FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Draft Final Audit Report on Gary Johnson 2012, Inc. (LRA # 905)

I. INTRODUCTION

The Office of the General Counsel ("OGC") has reviewed the proposed Draft Final Audit Report ("DFAR") on Gary Johnson 2012, Inc. ("the Committee"). The DFAR contains five findings: Finding 1 - Net Outstanding Campaign Obligations, Finding 2 - Amount Owed to the U.S. Treasury, Finding 3 - Use of General Election Contributions for Primary Election Expenses, Finding 4 - Reporting of Debts and Obligations, and Finding 5 - Extension of Credit by a Commercial Vendor. We concur with these findings, but we provide some comments on certain issues raised in Findings 2 through 5. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.

II. FINDING 2 - AMOUNTS OWED TO THE U.S. TREASURY

Finding Two recommends that the Committee repay a total of $ 334,914 to the United States Treasury. This finding has two aspects, the most significant of which is that the Committee used primary election funds on expenses incurred in connection with the general election. According to the Audit Division, the vast majority of these expenditures occurred

between May 5, 2012, the Candidate's date of ineligibility, and December 7, 2012. The Audit Division, therefore, recommends that the Committee repay a pro-rata portion of the total amount of funds so spent, in this case $333,664, to the United States Treasury. *See* 11 C.F.R. § 9038.2(b)(2)(iii) (setting forth formula for computing amount to be repaid).

We concur with Finding Two. In response to the Preliminary Audit Report, the Committee makes two arguments related to this finding and we provide comments on both. As a part of our comments in response to the Committee's first argument, we have comments on the Audit Division's calculation of the repayment for non-qualified campaign expenses.

A. The Calculation of The Repayment for Non-Qualified Campaign Expenses

1. The Commission Uses Repayment Ratio to Calculate Repayment for Nonqualified Campaign Expenses

First, the Committee contends that at all times when it received public funds, the amount of money it spent on qualified campaign expenses exceeded the amount of public funds it received. As a result, the Committee implies it can separate private contributions and public funds and conclude that it spent private funds, and not public funds, on any non-qualified campaign expenses. Initial Response, at 1.

We disagree with this argument. The Committee fails to take into account Commission regulations that prohibit the spending of *any* funds collected for the primary election on non-qualified campaign expenses. *See* 11 C.F.R. § 9034.4(a) (all contributions received for the primary election as well as public funds may only be spent on qualified campaign expenses). While the Commission can only seek a repayment under 26 U.S.C. § 9038(b) for the portion of total spending that represents public funds when a committee spends primary funds on non-qualified campaign expenses, *see Kennedy for President Committee v. Federal Election Commission,* 734 F.2d 1558, 1561 (D.C. Cir. 1984), a publicly-funded committee's private primary contributions and public funds are, as a matter of law, considered a "commingled pool of federal and private monies." *Kennedy for President Committee v. Federal Election Commission,* 734 F.2d 1558, 1564 (D.C. Cir. 1984).

To determine if any portion of public funds in this commingled pool of Federal and private funds was used to pay for non-qualified campaign expenses, the Commission does not examine how much of the public funds remained after the Committee paid for non-qualified campaign expenses. Rather, the Commission applies a repayment ratio to determine the pro rata share of total non-qualified campaign spending that is attributable to the use of public funds. 11 C.F.R. § 9038.2(b)(2)(iii) (the "repayment ratio"). The Committee's detailed examination of its actual spending, the result of which, it claims, shows that public funds were not actually spent on non-qualified campaign expenses is precisely the kind of analysis that the repayment ratio is intended to obviate. The *Kennedy* court recognized that, because all funds are commingled, the determination of the amount of public funds that were spent for non-qualified purposes "may never be perfectly accurate." *Id.* at 1562. Rather, Congress delegated to the Commission the task of devising a method that would reasonably estimate the amount of public funds improperly

spent. *Id.* This is what the repayment ratio is designed to accomplish. *See Explanation and Justification for Final Rule on Repayments by Publicly Financed Presidential Candidates*, 50 Fed. Reg. 9421 (Mar. 8, 1985) ("The use of such formulas is consistent with the court's opinion, which does not require a mathematically precise determination of the amount of the Federal funds spent improperly but only a reasonable determination of the amount of Federal matching funds so used.").[1]

2. The Audit Division Uses The Date That It Can Verify To Determine When The Committee's Accounts No Longer Contain Public Funds

