based on all of the

[1] Huffman was a candidate for the U.S. House of Representatives from the 10th District of North Carolina during the 2004 primary election. Huffman received 35% of the vote in the primary election, but needed 40% to avoid a runoff. Heather Howard, *Recount Confirms McHenry Winner: GOP Candidate for Congressional Seat Says He Hopes to Unite Party*, CHARLOTTE OBSERVER, August 26, 2004, at 1B. On August 17, 2004, he lost the runoff election by 85 votes to Patrick McHenry. *Id.* This was Huffman's first federal campaign. Previously, Huffman served as Sheriff of Catawba County, North Carolina, an elected position, for 22 years. Jim Morrill, *Lawmakers Weigh in on 10th Race; Group Backed by GOP Officials Runs Ad Blasting 3 Candidates in Primary*, CHARLOTTE OBSERVER, July 17, 2004, at 1B. Huffman's three opposing candidates in the primary election submitted one of the complaints in this matter.

[2] Counsel for the Committee contacted the Commission's Office of General Counsel on July 20, 2004 and then met with staff on July 30, 2004. The candidate, Dean Proctor, and Jamie Parsons, the campaign chairman, also attended the meeting. The *sua sponte* documents were submitted to the Commission on August 9, 2004.

information available in this matter, and for the reasons set forth below, the Commission finds find reason to believe that Lawrence David Huffman knowingly and willfully accepted an excessive contribution from Dean Proctor; that he knowingly and willfully allowed his name to be used to make a contribution in the name of another; and that he accepted a loan outside the ordinary course of business from People's State Bank. 2 U.S.C. §§ 441a(f), 441f and 441b.

II. FACTUAL AND LEGAL ANALYSIS

The complaints question the source and legality of six loans the candidate reported making to the Committee, totaling $266,747.01. The Committee's reports filed with the Commission indicate that the source of those loans was the candidate's personal funds. However, the complaints allege that the candidate had insufficient personal assets to make the loans. In support of that contention, the complaints make reference to the Financial Disclosure Statement the candidate filed with the U.S. House of Representatives. They also cite to news accounts that indicate that the candidate borrowed $100,000 against his retirement in early 2004 and that another $166,000 came from a bank loan. *See* Andrew Mackie, *High Stakes*, HICKORY DAILY RECORD, July 18, 2004. However, the complaints do not specify the particular source of the funds, but only argue that the candidate did not have enough personal assets to provide funds for these loans. The Committee's *sua sponte* submission addresses two of the loans questioned in the complaints and also provides information pertaining to a $150,000 line of credit.

Based on a review of the Committee's disclosure reports, it appears that from January through December 2004, the candidate loaned the Committee a total of $416,799.54. Of that

total, $167,142.54 was reported as coming from personal funds, $149,657 was reported as bank loans, and $100,000 was reported as a loan obtained through Dean Proctor.[3]

The loans complained of are the following, as reported on the Committee's original disclosure reports:

January 16, 2004	$6,647.01
March 1, 2004	$100.00
March 30, 2004	$100,000.00
May 10, 2004	$50,000.00
June 9, 2004	$10,000.00
June 17, 2004	$100,000.00

The Committee reported these loans to the Commission soon after they were each incurred. *See* 2004 April Quarterly Report and 2004 July Quarterly Report. Each of the loans was reported as coming from the candidate's personal funds. As will be discussed in further detail, contrary to what was actually reported by the Committee, of the loans the candidate made to the Committee, only $66,747.01 was actually derived from the candidate's personal funds. Specifically, the candidate made loans to the Committee, apparently from his personal funds, on January 16, 2004, March 1, 2004, May 10, 2004, and June 9, 2004. The remaining loans disclosed in the Committee's reports are discussed below.

