



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

TO: Patricia C. Orrock
Chief Compliance Officer

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SUBJECT: Draft Final Audit Report on the Conservative Majority Fund (LRA 986)

I. INTRODUCTION

The Office of the General Counsel has reviewed the Draft Final Audit Report ("DFAR") on the Conservative Majority Fund ("the Committee"). The DFAR contains five findings: Misstatement of Financial Activity (Finding 1); Disclosure of Occupation and Name of Employer (Finding 2); Failure to File Reports and Properly Disclose Independent Expenditures (Finding 3); Reporting of Debts and Obligations (Finding 4); and Recordkeeping for Communications (Finding 5). Our comments address Findings 3 and 4. We have no comments regarding the other findings. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.

II. FAILURE TO FILE REPORTS AND PROPERLY DISCLOSE INDEPENDENT EXPENDITURES (Finding 3)

The Interim Audit Report (“IAR”) concluded that the Committee failed to report \$469,136 in disbursements as independent expenditures. The Committee responded to the IAR and submitted a detailed itemization of its costs according to several categories of media-related expenses identified in the invoices it received from Infocision, Inc. – its principal media vendor. The Committee disagreed with the Audit Division’s characterization of its media-related expenses as independent expenditures in several respects. Following an analysis of the Committee’s response to the IAR, the Audit Division subtracted \$64,160 from its original total, and now concludes that the Committee failed to report \$404,976 in independent expenditures. The Audit Division did not otherwise modify its previous conclusions in the IAR.¹

Fundraising Communications as Independent Expenditures

The Committee contends it considered the cost of the communications at issue, regardless of whether the communications contained express advocacy, to be allocable between independent expenditures and fundraising expenses or wholly a fundraising expense on the basis that a communication that was intended to solicit contributions should not be categorized wholly as an independent expenditure.

The Audit Division concludes, in contrast, that if a communication contains express advocacy, it must be deemed an independent expenditure regardless of the purposes that the Committee intended the communication to fulfill. We agree with the Audit Division. The factors causing a communication to qualify as express advocacy in the Commission’s regulation defining that term do not include an examination of the speaker’s subjective intent or purpose. See 11 C.F.R. § 100.22; see also Express Advocacy; Independent Expenditures; Corporate and Labor Organization Expenditures, 60 Fed. Reg. 35291, 35295 (Jul. 6, 1995) (“[T]he subjective intent of the speaker is not a relevant consideration” under section 100.22). The Commission has arrived at this conclusion in previous audits. See Final Audit Report on National Campaign Fund, at 9, 12-13 (approved Oct. 22, 2012); Final Audit Report on Legacy Committee Political Action Committee (“Legacy PAC”), at 8, 10 (approved Jul. 31, 2012). We noted in comments on the audit of the Legacy PAC that the communicator’s subjective intent is not a factor the Commission considers when determining whether a communication contains express advocacy. See Memorandum from Christopher Hughey to Patricia Carmona, Draft Final Audit Report on the Legacy Committee Political Action Committee (LRA 815) at 3-4 (Jan. 24, 2012). Thus, to the extent that a communication that is the subject of a disbursement contains express advocacy, all of the costs associated with producing and disseminating or distributing that communication must be considered independent expenditures, regardless of whether the communications were motivated partly or wholly by a fundraising purpose.

¹ Some categories of communication described in the Committee’s response to the IAR, such as “fulfillment letters,” “follow-up letters,” and “thank you calls,” appear to raise a question as to whether the Audit Division currently possesses all of the Committee’s communications that were used to fulfill these functions. However, the Committee has represented that the Audit Division does currently possess all of the communications that the Committee used. The Audit Division therefore based its independent expenditure analysis upon this representation.

Categories of Media Expenses That Should Not Be Deemed Independent Expenditures

We have identified two categories of expenditures that should not be classified as independent expenditures. First, the expenditures that the Committee incurred to process contributions should not be classified as independent expenditures. The Audit Division classified certain categories of media expenses associated with the Committee's receipt and processing of contributions as independent expenditures because the contributions that were received were made in response to Committee communications containing express advocacy. For example, the Audit Division deemed costs incurred by the Committee to accept and process credit card information received from contributors, collectively denominated "Credit Card Processing" costs in the Committee's response to the IAR, to be independent expenditures because the contributions were purportedly submitted in response to a communication that contained express advocacy. The same rationale informs the Audit Division's classification of "Flags and Mailing Costs" and the subcategories of "Lock Box Services," "PO Box Rental Fees," and "Credit Card Fulfillment Charges"² within the broader category of "Direct Mail Related Costs."

