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April 14, 2015

SENT VIA EMAIL AND FIRST CLASS MAIL
Federal Election Commission
Audit Division
Mr. Marty Favin
999 E Street, NW
Washington, DC 20463
Audit@fec.gov

RE: Draft Final Audit Report on Gary Johnson 2012 Inc

Dear Mr. Favin:

I am writing on behalf of my client, Gary Johnson 2012 Inc ("GJ2012"), in response to the Draft Final Audit Report of the Audit Division ("DFAR").

I. Request for a Hearing before the Commission

GJ2012 requests a hearing to discuss its responses to Findings 1-5 in the DFAR, and to the comments on those same Findings in the March 18, 2015 Office of General Counsel memo ("OGC Memo").

II. Finding 1. Net Outstanding Campaign Obligations

GJ2012 accepts the Audit Division finding that GJ2012 did not receive matching fund payments in excess of its entitlement. Any changes to the Statement of Net Outstanding Campaign Obligations ("NOCO") to account for debt settlement or asset valuation can only be properly addressed if and when such actions are actually taken.

The Audit Division requested copies of invoices from this firm to corroborate the expenses added to the NOCO. Those fees listed are estimates of total cost for our services in relation to the audit, and, given the unpredictable nature of that process, will not be invoiced for until the work has been completed. Once GJ2012 has been invoiced for the work, copies of the invoices will be provided.

III. Finding 2. Amounts Owed to the U.S. Treasury

It should be noted from the outset that during the campaign, GJ2012 acted on a good faith basis that contributions received were subject to its understanding of what the disclaimer should have been had it been properly updated, and that were this the case its intended allocation formula for contributions received after the candidate's date of ineligibility ("DOI"), with the first $250 of each contribution being designated to the primary, was permissible. As the *Kennedy* court noted, "the violation of campaign spending limitations is often, if not usually, inadvertent." *Kennedy for President Committee v. FEC*, 734 F.2d 1558, 1560 (D.C. Cir. 1984). But for the failure to update the disclaimer on the campaign's donation page, this repayment issue would never have arisen, because the campaign acted in a manner consistent with what it intended the disclaimer to be, notionally the optimal format of such disclaimer. While the Commission has already ruled on the

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impact of the failure to change the disclaimer, it does not change that the outcome was an unintentional one, and that the Committee acted in good faith – if incorrectly – despite the error, and that its lack of intent is precisely the kind of inadvertent error the *Kennedy* court noted.

It is improper to base the committee's repayment obligation on the repayment ratio of 11 C.F.R. § 9038.2(b)(2)(iii), which is not a "reasonable method for determining the extent to which matching funds, rather than private contributions, were used for unqualified purposes." *Id.* at 1563. The OGC Memo's reliance on *Kennedy* to support the Audit Division's application of the repayment ratio seems misplaced, as that case clearly supports the committee's position on this issue.

While a committee is prohibited from spending both matching funds and comingled primary funds on non-qualifying expenses, the penalty is limited to repayment of the amount of matching funds that can be reasonably determined to have been spent on such expenses. *Id.* at 1562. As the court recognized, 26 U.S.C. § 9038(b)(2) "expressly limits the repayment obligation to . . . the amount of matching funds 'so used'"; "the statute plainly allows the Commission to take back only the amount of *federal funds* used for unqualified purpose." *Id.* at 1561, 1562 (emphasis in original).

The OGC Memo correctly notes that the *Kennedy* court left it to the Commission to decide on a method to determine the amount of matching funds used for non-qualifying purposes, but the court did impose limits on what that method could be – it must produce a reasonable estimation of the amount of matching funds spent on non-qualifying expense. *Id.* at 1563. The court stated that section 9038(b)(2) "delegates to the Commission the task of estimating the amount of federal funds, rather than private contributions, that were spent for unqualified purposes," and that the Commission had "the responsibility to make a reasonable determination that the repayment sum represents the matching funds used for unqualified purposes." *Id.* at 1562.

In *Kennedy*, a pro rata share of the total amount spent on non-qualifying expenses may well have been a reasonable estimate of the matching funds so spent, but that is not the case here. There, the matching funds were deposited into the same bank account as the funds used to pay for the non-qualifying expenses, but in the instant case, the matching funds were held in a separate account, and, at most, only a small fraction of the non-qualifying expenses were paid out it. The intentional segregation of funds was based on the Committee's belief that it operated under what was intended to be the correct disclaimer language, and consequently it is easy to determine that no federal funds were spent on non-qualifying campaign activity. Only by the disclaimer error, and artificial post-hac comingling of funds contained in separate accounts, does the Audit Division arrive at (notionally) additional funds being included in these calculations. Even if that is the case, it does not mean that actual federal funds were spent on non-qualifying campaign activity.

As the Audit Division's own findings indicate, matching funds were all deposited into GJ2012's primary election account, and the overwhelming majority of private contributions received post-DOI were deposited into the general account. *See* Calculation of unqualified expenses worksheet. GJ2012 considered these general contributions, and intended to spend them on general expenses. GJ2012 believed that its disclaimer had been updated, and operated on that assumption, treating contributions as general or primary based on the intended terms of the disclaimer. This detailed accounting resulted in the matching funds in the primary account only being used for qualified campaign expenses, and the Audit Division's own analysis supports this.