The Federal Election Campaign Act of 1971, as amended ("the Act"), permits candidates to make unlimited expenditures from their personal funds in connection with their federal campaigns. *See* 11 C.F.R. § 110.10; *see also Buckley v. Valeo*, 424 U.S. 1, 54 (1976) (holding restrictions on candidates' expenditures from personal funds unconstitutional). Personal funds

[3] As reflected on the Committee's most recently amended disclosure reports, the candidate made the following loans to the Committee in 2004: 01/16/04 - $6,647.01; 3/1/04 - $100; 5/10/04 - $50,000; 6/09/04 - $10,000; 06/17/04 - $100,000; 7/19/04 - $100,395.53; 7/27/04 - $100,000 (draw on line of credit); 08/16/04 - $25,000 (draw on line of credit); and 11/24/04 - $24,657 (draw on line of credit).

consist of assets that at the time of the candidacy "the candidate has legal right of access to or control over, and with respect to which he had - (i) legal and rightful title; or (ii) an equitable interest;" income such as salary and other earned income from bona fide employment, bequests to the candidate, dividends and proceeds from the sale of the candidate's stocks or other investments; and the candidate's share of assets owned jointly with a spouse. 2 U.S.C. § 431(26); 11 CFR § 100.33. Thus, the candidate could make unlimited use of his income and assets for his federal campaign.

In addition to loaning his campaign money from his personal funds, the candidate also loaned the Committee funds he obtained from financial institutions. Although the Act does not permit contributions by national banks, and prohibits candidates and committees from accepting such contributions, candidates are permitted to obtain bank loans and lines of credit for use in connection with their federal campaigns as long as those transactions are made in the ordinary course of business. 2 U.S.C. §§ 431(8)(B)(vii) and (xiv), 441b; Statement of Reasons, MUR 4944.

In a Chronology of Events ("Chronology") the Committee submitted as part of its *sua sponte* submission, the Committee specifically discusses the loans of March 30, 2004 and June 17, 2004 and also addresses a $150,000 line of credit the candidate obtained on July 19, 2004.

First, the candidate personally obtained a $100,000 loan on March 30, 2004 from People's State Bank ("People's"). He used the proceeds to purchase a ninety-day certificate of deposit from People's, which served as collateral for the loan. According to the Chronology, the candidate's "intent was to provide the certificate of deposit to the campaign for use as needed, but not to be spent unless needed." He explained that because he was uncertain whether the

campaign would actually need to use the funds, he decided to purchase a certificate of deposit so that the funds could earn interest during the term of the loan and offset the interest that accrued on the loan.

The candidate also clarified that "the purpose of the loan was to make funds available for campaign purposes." Accordingly, the Committee reported the loan on its original 2004 April Quarterly Report. A candidate who receives a loan for campaign purposes is deemed to have done so as the agent of his or her campaign. 2 U.S.C. § 432(e)(2). Thus, committees are advised that "[i]f a candidate obtains a bank loan for campaign-related purposes, the committee must report the loan[.]" *Campaign Guide for Congressional Candidates and Committees* (2004) at 71. However, since 2002 committees have been able to report these loans as contributions or loans from the candidate to the committee, *see* 11 C.F.R. § 104.3(a)(3)(vii)(B), provided that the financial institution is reported as a secondary source of the loan and that, on the report where the transaction first appears, the committee includes a Schedule C-1 disclosing the terms of the financial institution's loan to the candidate.[4] 11 C.F.R. § 104.3(d)(4). This reflects that there are in a sense two transactions involved in such a scenario – one between the financial institution and the candidate, and one between the candidate and his or her committee.

In this case, however, the second transaction was not immediately consummated. Although the candidate avers that he had "campaign purposes" in mind when he obtained the loan, he did not immediately lend or contribute the proceeds of the loan to the Committee. Rather, he used them to purchase a certificate of deposit that remained in his name, not the

[4] Schedule C-1 also must contain the date the loan was incurred, the due date of the loan, the amount of the loan, the interest rate, the name and address of the lending institution, the types and values of any collateral used to secure the loan or an explanation of the basis upon which the loan or line of credit was made. 11 C.F.R. § 104.3(d)(4).

