MIZUNO

LAW OFFICES
WEBSTER, CHAMBERLAIN & BEAN
1747 PENNSYLVANIA AVENUE, N.W.
WASHINGTON, D.C. 20006
(202) 785-9500
FAX: (202) 835-0243

ARTHUR L HEROLD
ALAN P DYE
EDWARD D COLEMAN
JAY H ROTZ
FRANK M NORTHAM
JOHN W HAZARD, JR
HUGH K WEBSTER
DAVID P GOCH
CHARLES M WATKINS
HEIDI K ABEGG
DAVID M ABRAHAMS*
JOHN R STROUT*

GEORGE D WEBSTER (1921-1996)
CHARLES E CHAMBERLAIN (1917-2002)
OF COUNSEL
J COLEMAN BEAN
KENT MASTERSON BROWN*

*NOT ADMITTED TO DC BAR

January 27, 2005

RECEIVED
FEDERAL ELECTION COMMISSION
OFFICE OF GENERAL COUNSEL
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VIA FACSIMILE & U.S. MAIL

Federal Election Commission
Office of the General Counsel
999 E Street, N.W.
Washington, D.C. 20463

Re: **MUR 5635**

To Whom It May Concern:

This letter constitutes the Conservative Leadership Political Action Committee's ("CLPAC") response to the Federal Election Commission's reason to believe findings based on Findings One and Three through Six of the Commission's Final Audit Report.

I. This MUR Has Implications Beyond The Parties Involved Herein.

New non-profit organizations, as well as others that lack capital and expertise, rely upon direct mail companies to help them build successful fundraising programs at little or no financial risk. New organizations have a particular need to rely upon this skill and expertise because they have not established a need for their cause and acceptance of their capability with the general public. A successful direct mail fundraising letter will establish this need and secure a donation.

Timing is also critical for direct mail fundraising. As many non-profits know, timing can be more important than perfect copy, especially during times of crisis. For example, a small non-profit attempting to raise funds right now to aid the tsunami victims would have difficulty securing the necessary capital and meeting tight deadlines without the help of an experienced direct mail fundraising firm. In the political realm, some organizations attempted to quickly capitalize on the heightened political exuberance following the Clinton years and build their donor base for the future. Especially for small and/or new political committees, these efforts are usually not possible without the availability of no-risk agreements.

No-risk contracts are generally contracts between non-profit organizations and professional direct mail fundraising firms which have expertise in marketing and fundraising, and which have confidence that their experience can help the non-profit raise money through direct mail. Often, because of this experience, direct mail fundraising firms are willing to enter into no-risk contracts to help protect the non-profit from devastating financial losses if the fundraiser's judgment proves wrong and adequate funds are not raised. No-risk contracts are used for several reasons. Sometimes they are used by non-profits who cannot afford to absorb the risk of a fundraising campaign being unsuccessful.[1] Sometimes they are offered by direct mail firms as a way for the non-profit to test out a new agency without a great deal of risk. Sometimes no-risk contracts are used when non-profits do not have the capital to start nationwide direct mail campaigns. Sometimes they are used when non-profits do not have a large in-house fundraising department. And, sometimes no-risk contracts are used when state charitable solicitation laws require solicitors to guarantee that a percentage of fundraising proceeds be paid to non-profit clients even when the costs exceed income. Irrespective of the reasons for using no-risk contracts, they are common in the direct mail industry, for political organizations and non-political organizations alike.

Direct mail fundraising is not just about raising money and building a donorbase. A large part of the fundraising letter is the inclusion of the issue(s) which are important to the organization. These letters not only raise money for the organization's future activities, but they convey important information about the issues. CLPAC's direct mail letters not only urged recipients to contribute to help raise funds for its upcoming independent expenditure campaign, but the letters also described the issues of importance to CLPAC.