Before applying the repayment ratio, however, the Commission must determine the date when a committee's account no longer contains public funds. 11 C.F.R. § 9038.2(b)(2)(iv). To calculate this date, the Commission examines the committee's expenditures starting with the date that the committee received its last payment of public funds. 11 C.F.R. § 9038.2(b)(2)(iii)(B). The Commission assumes that this last payment of public funds is expended on a last-in and first-out basis. *Id.* In the DFAR, the Audit Division states that the date upon which matching funds were no longer in the accounts was February 20, 2014. However, because the Committee has not provided an itemization of the general account's receipts, the Audit Division cannot determine with certainty what expenditures have been made for what purposes, and therefore whether expenditures were made for the general or the primary election using the February 20, 2014 date. Rather than using the date of February 20, 2014, the Audit Division instead uses the last date that it can verify – December 20, 2012 – which is the date the last contribution submitted for matching funds was deposited in the Committee's general account.

We concur with this approach. While extending the date when the Committee's accounts no longer contained public funds may produce a slightly higher repayment obligation for non-qualified campaign expenses,[2] the Audit Division does not have the information necessary to verify the nature of the expenditures using the later date. Given that the Commission's repayment determination must include a factual basis, 11 C.F.R § 9038.2(c)(1), we believe that the repayment determinations for non-qualified campaign expenses should be based on the dates for which the Commission can verify the nature of the expenditures. The DFAR indicates that the Audit Division has requested the necessary information and the Committee has not provided it. The Commission, therefore, has the option of issuing a subpoena to obtain this information. 11 C.F.R § 9038.1(b)(1)(v). We, therefore, recommend that the Audit Division raise this issue in the memorandum that forwards this report to the Commission.

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[1] For this reason, the Committee's argument regarding $7,301 spent on winding-down expenses that the PAR identifies as part of the non-qualified expenses for which repayment is required is also of no avail. *See* Interim Response, at 2. That the Committee may not have specifically used public funds, as opposed to other primary funds, to pay these expenses is not a relevant consideration.

[2] We understand from the Audit Division that using the estimated date of February 20, 2014 would result in an estimated additional repayment of $4,462.62.

B. The Commission May Only Seek A Repayment for Non-Qualified Campaign Expenses That Have Been Paid

Second, the Committee identifies several items that were not previously reported as debts and argues that, because of this information, "the effective matching funds cut-off date is moved forward, and the amount to be paid to the U.S. Treasury is reduced." Supplemental Response ("Supp. Response"), at 1. Specifically, the Committee states that if all the newly discovered debts are included as reportable debt, then the "matching funds cut-off date" is moved forward to October 22, 2012, and the amount the Committee must repay is reduced to a maximum of $33,930.70. Supp. Response, at 1. The Committee asks that the declared amount owed by the Committee be no greater than this amount, pending any additional deductions that may be appropriate to make in the future. *Id.* at 3.

We disagree with the Committee's assertion that a reduction in the amount of funds repayable for non-qualified campaign expenses is in order because of newly discovered reportable debts. Neither the existence nor the magnitude of the Committee's primary election debt has any relationship to the Committee's repayment obligation for non-qualified campaign expenses.[3] The Committee's repayment obligation is premised wholly upon its actual expenditures of primary funds, and not upon the mere incurrence of indebtedness in connection with the primary election. 11 C.F.R. § 9038.2(b)(2)(iv). *See Kennedy for President Committee v. Federal Election Commission*, 734 F.2d at 1565 (authority to seek repayment limited to amount of public funds actually spent on non-qualified expenses). It would be inequitable, in fact, for the Commission to seek repayment for debts that a committee has not actually paid. Rather, the effect of the Committee's discovery of additional debt would be to increase its net outstanding campaign obligations, thereby necessitating revision of the Statement of Net Outstanding Campaign Obligations. *See* 11 C.F.R. § 9034.5(a)(1) (statement of net outstanding campaign obligations composed consists in part of "[t]otal of all outstanding obligations for qualified campaign expenses as of the candidate's date of ineligibility . . .". The Audit Division has already accounted for these newly-discovered debts on the NOCO Statement.