Committee's (although he says that neither he nor the Committee knew until later that the bank had placed the certificate of deposit in his name). Because the certificate of deposit was in his name, he presumably controlled it personally and could have withdrawn it and done what he wished with the proceeds. Thus, the Committee was not required immediately to report the March 30 transaction. In fact, it was not required to report it until the candidate provided the proceeds to the Committee. After consulting with RAD in the wake of its *sua sponte* submission, the Committee amended its reports accordingly. As will be discussed, the Committee did ultimately use the proceeds of the certificate of deposit in July 2004, and reported the funds as a loan from the candidate in its Pre-Runoff Report filed in August 2004.

Further, it appears that People's made the original March 30 loan in the ordinary course of business. A loan is made in the ordinary course of business when it (1) bears the usual and customary interest rate of the lending institution for the category of the loan involved; (2) is made on a basis that assures repayment; (3) is evidenced by a written instrument; and (4) is subject to a due date or amortization schedule. 11 C.F.R. § 100.82(a). According to copies of the promissory note and security agreement the Committee provided as part of its *sua sponte* submission, the People's loan of March 30 was made for a period of ninety days, with variable interest at the bank's prime rate, and with a certificate of deposit used as collateral.

On June 30, the March 30 loan matured and was renewed. However, the renewal was apparently on terms that did not provide for collateral. The candidate did eventually use the loan proceeds for campaign purposes. Thus, questions arise regarding the legality of the renewed loan. Specifically, the information the Committee provided to the Commission raises the

question of whether the People's renewal loan was made on a basis that assured repayment as required by the Act and Commission regulations. 2 U.S.C. § 431(8)(B)(vii); 11 C.F.R. §§ 100.82(a) and (e). Loans are made on a basis that assures repayment if there is sufficient collateral, the bank has a perfected security interest in that collateral and the fair market value of the collateral is equal to or greater than the loan amount and any senior liens. 11 C.F.R. § 100.82(e)(1). Alternatively, banks can assure repayment by obtaining a written agreement in which the candidate pledges future receipts to the bank. 11 C.F.R. § 100.82(e)(2). Where none of these conditions exist, however, the Commission can also examine the totality of the circumstances surrounding the loan. 11 C.F.R. § 100.82(e)(3).

It is unclear whether the June 30 renewal loan complied with the Act. The original term of the March 30 loan was ninety days and expired on June 30, 2004. However, on June 30, the loan was renewed for another ninety days on different terms. The ninety-day certificate of deposit used as collateral for the March 30 loan was "released" on June 30, 2004 and no other collateral was used as security for the renewal loan.[5] Thus, the renewal loan remained unsecured. The Commission has no other information indicating how or whether the renewal was made on a basis that assured repayment. As a result, the information available at this time indicates that People's State Bank may have made a prohibited contribution in the form of an unsecured loan; therefore, there is reason to believe that Lawrence D. Huffman accepted the prohibited contribution in violation of 2 U.S.C. § 441b.

[5] By "released," Respondent apparently means that the certificate of deposit was no longer collateral for the loan. However, the candidate did not cash the certificate of deposit at this point; the loan proceeds remained in the certificate of deposit, on deposit at People's.

The Chronology also discusses the June 17, 2004 loan in the amount of $100,000. According to the candidate, in June 2004, he planned to obtain an additional loan to use in connection with his federal campaign and discussed the matter with Dean Proctor, the Committee's Finance Chairman. Proctor approached a number of banks about making a loan to the candidate. Proctor avers that "as a matter of convenience" because the candidate was traveling out of town at the time and because he "was asked by the campaign to expedite the loan to David Huffman because of the increasing expenses of the campaign," he decided to draw on his own personal credit line with Branch Banking and Trust Company ("BB&T") and provide those funds to the campaign. His intention, he avers, was that when the candidate returned, he and BB&T would "execute the paperwork to make the loan directly to [the candidate]." Proctor withdrew $100,000 from his personal line of credit, endorsed the check made out to him, and gave the check to the candidate, who then deposited the funds into his personal bank account. The candidate then wrote a check for $100,000 to the Committee from his personal bank account, which the Committee subsequently recorded as a loan from the candidate in its 2004 July Quarterly Report. When it initially reported the loan, the Committee did not disclose that Proctor was the source of the funds.