No-risk contracts serve several purposes and are an important part of direct mail fundraising. Without them, many new or small non-profit organizations would not be able to grow or effectively communicate their message. No-risk contracts are very common and widely used. Therefore, any change of course by the Commission is best done through a rulemaking, which provides an opportunity for the regulated community to comment, rather than through an investigation of one political committee.

II. Background Of The Agreement Involved In This Case.

[1] The United Cancer Council, Inc. provides a good example of this danger. UCC had a no-risk contract with a direct mail fundraising firm; when the contract ended, UCC had almost half a million dollars in the bank, as well as a donor list of more than 1.1 million names. UCC then retained another firm to provide it with direct mail fundraising services Unlike its previous no-risk contract, UCC was responsible for all fundraising costs incurred. The direct mail solicitations failed to generate income sufficient to cover the costs. Faced with significant fundraising expenses incurred under its contract that exceeded its financial resources, UCC was forced to file for bankruptcy under Chapter 7. *See United Cancer Council, Inc v Commissioner of Internal Revenue Service*, 165 F.3d 1173 (7th Cir. 1999), Amicus Brief of Bruce W. Eberle & Associates, Inc., et al (Nos. 98-2181, 98-2190), available at http://www.freespeechcoalition.org/ucamicus.htm.

For a proper understanding of CLPAC's positions, a review of the Agreement involved in this case, as well as how the direct mail industry operates, may be helpful.

As noted on page 14 of the Final Audit Report, CLPAC entered into an agreement with American Target Advertising ("ATA") for direct mail fundraising services. This agreement was subsequently amended on September 28, 2000, and again on October 11, 2000. All versions of the Agreement provided for two types of mailings – prospect and housefile.

A prospect fundraising mailing involves the use and/or rental of many mailing lists, including untested lists, copy, and techniques. Prospect fundraising letters are sent to people who have not previously responded with a contribution. Generally, prospect fundraising generates a very low return rate (around 2%) as compared with a mailing to an organization's housefile list, and such fundraising programs are inherently speculative. A response from a prospect fundraising letter is important for two reasons: (1) it usually results in a contribution; and (2) the donor's name is added to the housefile for future mailings.

A housefile mailing is a mailing made to names developed from the prospect mailings. A housefile mailing generates a larger response rate and more contributions because these donors have usually already contributed and/or shown an interest in the organization. It is expensive and time consuming to develop a housefile list, but once developed, it is very valuable to the organization. Unfortunately, new or small organizations usually do not have the funds to develop a housefile list.

The original agreement between CLPAC and ATA contained, among other things, a "no risk" provision for fundraising through direct mail. Specifically, it stated that "[a]ll third-party invoices will be incurred in ATA's name. CLPAC will be responsible for payment of costs incurred hereunder only to the extent of the amount of moneys raised under this Agreement." Contrary to the conclusion reached in the Final Audit Report, this provision is one of limitation, not obligation. CLPAC is not mandated by the Agreement to pay all costs up to the monies raised; rather, CLPAC is potentially liable only for expenses up to the monies raised. This limitation must be read in conjunction with the rest of the Agreement, particularly the disbursement of income provisions.

The original agreement specified how income received from the two kinds of mailings was to be disbursed. Under the original agreement, ATA was required to disburse, and CLPAC was entitled to receive, 70% of the net housefile income, and any net income in excess of $1,000,000 from prospect mailings. The Agreement was later amended to provide that CLPAC was to receive only 50% of the net housefile income, but would receive net income from the prospect mailings before the $1,000,000 prospect income reserve was met. The trade-off for receiving net income from the prospect mailings before the $1,000,000 reserve was met was that CLPAC would receive 20% less of the more valuable net housefile income.

As consideration for the arrangements described above, ATA received a copy of the CLPAC housefile, and under the Agreement, ATA was given the exclusive marketing rights to those names. See paragraph 8 of the Original Agreement. Furthermore, paragraph 8 provides that "ATA may use the housefile for *any purpose*" while CLPAC is constrained in its use of the housefile. (emphasis added). While these exclusive marketing rights were very valuable to CLPAC, this bargained-for exchange made it possible for CLPAC to engage in fundraising for its planned independent expenditures at a critical time before the 2000 elections. Therefore, ATA did not get the short end of the stick with the no-risk contract entered into with CLPAC because ATA owned a copy of the valuable housefile. This normal and customary provision was in exchange for the risk that ATA bore with the no-risk contract.

