FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

MAY 1 9 2005

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

RE: MUR 5496
Huffman for Congress and
David Blanton, in his official capacity as
treasurer

Dear Ms. Mitchell:

On August 6 and August 11, 2004, the Federal Election Commission notified your clients referenced above 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 clients at that time. Further, on August 9, 2004, you made a *sua sponte* submission concerning the above named Respondents. 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 complaints, and information supplied by your clients, the Commission, on May 5, 2005, found that there is reason to believe the Huffman for Congress committee and David Blanton, in his official capacity as treasurer, violated 2 U.S.C. §§ 434(b), 441a(f) and 441f, provisions of the Act. The Commission also found reason to believe that your clients 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 clients violated 2 U.S.C. § 441b concerning a Ford Explorer purchased from Dale Jarrett Ford, Inc.

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]

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: Huffman for Congress
and David Blanton,
in his official capacity as treasurer

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

[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.

[redacted]

also address some of the other loans the candidate made to the Committee. Based on all of the information available in this matter, and for the reasons set forth below, the Commission finds find reason to believe that Huffman for Congress and David Blanton in his official capacity as treasurer, knowingly accepted an excessive contribution and a contribution in the name of another from Dean Proctor in violation of 2 U.S.C. §§ 441a(f) and 441f; that they accepted a loan outside the ordinary course of business from People's State Bank in violation of 2 U.S.C. § 441b; and that they violated 2 U.S.C. § 434(b) for inaccurately reporting a $100,000 loan and a $150,000 line of credit.

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. However, when the January and March loans were first reported, the Committee failed to include information concerning the due dates or interest rates. *See* 2004 April Quarterly Report. In response to a Request for Additional Information ("RFAI") from the Reports Analysis Division ("RAD"), the Committee amended the Schedule C-1 forms filed as part of its 2004 April Quarterly Report to indicate "None" for the due dates and "0%" for the interest rates for the January and March loans.[4]

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

[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).

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 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

[4] RAD sent its RFAI concerning the January and March loans on May 4, 2004. The Committee amended its 2004 April Quarterly Report on May 20, 2004.

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.[5] 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 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. Thus, there appears to be no violation of the reporting requirements of 2 U.S.C. § 434(b) as a result of the March 30th transaction.

Further, it appears that People's made the original March 30 loan in the ordinary course

[5] 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).

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.[6] 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 Huffman for Congress and David Blanton, in his official capacity as treasurer, accepted the prohibited contribution in violation of 2 U.S.C. § 441b. Further, as will be discussed below, it appears the Committee did not properly report the June 30 renewal loan in its reports to the Commission.

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

[6] By "released," Respondents apparently mean 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.

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.[7] 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 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 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.

However, the Committee inaccurately reported the funds from the certificate of deposit as coming from personal funds. The funds in the certificate of deposit, of course, were the proceeds of the March 30 loan, as renewed without collateral on June 30. As instructed by RAD, the Committee removed the March 30 certificate of deposit from its 2004 April Quarterly Report under the theory that the candidate had not actually provided the funds to the Committee at that time. However, when the funds were actually disbursed to the Committee, they had to be

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

properly reported. Following its receipt of the loan, the Committee needed to report to the Commission whether the candidate used personal funds, borrowed money from a lending institution or obtained the funds from some other source. 2 U.S.C § 434(b); 11 C.F.R. §§ 104.3(a) and (d). Because the funds in the certificate of deposit were derived from a bank loan that the candidate obtained for use in his federal campaign, the Committee should have reported the bank as an endorser/guarantor on Schedule C-1 and should have reported the terms of the bank loan. 11 C.F.R. § 104.3(d)(4). However, even after its *sua sponte* submission, the Committee never did file a Schedule C-1 and report the terms of the People's loan to the Commission. Therefore, there is reason to believe that Huffman for Congress and David Blanton, in his official capacity as treasurer, violated 2 U.S.C. § 434(b).

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.[8] 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. Therefore, 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. The

[8] 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).

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. Finally, because both Proctor and Huffman were agents of the campaign and their knowledge is attributable to the campaign, the campaign knowingly accepted an excessive contribution in the name of another. Accordingly, there is reason to believe that Huffman for Congress and David Blanton, in his official capacity as treasurer, violated 2 U.S.C. §§ 441a(f) and 441f.

The Committee's *sua sponte* submission also makes reference to the $150,000 line of credit the candidate obtained from BB&T on July 19, 2004 after he repaid the illegal loan from Proctor. At the time of the submission, the line of credit was unsecured. The promissory note drawn up on July 19, 2004 that accompanied the *sua sponte* submission makes no reference to any collateral being used as security for the loan. The Chronology states that the line of credit was "to be secured by [the candidate's] personal residence but a closing date for that transaction has not yet occurred. The loan is unsecured in the interim." In subsequent documentation, the candidate stated that the line of credit was secured "with collateral in which [he has] ownership" and that he has "sufficient equity and ownership to secure the loan," but he provided no further details.

As part of its *sua sponte* submission, the Committee provided a letter from BB&T dated July 29, 2004 that outlines some of the terms of the line of credit, including that it was to be

secured by the personal residence the candidate owned jointly with his spouse. In obtaining a bank loan, candidates can use assets they own jointly with a spouse as collateral for the loan. 11 C.F.R. § 100.52(b)(4); AO 1991-10. However, the value of the candidate's share of the asset must equal or exceed the amount of the loan. 11 C.F.R. § 100.52(b)(4). The Committee also submitted appraisal reports for a personal residence and a parcel of land that the candidate owned jointly with his spouse, with a total value of $305,000. If the candidate's share is one half, then he could have used half the value of the jointly held properties (i.e., $152,500) as collateral for the line of credit. Information provided by the candidate indicates that as of December 2003 one of those properties was subject to a mortgage of $23,988. The Commission is not aware of any other liens on the properties. Thus, if this collateral was in fact used to secure the line of credit, it would appear to be adequate.

The line of credit was reported in the Pre-Runoff Report filed on August 5, 2004. Although the Committee properly reported the bank as the source of the funds for the $150,000 line of credit, the Committee failed to specify any collateral or other assurance of repayment on the corresponding Schedule C-1. The Committee continued reporting draws on the line of credit in its 2004 October Quarterly and 2004 Year End Reports, but the corresponding Schedule C-1s never reflected any collateral. The Commission has no information regarding when the candidate's property actually collateralized the line of credit. In light of the information indicating that arrangements were made to collateralize the line of credit and that the collateral would have been adequate, the Commission finds reason to believe that Huffman for Congress and David Blanton, in his official capacity as treasurer, violated 2 U.S.C. § 434(b) by failing to completely report the nature of the collateral or other source of repayment.