We believe, however, that these costs are different from the costs directly associated with the production and distribution of the communications containing express advocacy that prompted the submission of contributions. An independent expenditure is an expenditure made specifically "for a communication expressly advocating the election or defeat of a clearly identified candidate." 52 U.S.C. § 30101(17); 11 C.F.R. § 100.16(a) (emphasis added). The expenditures made by the Committee to process credit card contributions or to reserve a lock box or a post office box to receive contributions are not expenditures made for communications *per se*. We recommend, therefore, that the Audit Division revise the DFAR to deduct the costs associated with "Credit Card Processing," "Flags and Mailing Costs,"³ "Lock Box Services," and "PO Box Rental Fees" from the independent expenditure total.⁴

² "Credit Card Fulfillment Charges" do not appear as such in the Committee's response to the IAR. Rather this is one of three components of the subcategory "Miscellaneous," appearing under the broad heading of "Direct Mail Related Costs" in the response. It is our understanding from the Audit Division that the credit card fulfillment charges are essentially a form of credit card processing cost, and therefore, their classification should be the same as the credit card processing charges.

³ We believe that this is so even though the flags in particular were offered to potential contributors as premiums during the course of the same communication containing express advocacy that solicited the contributions. Even though the flags were offered as incentives to contribute as part of the express advocacy communication, we understand the cost identified here to refer to the cost of sending the flag to the contributor after the contribution is received. The flags, in and of themselves, are not communications expressly advocating the election or defeat of clearly identified candidates. See 11 C.F.R. §§ 100.16, 100.22.

⁴ Further, while we agree with the classification of costs associated with the category of "Bumper Stickers" as independent expenditures, that agreement is not premised on the theory that the bumper stickers were sent in response to the receipt of contributions inspired by express advocacy communications, but rather on the express advocacy content of the bumper stickers themselves. The bumper stickers contain the words "Romney – Believe in America" and "For 2012," words similar to the words listed in 11 C.F.R. § 100.22(a) as examples of express advocacy.

Second, the costs associated with the Committee's interactive voice response ("IVR") program should not be classified as independent expenditures. The Committee describes this program as an automated telephone protocol device that was used to screen callers and direct potential contributors to the live telephone operators conducting inbound telephone calls on behalf of the Committee. According to the Committee, the IVR included a pre-recorded statement informing the caller that the Committee tried to reach them and that it was locating people opposed to then- President Obama's re-election. The caller was then given the options of being transferred to a live communicator, entering his or her telephone number into the "Do Not Call" list, or hanging up. It is our understanding that the Audit Division classified the expenditures associated with the IVR Program as independent expenditures because at least some portion of the callers would have elected transfer to a live communicator, who would have made express advocacy communications in conjunction with a solicitation of funds.

The question of whether the costs associated with the creation and operation of the IVR Program may be characterized as independent expenditures is a closer one than the question of how to categorize the costs for credit card processing, discussed above. At least a portion of the callers are directed by means of the IVR Program to live telephone operators who conduct colloquies with the callers that include express advocacy as part of the inbound telephone call program. However, a practical difficulty exists. We understand that the Audit Division lacks sufficient information to enable it to allocate the costs of the IVR Program in accordance with the actual proportions of callers who exercise each of the options that the IVR Program makes available. Given this practical difficulty, we recommend that the IVR Program disbursements be deducted from the independent expenditure total in the finding.

Categories of Media Expense That Should be Moved to Finding 5 – Recordkeeping for Communications⁵

We recommend that Audit Division move two categories to the recordkeeping finding. The first of these is included within the subcategory of "Outside Services," which itself is a sub-