The provisions in the no-risk agreement with CLPAC are similar to provisions contained in other agreements ATA has entered into with both political and non-political clients alike. The agreement provides that at the end of ATA's fundraising for CLPAC, ATA is fully responsible under the agreement for *any* costs for services or goods used in the mailings. Under the terms of the agreement, ATA received certain direct financial payments and control of valuable donor names and addresses generated under the agreement. The agreement specifically provides that CLPAC has no direct obligations for services and goods ATA contracts for in providing its direct mail services. All sub-vendor invoices were to be incurred in the name of ATA. As demonstrated in the affidavit of Mark Fitzgibbons (previously provided to the Commission), these contract provisions represent ATA's standard and usual course of business used with dozens of other clients and are common contractual terms in the fundraising industry.

After ATA had provided direct mail services for CLPAC, CLPAC learned that, in direct contravention of the agreement, ATA had entered into third party invoices in CLPAC's name.[2] As a result, these third party sub-vendors demanded payment of CLPAC of amounts which, pursuant to CLPAC's no risk agreement with ATA, should have been paid by ATA. CLPAC sent letters to all sub-vendors disavowing ATA's unauthorized act, copies of which have been previously provided to the Commission.

To fully understand CLPAC's responses, it is important to look at another important part of the background of this case. What was supposed to be a successful fundraising effort turned into unexpected losses caused by late and botched mailings near the date of the 2000 elections. During a critical period in the mailing process, one of the vendors had a fire at their mail plant, which delayed the mailing and delivery of some of the letters. Disputes with some of the other vendors contributed to the losses. Because of the no-risk arrangement, all that mattered to CLPAC was the success of the direct mail program. CLPAC had no authority or ability to take emergency steps to get the letters

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[2] CLPAC does not suggest that ATA's failure to enter into third-party agreements in its own name was intentional rather than inadvertent.

out on time. Any increased costs resulting from the botched mailings were the result of the vendors as well as ATA's emergency steps to get the letters out on time.

After the letters went out, the vendors threatened litigation to obtain their entire invoice amounts. Some of ATA's vendors, unaware that ATA had no authority to enter into any contract in CLPAC's name, mistakenly complained to CLPAC. The problem was further compounded when CLPAC mistakenly reported the amounts of the outstanding invoice amounts as debts on its reports to the Commission. When CLPAC realized that these debts were solely ATA's debts and that ATA had no authority to incur debts in CLPAC's name, CLPAC amended its FEC reports to remove these debts. CLPAC also informed all of these vendors that they were to look solely to ATA for payment, as specified in CLPAC's agreement with ATA.

III. Specific Findings

Finding 1 – Receipt of Apparent Impermissible Contributions

CLPAC did not contract with the three individuals and the corporation referred to in Finding 1. CLPAC did, however, contract with ATA for direct mail services. CLPAC was not involved in how or in what manner ATA provided these services. As discussed above, ATA contractually could not incur debts in CLPAC's name. Therefore, any advances or short term loans made must be attributed solely to ATA, which bore *all* liability for the services being provided by the three individuals and the corporation referred to in Finding 1. Any advances or short term loans made were done so on behalf of ATA, not on CLPAC's behalf. Therefore, the transactions at issue are distinguishable from those addressed in MURs 3027 and 5173.

In MUR 3027, the General Counsel's Report states on page 5:

> In this particular case, however, the facts presented suggest that certain mitigation is warranted in the resolution of this issue. Specifically, the facts noted above indicate that TVC, a large direct mail company serving political and non-political clients, had an established lending relationship with DMF&E, a finance company organized to engage in the business of securing financing and escrow services for the need of the direct marketing industry. As part of its normal business practice, TVC obtained a line of credit from DMF&E to do its mailing for its client PAPAC. Apparently according to an agreement with DMF&E, TVC was legally liable for repayment of the credit expended. There is no evidence that DMF&E knew the PAPAC client to be a federal political committee.