[3] While debt *per se* would not affect the Committee's repayment obligation, changing the matching funds cut-off date would affect the calculation of the amount of funds that the Committee must repay to the U.S. Treasury because the cut-off date determines how much of a committee's non-qualified expenses should be included in the repayment ratio. *See* 11 C.F.R. § 9038.2(b)(2)(iv) ("Repayment determinations under 11 CFR 9038.2(b) will include all non-qualified campaign expenses paid before the point when committee accounts no longer contain matching funds . . ."). The Committee's calculations suggest that the *later* the matching funds cut-off date is, the less the amount of funds it must repay to the U.S. Treasury. *See* Supp. Response, at 1 (noting that if cut-off date is moved to October 4, then Committee will owe no more than $110,941.76, whereas if cut-off date is moved to October 22, then Committee will owe no more than $33,930.70). This relationship is the opposite of the relationship posited in section 9038.2(b)(2)(iv). Under that provision, the *earlier* the matching funds cut-off date is, the less the Committee will be required to repay. This is because fewer non-qualified campaign expenses would be included in the calculation with an earlier date, as section 9038.2(b)(2)(iv) shows.

III. FINDING 3 - USE OF GENERAL ELECTION CONTRIBUTIONS FOR PRIMARY ELECTION EXPENSES

Finding Three concludes that the Committee used $12,396 in contributions designated for the general election to pay expenses incurred in connection with the primary election before the date of the primary election.[4] The Committee originally deposited $22,396 in contributions designated for the general election in its primary election account, but shortly thereafter transferred $10,000 of this amount to its general election account. The balance of $12,396 remained in the primary election account.

In response to this finding, the Committee states that it treated the $12,396 as "an advance against anticipated matching funds, which the [Commission] notes were not paid to [the Committee] until after the [date of ineligibility]." Initial Response, at 2. This statement implies that the use of contributions designated for the general election in this manner is permissible.

To the extent that the Committee is characterizing the advance of general election funds as a loan to the primary account, the Commission's regulations specify that such loans must come from a qualified financial institutions, which the general account clearly was not. 11 C.F.R. § 100.82(e)(2). *See also Explanation and Justification for Final Rule on Loans From Lending Institutions to Candidates and Political Committees*, 56 Fed. Reg. 67118 (Dec. 27, 1991) (provision does not extend to loans from lenders other than banks or other qualified financial institutions).

Alternatively, the Committee's use of its general election contributions to pay for primary election expenses could be viewed as a transfer of funds from the general election account to the primary election account. *See* Advisory Opinion 1996-04 (LaRouche) (Commission analyzed proposed "loan" of funds from previous presidential primary committee to current campaign committee based on anticipated receipt of public funds as transfer between committees). However, none of the transfer rules permit such a transfer under the circumstances presented here. While campaigns are permitted to transfer unused primary election contributions to their general election accounts in spite of the contribution limitations announced in section 110.1, *see* 11 C.F.R. § 110.3(c)(3), Commission regulations do not authorize transfers from the general election account to the primary election account.

The Commission has issued audit reports in the past in which publicly funded presidential campaigns misallocated the costs of goods of services between their primary and their general election committees, or their general election legal and accounting compliance fund (GELAC) committees. In those reports, the Commission recommended reimbursement by one committee to the other to bring the various committees within their expenditure limitations. *See Final Audit Report on Dole for President, Inc.*, at 24 (approved June 3, 1999); *Final Audit*

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[4] The date of the primary election in this case is identical to the date of ineligibility – both being May 5, 2012 – the date upon which the Candidate received the nomination for election to the office of President by his party during his party's nominating convention. *See* 52 U.S.C. § 30101(b); 11 C.F.R. § 100.2(e) (selection of nominee at convention with authority to nominate is an election). *See also* 26 U.S.C. § 9032(7); 11 C.F.R. § 9032.7 (same).

Report on Kerry-Edwards 2004, Inc. and the Kerry-Edwards 2004 Inc. General Election Legal and Accounting Compliance Fund, at 14-22 (approved June 14, 2007); *Final Audit Report on Clinton/Gore '96 Primary Committee*, at 10-16 (approved June 3, 1999).[5] *See also* 11 C.F.R. § 9034.4(e) (providing bright-line rule for attributing expenditures of publicly-funded committees to the primary or the general election). However, the ability of committees in this position to undertake corrective action for a misallocation of expenditures does not cure the underlying impropriety of one committee's (or, in this case, one account's) payment of another committee's expenses.