⁵ The Audit Division has also asked whether one disbursement currently located in Finding 5 and one disbursement currently located in Finding 3 should remain in these findings, or should otherwise be considered operating expenditures. These disbursements are: (1) \$79,334 for a television advertisement reflected in invoices as "Repeal Obamacare" in Finding 5; and (2) \$100 to open an escrow bank account in Finding 3. As to the first disbursement, invoice descriptions appear to reflect both an "Obama/Care" advertisement and a "Repeal Obamacare" advertisement, however the Audit Division has a copy of only one advertisement with this theme, entitled "ConMaj Obamacare – SD Video Sharing". The Audit Division concludes that this advertisement does not constitute express advocacy and we agree with this conclusion. We recommend that the Audit Division accept the Committee's representation in this matter and consider the \$79,334 expenditure to be an operating expenditure. Such action would be consistent with the Audit Division's acceptance of the Committee's representation that the Audit Division has in its possession all of the communications that the Committee used. It is also conceivable that the different invoice descriptions reflect the same advertisement insofar as both describe the theme of the advertisement. As to the second disbursement, the \$100 charge is reflected on the pertinent invoice only as "outside-prospecting" and the Audit Division has indicated that it has no bank documentation to verify the charge. Because of the absence of documentation to verify the nature of the expense, we recommend that this disbursement be relocated to Finding 5. We note also, however, that if the Committee does provide verifying documentation, the \$100 disbursement would not be an independent expenditure under the same rationale that we have set forth in connection with the credit card processing costs, above, and therefore would not properly be placed in Finding 3 in any event.

classification of the "Other Vendors" category in the Committee's response to the IAR, and consists of commissions paid to a firm known as Political Media Company. The second of these is a subcategory of "Direct Mail Related Costs" denominated "Sample Premium Charge." These costs are not linked to any particular communications on any invoices. *See* Memorandum from Lisa J. Stevenson to Patricia C. Orrock, IAR on the Colorado Republican Committee (LRA 961) (rec'd by Audit Division Dec. 11, 2015); Memorandum from Lisa J. Stevenson to Patricia C. Orrock, IAR on the Conservative Campaign Committee (LRA 996) (Nov. 25, 2015); Memorandum from Lisa J. Stevenson to Patricia C. Orrock, IAR on TeaPartyExpress.Org (LRA 995) (Dec. 1, 2015); and Memorandum from Lisa J. Stevenson to Patricia Orrock, IAR on the Illinois Republican Party (LRA 1006) (Dec. 22, 2015). Given the absence of the underlying communications, we recommend that the Audit Division move these expenditures to the recordkeeping finding.

III. REPORTING OF DEBTS AND OBLIGATIONS (Finding 4)

In its response to this finding, the Committee argues that although its creditor submitted an invoice to the Committee containing charges totaling \$92,411, the actual responsibility for paying those amounts rested with a separate, independent entity organized under section 527 of the Internal Revenue Code known as the New Conservative Coalition ("NCC").⁶ The Committee submitted a copy of the face of a check payable to Infocision, Inc. executed by the NCC for \$93,990,⁷ which was intended to satisfy the outstanding invoice erroneously directed to the Committee. The Audit Division observes in the DFAR that there is insufficient evidence that this check was actually negotiated and, therefore, concludes that there is insufficient evidence to indicate that these debts were not the responsibility of the Committee.

The Committee's attribution of these invoice charges to NCC rather than to itself suggests the possibility that the Committee may have been required to report this debt as disputed debt pursuant to 11 C.F.R. § 116.10(a). *See also* 11 C.F.R. § 116.1(d) ("disputed debt" defined in pertinent part to include bona fide disagreement between creditor and debtor regarding existence of obligation). A necessary condition of a requirement to report disputed debt, however, is the receipt by the debtor committee of something of value from the creditor. 11 C.F.R. § 116.10(a) (political committee shall report disputed debt if creditor has provided something of value to committee). *See also* Matter Under Review ("MUR") 6654 (Friends of Weiner), Factual and Legal Analysis, at 4, 6 (Feb. 5, 2014) (to show a disputed debt, there must be information that indicates the creditor provided something of value to the committee).

⁶ Finding 4 reflects the Audit Division's calculation that the Committee failed to report \$67,800 in debt to Infocision. The Audit Division has explained to us that it derived this amount by subtracting the debt to Infocision that the Committee did report (\$260,450) from the sum of the amounts charged in Infocision invoices (\$328,250). The Committee asserts, however, that \$92,411 of the total amount of Infocision invoices of \$328,250 were actually the responsibility of the NCC. Thus, the Committee contends that it only bore responsibility for reporting \$235,839 (\$328,250 - \$92,411) in debt to Infocision. If the Committee's representation is accurate, this would signify that the Committee reported all of its debt owed to Infocision and, in fact, over-reported that debt.