Like TVC[3] in MUR 3027, ATA serves political and non-political clients and has adequately demonstrated that it has established business relationships with companies that make loans to ATA. Like the agreement in MUR 3027, CLPAC's agreement with ATA provided that ATA was legally liable for costs incurred with its vendors. The Commission accepted the credit arrangement in MUR 3027 and dismissed its claim against DMF&E; likewise, the Commission should dismiss its claim against CLPAC and ATA based on these similar credit arrangements.

MUR 5173 is also distinguishable from CLPAC's arrangement with ATA. First, there appears to be no evidence in MUR 5173 that there was an established relationship between the direct mail fundraising firm and at least one of the vendors (DMFE). Second, the contract at issue in MUR 5173 was not a no-risk contract. Third, the loan agreement at issue in MUR 5173 was signed by both the direct mail fundraising firm and by the political committee.

In this case, ATA has demonstrated that there exist established business relationships with its vendors. Furthermore, the contract at issue here is a no-risk contract. Finally, CLPAC did *not* sign any loan agreement or credit arrangement with any of ATA's vendors. As demonstrated in previously submitted letters from ATA, these advances to ATA are common in the industry, and ATA has entered into substantially similar agreements with both political and non-political clients. Therefore, no impermissible contributions resulted.

Unfortunately, a reporting mistake did occur. CLPAC incorrectly reported the debts incurred by ATA as debts incurred by CLPAC. However, these obligations did not require disclosure in the first instance because ATA was solely responsible for them. When CLPAC learned that ATA had incurred these debts in CLPAC's name in contravention of the agreement, and that the amounts had been incorrectly reported, CLPAC corrected its filings by recording credits from these sub-vendors on its reports. CLPAC believed this to be an appropriate means to eliminate the incorrectly listed debts on its reports. This reporting mistake does not turn otherwise permissible arrangements into impermissible contributions.

Should the Commission find that impermissible contributions resulted from postage advances, the amount of the impermissible contribution should be based only on the amounts actually advanced, and not on interest.

Finding 3 – Impermissible Contributions

The Final Audit Report incorrectly states that if the terms of the Agreement were followed, CLPAC should have been responsible for, at a minimum, expenses totaling $4,666,695, and that based on the amount deposited into the escrow account and the

[3] TVC is the former name of ATA.

apparent losses by ATA, the distribution of $465,000 to CLPAC represents a contribution by ATA. The Final Audit Report also opines that undocumented credits in the amount of $1,769,353 and the payments by other entities in the amount of $1,707,152 on behalf of CLPAC, represent the receipt of impermissible contributions totaling $3,941,505.

The payments by other entities cannot result in the receipt of impermissible contributions because these debts were solely ATA's obligation; they were not an extension of credit to CLPAC. Therefore, payments made to vendors by ATA were not made "on behalf of CLPAC." Any credits issued by these vendors to ATA were not made "on behalf of CLPAC." As discussed above, ATA was contractually prohibited from entering into any contracts in CLPAC's name. Any debts incurred, and any subsequent credits issued, were solely on ATA's behalf for services provided by its vendors *to ATA*.

Nor did the payment of $465,000 by ATA to CLPAC result in an impermissible contribution. CLPAC was liable for the payment of costs *at most* for the extent of the moneys raised under the Agreement. The Agreement did not provide that no disbursement could be made until all costs were paid. In fact, the express language of the amended Agreement provides otherwise – CLPAC was entitled to receive net income from the prospect mailings even before the $1,000,000 buffer amount was reached.