IV. FINDING 4 - REPORTING OF DEBTS AND OBLIGATIONS

Finding Four concludes that the Committee failed to continuously report debts totaling approximately $407,000 owed to six creditors. Of this amount, $300,000 represented a bonus owed to the Committee's principal campaign consultant, NSON, which, according to the terms of the contract between NSON[6] and the Committee, was payable to NSON "for receiving any party nomination as either [Vice President] or [President]." *See* Addendum to NSON Service Agreement, signed Oct. 14, 2011. The Audit Division concludes that the Committee's reporting obligation with respect to the bonus began on the date of the Candidate's nomination, May 4, 2012.

The Committee argues in its Initial Response, however, that it was not required to report the bonus owed to NSON as a debt until it received the invoice for the bonus, citing a provision of its contract with NSON specifying that payments would not be due until receipt of the invoice. Initial Response, at 3. According to the PAR, the Committee did not receive an invoice for the bonus (actually for one-half of the bonus amount, or $150,000) until December 21, 2012.

In its Supplemental Response, the Committee states that it defers to the "Audit staff's recommendation that the Committee treat the bonus as a primary expenditure." Supp. Response, at 3. Based upon our understanding that the Committee has not actually made an expenditure to pay the bonus to NSON as of yet, this statement may indicate the Committee's acceptance of the Audit Division's position regarding when reporting of the debt should have begun. In the event that it does not, however, we agree with the Audit Division that the Committee was required to begin reporting the debt to NSON for the bonus on May 4, 2012, and to report the debt continuously thereafter under 11 C.F.R. § 104.11(b). This regulation requires debts or obligations, "including a loan, written contract, written promise or written agreement to make an

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[5] These recommendations were made in the context of findings that the committees in question exceeded their expenditure limitations. The Audit Division, however, is not recommending such corrective action in this case, because its calculations already assume that such correction would have taken place in the ordinary course of events. This corrective action would not have an impact on the Committee's repayment obligation because the Committee used general election funds to pay primary election expenses.

[6] The PAR noted that NSON is a registered corporation in the State of Utah that also does business as Political Advisors. It is our understanding that Political Advisors is the Committee's principal creditor and that it provided political consulting services to the Committee. The PAR also noted that although the Committee reported disbursements to this entity as disbursements to Political Advisors, the entity billed the Committee as NSON.

expenditure", if totaling over $500, to be reported "as of the date on which the debt or obligation is incurred." 11 C.F.R. § 104.11(b).

Here, according to the terms of the contract, payment of the $300,000 bonus was conditioned upon the Candidate's receipt of nomination to the office of Vice President or President. This condition occurred on May 4, 2012. Consequently, the Committee incurred an obligation to pay the bonus on that date, and, according to the terms of section 104.11(b), a concomitant obligation to begin reporting its debt in this amount to NSON.

V. FINDING 5 - EXTENSION OF CREDIT BY A COMMERCIAL VENDOR

Finding Five concludes that NSON made a prohibited corporate contribution to the Committee by extending credit to the Committee outside of its normal course of business and by not making commercially reasonable attempts to collect approximately $1.75 million dollars in debt owed by the Committee for services rendered. The PAR notes that NSON provided services to the Committee between April 2011 and December 2012, for which it billed the Committee approximately $2.2 million. As of March 2013, however, approximately $1.75 million had been outstanding for over 120 days, and approximately $936,000 remains outstanding to date.

We do not have comments on the substance of this finding. However, we do have two observations regarding the Committee's statement that NSON may agree to waive interest assessments it has recently applied to the Committee, and perhaps the underlying principal indebtedness as well, in exchange for assets of the Committee. *See* Interim Response, at 3-4. First, as the DFAR notes, Commission regulations would not allow the Committee to settle its debt to NSON, or take any action on that settlement, without previous Commission review and approval of a debt settlement plan embodying the terms of the proposal. *See* 11 C.F.R. § 116.7(a). Second, the Committee refers to specific assets that it may use to settle part of its debt to NSON. However, the DFAR notes that these assets were not previously disclosed. Further, the existence of these assets has not actually been verified. Assuming proper verification of the existence of these assets, the Committee would be required to disclose them in its Statement of Net Outstanding Campaign Obligations. 11 C.F.R. § 9034.5(a), (c). Thus, that statement will require amendment in light of any previously undisclosed assets. *See* 11 C.F.R. § 9034.5(a)(2)(ii) (statement of net outstanding obligations includes "[t]he fair market value of capital assets and other assets on hand.")