Shortly after the Committee filed its 2004 July Quarterly Report with the Commission, questions were raised in the press about the candidate's loans to his campaign. *See* Morrill, *supra* note 1, at 1B. According to Respondents, on July 17, 2004, the same date that a news account concerning the loans appeared in a local paper, Gaye Watts, a friend of Proctor's who was also the Finance Director for a rival candidate, went to Proctor's house to discuss the candidate's loans. Proctor states that he described to her "the manner in which the [June 17] loan

had been obtained for the campaign." At that point, according to Proctor, Watts told him that the transaction was illegal. Upon learning of the illegality, Proctor says he immediately contacted others involved with the campaign's finances and discussed the matter with them. They also contacted an attorney who confirmed the impropriety of the arrangement. Upon receiving such confirmation, Proctor, the candidate and the Committee assert they immediately took steps to reverse the transaction.

On July 19, 2004, the candidate cashed the certificate of deposit that was previously used as collateral for the March 30 loan and which now held the proceeds of the June 30 renewal loan, and used the proceeds to repay Proctor. According to the candidate, his intent was to unwind the transaction and correct any mistakes. Since the certificate of deposit had been intended to be used by the campaign, when he cashed the certificate of deposit the candidate asked People's to provide a cashier's check to "Huffman for Congress" instead of payable to the candidate himself.[6] Upon receipt of the cashier's check, the Committee then produced a check in the amount of $100,000 payable to the candidate in order to repay him for the June 17 loan that had been reported as being from the candidate's personal funds but was really from Proctor. The candidate used that $100,000 payment from the Committee to repay Proctor, who then repaid his own line of credit. The candidate then obtained his own line of credit from BB&T in the amount of $150,000.

The Committee reported the receipt of the funds from the certificate of deposit as a loan from the candidate incurred on July 19, 2004 in the amount of $100,395.00 and also reported that it made a $100,000 disbursement to the candidate on July 19, 2004. Both transactions appeared

[6] The candidate states that "the certificate of deposit was always intended to be used by the campaign, if it was used at all."

in the Committee's Pre-Runoff Report. In addition, the Committee amended its 2004 July Quarterly Report with respect to the June 17 loan by adding Proctor as an endorser/guarantor on the corresponding Schedule C-1. Then, because the Committee paid it off in July, the June 17 loan no longer appeared in subsequent disclosure reports to the Commission.

Proctor exceeded the Act's contribution limits when he drew $100,000 on his line of credit and then provided those funds to the candidate for use in his federal campaign. 2 U.S.C. § 441a(a). A loan is considered a contribution under the Act and thus, cannot exceed the contribution limits. 11 C.F.R. § 100.52. Further, loans endorsed or guaranteed by persons, other than a bank or a spouse, are also considered contributions under the Act.[7] 2 U.S.C. § 431(8)(B)(vii); 11 C.F.R. §§ 100.52(a) and (b)(3). According to Commission records, Proctor had contributed $4,000 to the Huffman campaign, distributed among the primary and runoff elections. Any additional funds provided by Proctor to the candidate or the Committee would exceed the Act's contribution limits. Likewise, any loan that Proctor made or guaranteed for the candidate would also be considered a contribution and could not exceed the limits. Therefore, the June 17 loan that Proctor obtained on behalf of the candidate exceeded the Act's limits. Moreover, Proctor provided the funds to the candidate, who acted as an intermediary, and provided them to the campaign in his own name. Because a loan is a contribution, Proctor made a contribution in the name of another and Huffman allowed his name to be used to make a contribution in the name of another. Accordingly, there is reason to believe that Lawrence D. Huffman violated 2 U.S.C. §§ 441a(f) and 441f.

[7] A candidate's spouse is bound by the same contribution limits as any other individual. 2 U.S.C § 441(a); 11 C.F.R. § 110.1(i). However, the spouse is permitted to co-sign a loan for the candidate when the loan involves the use of a jointly owned asset as collateral and where the value of the candidate's share of the property equals or exceeds the amount of the loan. 11 C.F.R. § 100.52(b)(4).