This arrangement is similar to the arrangement approved by the Commission in AO 1979-36. In that advisory opinion, the agreement between a direct mail fundraising firm and a campaign committee provided that "irrespective of the actual total amount of fees and expenses, the Committee shall only be required to pay a maximum of ¾ of the total amount of contributions received during the period of the Agreement as a result of Working Names direct mail activities." Submitted with the request for the advisory opinion was an affidavit stating that within the direct mail industry, this type of proposed financing agreement represents an ordinary mode of operation. The Commission concluded that if this arrangement is of a type which is normal industry practice and contains the type of credit which is extended in the ordinary course of business with terms which are substantially similar to those given to nonpolitical, as well as political, debtors of similar risk and size of obligation, and if the costs charged the Committee for services are at least the normal charge for services of that type, then the amounts expended by the direct mail fundraising firm would not be considered to be campaign contributions.

Although it has been over 25 years since the Commission approved AO 1979-36, the direct mail industry still uses these types of financing arrangements. As amply demonstrated by ATA in its previous submissions to the Audit Division, the no-risk agreement, and its relationships with its vendors, are its normal and established practice for both its political, and its nonpolitical, clients. Therefore, the Commission should find that no impermissible contributions resulted.

Should the Commission find that the $465,000 is an impermissible contribution, this amount must be reduced to account for the valuable housefile list and exclusive marketing arrangement that ATA received as consideration.

Finding 4 – Disclosure of Outstanding Debts

CLPAC incorporates herein its responses to Findings 1 and 3. Because these debts were solely ATA's obligation, per CLPAC's Agreement with ATA, they were not outstanding debts of CLPAC. Contractually speaking, the vendors' sole recourse for payment of these debts was against ATA. CLPAC never entered into any contracts with any of the vendors; ATA was contractually prohibited from entering into any contracts in CLPAC's name. Therefore, the debts were solely ATA's arising out of services provided to ATA and CLPAC never had an obligation to report these debts in the first instance. As such, no debt settlement agreement was necessary.

Findings 5 and 6 – Disclosure of Occupation/Name of Employer and Disclosure of Disbursements

As CLPAC has previously stated, it encountered several problems in disclosing occupation and name of employer. First, CLPAC used to file its FEC reports using private vendor software. When the software maintenance contract was not renewed, CLPAC was effectively locked out of the software.

Second, the original source documents were never provided to CLPAC. These documents went to the vendor contracted by ATA who was doing caging and list maintenance of the housefile list. Because the contracts were between ATA and its vendors, the bills were paid from the escrow account. CLPAC did not have the authority to approve any disbursements from that account; as such, the original invoices were never in the possession of CLPAC.

Despite these problems, CLPAC has made every effort to obtain the necessary documents from ATA and its vendors. However, these vendors either did not maintain the contributor response devices or the documents necessary to permit CLPAC to disclose the purposes requested, or no longer have them. Therefore, CLPAC is unable to make the amendments to disclose the necessary information. CLPAC is further hampered in its efforts to file "complete amended electronic reports" because it does not have access to the previously filed electronic reports. Therefore, to amend its reports, CLPAC would be forced to reenter data from thousands of pages.

IV. Conclusion

As CLPAC and ATA have sufficiently shown, the no-risk agreement involved in this case was in the normal course of business. Political and non-political organizations use similar no-risk arrangements in order to conduct their direct mail fundraising. Therefore, no impermissible contributions, extensions of credit, or improper reporting of outstanding debts resulted from this arrangement. As such, the Commission should find no probable cause to believe that a violation of the Federal Election Campaign Act has occurred.

Furthermore, resolution of the no-risk contract, and its corresponding issues in this case, affects not just the Respondents in this case, but a large number of the regulated community who have been using no-risk arrangements for their direct mail fundraising. As such, these issues should be decided in the larger and more open context of a rulemaking.

If you have any questions or need additional information, please do not hesitate to contact us.

Very truly yours,

Heidi K. Abegg

Alan P. Dye
Frank M. Northam
Heidi K. Abegg

Attorneys for Conservative Leadership PAC