FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

October 31, 2012

SENSITIVE

MEMORANDUM

TO: The Commission

FROM: Lisa J. Stevenson
Deputy General Counsel - Law

Lorenzo Holloway
Assistant General Counsel
For Public Finance and Audit Advice

Margaret J. Forman
Attorney

SUBJECT: Request for Consideration of a Legal Question – Democratic Party of Illinois (LRA 921)

I. INTRODUCTION

On October 4, 2012, the Commission received a Request for Consideration of a Legal Question ("Request") from counsel on behalf of the Democratic Party of Illinois ("DPI" or the "Committee"), which the Commission voted for audit pursuant to 2 U.S.C. § 438(b).[1] Attachment.

The Request addresses a proposed audit finding pertaining to the requirement in 11 C.F.R. § 106.7(d)(1) that state party committees maintain monthly payroll logs of the percentage of time each employee spent in connection with a Federal election. The auditors found that the Committee did not maintain a monthly log or any other supporting documentation for any

[1] At least two Commissioners agreed to consider this Request pursuant to the Policy Statement Regarding a Program for Requesting Consideration of Legal Questions by the Commission, 76 Fed. Reg. 45798-45799 (Aug. 1 2011).

The Commission's action on this Request affects a total of 13 state party committees. The Commission has also received another request regarding this issue, which has been addressed in a separate memorandum from the Office of General Counsel.

of its paid employees. The issue presented in the Request is whether the monthly time log requirement applies to employees who are paid with 100% federal funds.

We conclude that under the literal language of the regulation, it does. But there is a separate question, as a prudential matter, of whether the Commission wishes to pursue recordkeeping findings in these circumstances. Where employees are paid with 100% federal funds, the soft money concerns underlying the regulations are absent. The only significance a log could have in these circumstances is verifying whether the disclosure of disbursements is on the correct line on the Detailed Summary Page of a committee's disclosure reports. The Audit Division submits that it needs the logs for this purpose and a recordkeeping finding is appropriate. Whether the Commission believes this purpose is sufficiently important to require a recordkeeping finding where no logs (or affidavits) are available is a matter of policy for the Commission to determine.

II. COMMITTEES ARE REQUIRED TO KEEP MONTHLY LOGS FOR EMPLOYEES PAID EXCLUSIVELY WITH FEDERAL FUNDS

A state party committee "must keep a monthly log of the percentage of time each employee spends in connection with a Federal election." 11 C.F.R. § 106.7(d)(1). To determine if a state party committee must allocate the salary, wages, and benefits of its employees, it must examine the percentage of time that its employees spent on federal election activity ("FEA") or activity in connection with federal elections. Salaries and benefits for employees who spend more than 25% of their compensated time on FEA or activities in connection with a federal election in a given month must be paid only from a federal account. 2 U.S.C. § 431(20)(A)(iv); 11 C.F.R. § 106.7(d)(1)(ii); *see* 2 U.S.C. § 441i(b)(2). Employees who spend less than 25% of their time on FEA or activities in connection with a federal election may be allocated as administrative costs or paid from the federal account. 11 C.F.R. § 106.7(d)(1)(i). Employees who spend none of their compensated time on FEA or activities in connection with a federal election may be paid entirely with funds that comply with state law. 11 C.F.R. §§106.7(c)(1) and 106.7(d)(1)(iii).

We conclude that, read literally, the regulations support the conclusion that state party committees must maintain a monthly log under 11 C.F.R. § 106.7(d)(1) for all employees, including those paid from and reported as solely 100% federal funds. Although 100% of the time spent on federal activity represents the whole or complete time spent on federal activity, this is still a percentage and therefore must be documented.

We understand the Committee's concern about the necessity for a log when employees are paid with 100% of federal funds. Section 106.7(d) supports the statute's requirement that state and local party committees treat as "federal election activity," payable with 100% federal funds, the salaries and benefits of any employee who spends more than 25% of his or her compensated time during the month on activities in connection with a federal election. 2 U.S.C. §§ 431(20)(A)(iv), 441i(b)(1). Where employees are paid with 100% federal funds, there is by definition no concern that an inadequate share of federal funds was used to pay these employees.[2] Thus, the Committee

[2] We recognize the Commission's 3-3 split on a similar issue in the Georgia Federal Elections Committee audit involving employees whom the committee asserted spent *no* time on activity in connection with federal elections. In

questions the "rational connection between [section] 106.7(d)'s recordkeeping requirement, and the need to ensure compliance with the soft money spending limitations, when the employees are paid 100% federally." Attachment at 2. The Committee also states that requiring monthly logs under these circumstances "would create a whole new category of burden, while serving no evident or stated purpose." *Id.*