⁷ The difference of \$1,579 (\$93,990-\$92,411) reflects a media expense that the Committee concedes it incurred itself, but that NCC apparently paid. According to the DFAR, the Committee treated NCC's payment of this Committee expense as an in-kind contribution to the Committee, with the excessive portion (\$579) payable as a refund.

Here, the Audit Division has informed us that the service charges reflected on the relevant invoices were for the same types of activities that Infocision unequivocally undertook on behalf of the Committee. Nevertheless, the Audit Division does not have sufficient information to determine whether the services reflected in the invoice were provided to NCC or to the Committee. In the absence of that information, we are unable to conclude at this time whether the Committee had an obligation to report the charges as disputed debt.

If the Committee received the services, there is also the possibility that the Committee received an in-kind contribution. If NCC incurred the charges for the benefit of the Committee, or were for services that the Committee, rather than NCC, received, then NCC in so doing would have made an in-kind contribution to the Committee. 52 U.S.C. § 30101(8)(A)(i); 11 C.F.R. § 100.52(a), (d) (contribution includes, in pertinent part, "anything of value" given for the purpose of influencing an election, and "anything of value" includes goods or services provided without charge or at less than the usual and normal charge).

To determine if the invoice at issue reflects a disputed debt and to determine if the Committee received an in-kind contribution, the Audit Division may wish to inquire whether the Committee received the services at issue in the invoice, or the benefit of the services, rather than NCC.

Finally, the Audit Division has suggested to us the possibility that the NCC and the Committee may in fact be the same entity. The DFAR identifies certain connections between NCC and the Committee. The DFAR notes that the Committee's executive director was also the treasurer of NCC, and that Infocision's alleged billing error transpired during the month of July 2012, during which the NCC was dissolving and the Committee was forming. The Audit Division has also noted that the invoices erroneously billed to the Committee, and which would have been properly directed to NCC, contain the same descriptions of services, the same costs, and used the same calendar dates of service for billing purposes, as do the invoices properly billed to the Committee.

If the relationships between NCC and the Committee were so extensive as to render them essentially the same entity, then the Committee might be deemed responsible for reporting debts incurred by NCC. The Commission has in the past considered the question of whether a party committee's control of an ostensibly separate legal entity was so pervasive as to warrant considering the party committee and the ostensibly separate entity to be in fact a single entity. See MUR 1503, General Counsel's Brief in the Matter of Jefferson Marketing, Inc. and the National Congressional Club, at 5-6 (Aug. 17, 1984); MUR 1503, Consent Order, at 3, par. V (May 15, 1986); MUR 4250, First General Counsel's Report, at 6-8⁸ (May 8, 1997).⁹ While the

⁸ The Commission did not approve this office's recommendation in MUR 4250 to find that the ostensibly separate entities were in fact a single entity by the required four votes. See Statement of Reasons of Commissioner Scott E. Thomas and Commissioner Danny Lee McDonald in MUR 4250 (Jan. 28, 2000); Statement of Reasons of Commissioner Lee Ann Elliott in MUR 4250 (Mar. 10, 2000).

⁹ With respect to reporting violations, these MURs were principally concerned with the making and receiving of contributions and the associated failure to report contributions, rather than with the failure to report debt. MUR 4250 also was concerned with the proper allocation of nonfederal and federal spending. Nevertheless,

entities at issue in the MURs existed simultaneously whereas the NCC and the Committee existed sequentially, we do not view this difference as detracting from the principle that reporting obligations of one entity may be imputed to another entity where it can be demonstrated that the ostensibly separate entities in fact share a single identity.

We note, however, that in the above MURs, the Commission pursued an extensive inquiry into the relationships between the entities that employed considerations similar to those used by the Commission to ascertain whether genuinely separate entities or their committees are affiliated. See 11 C.F.R. § 100.5(g)(4) (containing multiple factors to be employed in determining affiliation where *per se* affiliation is not present). Given this, we do not believe that the facts identified by the Audit Division above would suffice to establish that NCC and the Committee were not independent entities. If the Audit Division wishes to pursue this inquiry, we would be available to advise it regarding the factual questions that would be necessary to ask the Committee.

the principle of avoiding potential circumvention of reporting obligations generally, would also apply here if such a relationship did in fact exist.