The information available at this time provides reason to investigate whether Proctor's excessive contribution and contribution in the name of another were knowing and willful. 2 U.S.C. §§ 437g(a)(5)(B) and 437g(d). The phrase "knowing and willful" indicates that "actions [were] taken with full knowledge of all of the facts and a recognition that the action is prohibited by law." 122 Cong. Rec. H 3778 (daily ed. May 3, 1976); *see also Fed. Election Comm'n v. John A. Dramesi for Cong. Comm.*, 640 F. Supp. 985, 987 (D.N.J. 1986) (distinguishing between "knowing" and "knowing and willful"). A knowing and willful violation may be established "by proof that the defendant acted deliberately and with knowledge" that an action was unlawful. *United States v. Hopkins*, 916 F.2d 207, 214 (5th Cir. 1990). The evidence does not have to show that a respondent "had specific knowledge of the regulations" or "conclusively demonstrate" a respondent's "state of mind," if there are facts and circumstances from which a reasonable inference can be made that the respondent knew his or her conduct was illegal. *Id.* at 213–15. An inference of a knowing and willful violation can be drawn from an "elaborate scheme [to] disguis[e]." *Id.*

Proctor avers that he did not attempt to hide the facts of the illegal loan, but rather was open in discussing the details of the loan with an opposing candidate's Finance Director. If it occurred as he describes it, Proctor's discussion with Ms. Watts would not be consistent with the actions of a person who was trying to conceal a 441f scheme. Indeed, Proctor asserts that until she told him, he did not know that the transaction was illegal. Further, upon discovery of the illegality both Proctor and the candidate appear to have immediately taken steps to rectify the situation.

However, Proctor's account remains to be verified. No reference to his conversation with Watts appears anywhere in the complaint filed by the opposing candidates. *See* Complaint dated August 3, 2004. One might think that if an opposing campaign knew of Proctor's admission that he was the source of the funds, it would have referred to the admission in the complaint. Moreover, the Committee has offered no affidavit by Watts or any other similar corroboration of this portion of Proctor's account. In addition, there are inconsistencies between the version of events Proctor offered at his meeting with staff and the version in the written *sua sponte* materials, as well as between each of those versions and extrinsic facts. At the July 30 meeting with staff, Proctor indicated that the Committee did not immediately need the proceeds of the June 17 loan, but that there was a desire to obtain the loan quickly in order to make the Committee's financial position, as reflected in its cash on hand, look stronger at the time of its next disclosure report. In the Committee's written submission, Proctor indicates that there was a desire to obtain the loan quickly "because of the increasing expenses of the campaign." These rationales are potentially at odds with each other. Moreover, if the former justification was the case, it is unclear why, with the close of books date for the next report still 13 days away, the Committee could not wait for Huffman to return from out of town to obtain the loan himself; and if the latter justification was the case, it is unclear why the Committee could not simply draw on the $100,000 Huffman had on deposit at People's State Bank for precisely such a contingency.[8]

In another potential inconsistency, Proctor stated in the July 30 meeting, and local media accounts refer to Huffman as saying, that one of the earlier loans was borrowed against

[8] Both Proctor and the candidate aver that "the campaign had at its disposal the $100,000 on deposit at People's State Bank, starting from the date when the BB&T bank loan proceeds were deposited into the campaign account through the date when the BB&T loan was repaid."

Huffman's retirement. *See* Andrew Mackie, *High Stakes; Candidates Ante up $1.4 Million of Their Own Money in Republican Primary,* HICKORY DAILY RECORD, July 18, 2004. However, none of the reports filed by the Committee and none of the *sua sponte* documents show any loan either borrowed from or collateralized by Huffman's retirement savings.

Ultimately, because the Commission will be investigating these potential inconsistencies in part for the purpose of determining whether the violations were knowing and willful, in the interest of fair notice to the Respondent the Commission finds that the violations connected to the Proctor transaction were knowing and willful.