Of the total $1,199,701 that the Audit Division claims was spent on non-qualifying expenses, it identifies a total of $2,510.32 that was paid out of the primary account. Although GJ2012 maintains that even these amounts were not paid for with matching funds, this figure is the maximum possible amount of matching funds that could have been used to pay for non-qualifying expenses. The remaining $1.1 million in non-qualifying expenses was paid out of the general account, which none of the matching funds were ever deposited into.

As in *Kennedy*, the Commission is vastly overestimating the amount of matching funds that were spent on non-qualifying expenses, and, as in that case, its methodology must be rejected. The Audit Division's calculation of when matching funds were no longer in the account is fundamentally flawed, since those funds were only ever in the primary account, and their analysis uses both accounts. The repayment ratio therefore estimates in an incongruent manner GJ2012's repayment obligation from the activity of a bank account that never contained matching funds, and, as the *Kennedy* court said, the Commission's discretion in choosing a methodology of calculating repayment "does not legitimate such a clearly unreasonable formula as the one used by the FEC in this case." *Id.* (footnote omitted).

The OGC Memo states that the repayment ratio was intended to avoid forcing the Commission to conduct in-depth analyses of committee finances in order to determine the appropriate repayment obligation. Considering imitation on agency time and resources, that is certainly an admirable goal. However, that does not relieve the Commission of its obligation to reasonably estimate the amount of matching funds to be repaid, and should not prevent the committee from conducting its own analysis to show that its repayment obligation is lower than that calculated by whatever method the Commission uses. In this case, the Commission has already conducted a sufficiently in-depth analysis of GJ2012's finances to determine that the repayment ratio vastly overstates GJ2012's repayment obligation, and, having done so, it cannot willfully ignore those results.

Finally, with respect to the funds submitted for matching that were identified as being ineligible, GJ2012 has not found any indication that the funds were misattributed. The $1,250 total will be included in any amount repaid to the US Treasury.

IV. Finding 3. Use of General Election Contributions for Primary Election Expenses

GJ2012 urges the Commission to reconsider its arguments regarding the use of general election funds as an advance against matching funds.

V. Finding 4. Reporting of Debts and Obligations

The Audit division specifically found that the $300,000 contractual win bonus was a primary expense, and should have been paid from primary funds. Consequently, in order to comply with Commission directive here, NSON reallocated the $171,200 in payments from GJ2012 to NSON during the 30 days subsequent to the DOI (5/5/14 – 6/4/12) to what would have been the earlier invoices based on the reasonable preference of the time-limited win bonus over other pre-DOI expenses.. The remaining balance of the $300,000 win bonus would be a non-qualified campaign

expense and will be addressed through the ultimate debt settlement negotiation between NSON and GJ2012, subject to Commission approval.

VI. Finding 5. Extension of Credit by a Commercial Vendor

The Audit Division objects to redaction of the NSON contracts submitted with GJ2012's response to the Preliminary Audit Report. However, it would work an unreasonable burden on NSON to be forced to disclose its other clients – including being in violation of relevant contract or trade custom – in order to demonstrate the similarity of terms here, and neither the statute nor regulations require such. The client identity–redacted contracts clearly demonstrate that NSON was conducting its services in a manner consistent with its ordinary course of business for other clients.

With respect to NSON's regular invoicing for services it provided the committee, the Audit Division points to a small number of invoices out of a great many from the campaigns principle vendor that were invoiced late as evidence that NSON is not attempting to collect on its outstanding debts. Although some invoices were received "late" relative to the services performed, these are the exceptions rather than the rule. Moreover, it is not obviously outside the ordinary course of business for an enterprise to be sluggish in its own invoices, particularly where such a substantial number of invoices were issued. Mistakes happen in business, as in government, and it is patently unreasonably to draw the inference that this constitutes a pattern of intentional unlawful conduct.

The Audit Division notes that, other than the balance of its bank accounts, GJ2012 did not include any assets on the NOCO, but referred in its response to the Preliminary Audit Report to the possibility of settling its debts with NSON in exchange for certain committee assets. The assets referred to are currently intangible and not readily susceptible to easy valuation. For example, the use of the name, likeness, and/or signature of the candidate for fundraising, or a copy of the committee's mailing and email lists might be worth a great deal, but the time and resources required to convert these intangible assets into a tangible form with a readily identifiable fair market value is substantial, and the Committee must first resolve its audit matter to understand what resources and obligations it still has.

With respect to the remaining outstanding debt of GJ2012 to NSON, the parties have agreed to defer resolution of that matter until conclusion of the audit process. The outcome of the audit bears directly on the scope of committee assets – and potentially the amounts owed to NSON. Consequently, providing a comprehensive debt settlement plan to the Commission for its approval must necessarily wait until conclusion of the audit process for the parties to possess all materially relevant facts to such negotiation.

Sincerely,
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