The additional purpose served by the logs is to differentiate salary and benefits payments that qualify as FEA – which are reported on line 30(b) of the Detailed Summary Page – from payments to employees who spent less than 25% of their compensated time during a month on activities in connection with a federal election, but whose salaries and benefits the Committee voluntarily chose to pay with 100% federal funds. Payments in this latter category should be reported as federal operating expenses on line 21(b) of the Detailed Summary Page, not as FEA. *See* 11 C.F.R. §§ 104.14(b)(1), 104.17(a)(4). Here, the Committee reported all of its payroll payments on line 30(b) as FEA. Because the Committee did not maintain monthly logs, the Audit Division cannot verify that these payroll payments have been disclosed on the correct line of the detailed summary page. The Audit Division submits that it needs the logs to verify that the salary and benefit payments at issue have been disclosed on the correct lines of the Detailed Summary Page. *See* 11.CF.R. § 104.14(b)(1).

The Committee states that because section 106.7 is located in Part 106, and not Part 104, of the Commission's regulations, this regulation is limited to allocation, and therefore a log is not required for employees paid with 100% federal funds. In support of its position, the Committee asserts that "[t]he stated purpose of section 106.7(d)(1) was to 'provide documentation *for allocation purposes.*'" Attachment at 1-2 (quoting *Prohibited and Excessive Contributions: Non-Federal Funds or Soft Money*, 67 Fed. Reg. 49064, 49078 (Jul. 29, 2002)) (emphasis added in attachment). But the Commission in this quote was not addressing the "stated purpose" for section 106.7(d)(1). The Commission was addressing the "stated purpose" for proposed 11 C.F.R. § 300.33(b)(1), which was never promulgated. This proposed provision "would have required State, district, and local party committees to keep time records for all employees, the purpose being to provide documentation for allocation purposes." *Prohibited and Excessive Contributions: Non-Federal Funds or Soft Money*, 67 Fed. Reg. 49064, 49078 (Jul. 29, 2002). The Commission rejected the original proposed provision because it chose not to allocate employee salary, noting "in response to the NPRM, a State party committee asserted that time sheets would be 'burdensome,' that written certifications by employees would be 'equally impractical,' but that a tally sheet kept by the employer would be 'more reasonable.' The same commenter nonetheless urged the Commission not to require any particular method of

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that audit, the Commission split on the issue of whether the Commission could require a committee to keep a log for such employees. In a motion that failed 3-3, three Commissioners asserted that "the Commission does not have jurisdiction to impose recordkeeping and documentation requirements on employee activity that a State party committee claims is solely non-Federal." *See* Commission Agenda Document No. 11-10-B (Motion on Audit Division Recommendation memorandum on the Georgia Federal Elections Committee, *considered in Open Session* Mar. 3, 2011). Here, unlike with the Georgia Federal Elections Committee, a number of the Committee's employees may have spent 100%, or some part thereof, of their time on activities in connection with a federal election and were paid with 100% federal funds, so the three Commissioners' concerns regarding jurisdiction over "solely non-federal" activity may be reduced.

documentation." *Id.* The Commission, acknowledging the reasons provided by the commenters, decided to "require[] only that a monthly log be kept of the percentage of time each employee spends in connection with a Federal election." *Id.* Thus, the Commission chose a recordkeeping requirement in the form of a monthly log as a lesser burden than the detailed time records as part of an allocation formula.

Nothing in the Commission's explanation for section 106.7(d)(1) indicates that the Commission's decision to place this recordkeeping requirement in Part 106 excludes employees paid with 100% federal funds. To the contrary, the subparagraphs of the regulatory provision imposing a monthly log requirement anticipate three allocation scenarios – paid with 100% federal funds under (d)(1)(i) or (ii), allocation between federal and non-federal under (d)(1)(i), and paid with 100% state funds under (d)(1)(iii).

III. RECOMMENDATION

The Office of the General Counsel recommends that the Commission conclude that 11 C.F.R. § 106.7(d)(1) requires the Committee to keep a monthly log for employees paid exclusively with federal funds.

Attachment

Request for Legal Consideration from the Democratic Party of Illinois.

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October 4, 2012

BY HAND

Ms. Shawn Woodhead Werth
Secretary and Clerk
Federal Election Commission
999 E Street, N.W.
Washington, DC 20463

Re: Democratic Party of Illinois
Request for Consideration of Legal Question

Dear Ms. Werth:

I write on behalf of my client, the Democratic Party of Illinois ("the DPI"), pursuant to the Policy Statement Regarding a Program for Requesting Consideration of Legal Questions by the Commission, 76 Fed. Reg. 45,798 (2011). The Commission should reject the Audit Division's contention that, under the allocation rules, a state party, when paying employees entirely with federal funds, must still keep logs showing the percentage of time they spent in connection with a federal election. Neither the Act nor Commission rules support this position.

The Commission selected the DPI for audit under 2 U.S.C. § 438(b) for its 2010 election cycle activities. The DPI cooperated with the auditors throughout, providing the requested records and responding to the auditors' inquiries. The auditors began field work on April 30, 2012, and held the exit conference on May 18, 2012. On September 12, 2012, the auditors formally informed the DPI of a finding that it failed to keep monthly logs for its employees in violation of 11 C.F.R. § 106.7(d)(1), even though the DPI did not allocate the costs of these employees' salaries and benefits, but rather paid them entirely with federal funds.

It is not the Commission's recordkeeping rules at part 104 that are at issue here, but rather its *allocation* rules at part 106. The particular rule involved, 11 C.F.R. § 106.7(d)(1), implements the restrictions on financing Federal election activity under the Bipartisan Campaign Reform Act of 2002, which generally prohibit state political parties from paying for FEA with nonfederal funds. The stated purpose of section 106.7(d)(1) was to "provide documentation ***for allocation***

purposes." Prohibited and Excessive Contributions; Non-Federal Funds or Soft Money, 67 Fed. Reg. 49,064, 49,078 (2002) (emphasis added). The reason was clear. If BCRA allows state parties to pay employees with nonfederal funds only when they devote no more than 25 percent of their time to federal elections, then there must be a way to determine how they spent their time. But when the state party pays its employees 100% federally, then there is no need to verify its decision not to allocate. In that case, there is no allocation, and the employees by definition have been properly paid.

The Commission wrote section 106.7(d)(1) with some sensitivity for the burdens that it would place on state parties. It rolled back an initial proposal to have the employees keep "time records," realizing after notice and comment that this proposal would be "burdensome" and "impractical." *Id.* The auditors' novel interpretation would have the Commission lurch in the opposite direction. It would create a whole new category of burden, while serving no evident or stated purpose.

If adopted and enforced, the auditors' interpretation would violate the Administrative Procedure Act, which bars "agency actions, findings, and conclusions" that are "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law." 5 U.S.C. § 706(2)(A). The agency must examine the relevant data and articulate a satisfactory explanation for its action, demonstrating a "rational connection between the facts found and the choice made." *Burlington Truck Lines v. United States*, 371 U.S. 156, 168 (1962). Here, there is no such connection. There is no rational connection between 106.7(d)'s recordkeeping requirement, and the need to ensure compliance with the soft money spending limitations, when the employees are paid 100% federally in the first place.

Courts have already corrected the Commission over its rules on paying state party employees, and their logic is instructive here. In *Shays v. FEC*, 414 F.3d 76 (D.C. Cir. 2005) ("Shays I"), the United States Court of Appeals for the District of Columbia Circuit held that the Commission acted arbitrarily and capriciously when it failed to explain the state party employee allocation rules. *See id.* at 110–12. The court looked to the "statutory context" behind the rules, and asked how the FEC could justify allowing employees who spent up to 25 percent of their time on federal election activities to be paid entirely nonfederally. *Id.* at 111. The Commission replied that its policy was a necessary "implication" of the requirement that parties pay more federally active employees entirely with federal funds. *Id.* at 110. The court found that this implication "makes no sense," that "the Commission gave no other justification for" its rule, and that the rule was arbitrary and capricious as a result. *Id.* at 112.

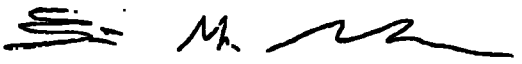
By the court's logic, the auditors' position suffers from the same defect. Here, the "statutory context" is allocation. The law is intended to ensure that state parties do not impermissibly subsidize their Federal election activity with soft money. *Id.* at 111. Because section 106.7(d)(1) says simply that state parties "must keep a monthly log of the percentage of time

each employee spends in connection with a Federal election", the auditors draw the "implication" that the recordkeeping requirement extends to federally paid employees, as well. 414 F.3d at 110. Yet there is no logical connection between the statutory objective of avoiding circumvention of the soft money restrictions, and the auditors' position. Requiring state parties to keep time logs to support paying their employees 100% federally "makes no sense." *Id.* at 112.

Finally, the auditors' position adds insult to injury. In a world where corporations and unions may make independent expenditures, *see Citizens United v. FEC*, 558 U.S. 310 (2010); where nonconnected PACs may raise unlimited, unrestricted contributions to make independent expenditures, *see SpeechNow.org v. FEC*, 599 F.3d 686 (D.C. Cir. 2010) (en banc); and where national parties may raise federal funds in larger amounts indexed to inflation, *see* 2 U.S.C. § 441a(a), state parties are among the most disfavored actors. The auditors' position would compound the heavy compliance burdens that are already laid upon the state parties' shoulders, adding an arbitrary, unsupported recordkeeping requirement. The Commission can fully enforce BCRA, and avoid worsening the gaping imbalance between state parties and other actors, by rejecting the auditors' position.

We appreciate the Commission's consideration of this matter.

Very truly yours,



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