



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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

I. INTRODUCTION

The Office of the General Counsel ("OGC") has reviewed the proposed Preliminary Audit Report ("PAR") on Gary Johnson 2012, Inc. ("the Committee"). The PAR 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. Our comments address various aspects of these findings. We concur with aspects of the findings not specifically discussed in this memorandum. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.²

II. NET OUTSTANDING CAMPAIGN OBLIGATIONS

The PAR concludes that the Committee has remaining net outstanding campaign obligations, and therefore the Committee did not receive public funds in excess of its entitlement. We concur with this finding, but we recommend that the Audit Division revise the PAR to explain why the PAR's conclusion that the Committee has remaining net outstanding campaign obligations is different from the Commission's final determination that the Committee was no longer entitled to receive public funds because it did not have net outstanding campaign obligations.

The Commission made a final determination on November 14, 2013, that the Committee was no longer entitled to receive public funds because it did not have any remaining net outstanding campaign obligations. *See* Statement of Reasons in Support of Final Determination on Entitlement In the Matter of Governor Gary Johnson, LRA # 905, at 1 (Nov. 14, 2013) ("Statement of Reasons"). At the time of the suspension, however, the Commission noted that the audit of the Committee was still pending and that the exit conference had not yet taken place. Statement of Reasons, at 8 n.12. The Commission observed that the Committee would have the opportunity to respond to the Audit staff's findings once the audit resumed, and that the final determination only governed the Committee's *future* entitlement to matching funds, and did not address whether the Committee had received public funds in excess of its entitlement. *Id.*

Following the Commission's final entitlement determination and the resumption of the audit, the Committee submitted additional documentation, on January 24, 2014, which reduced, but did not eliminate its surplus position, and then submitted evidence of additional debt on June 18, 2014, which showed that the Committee actually had net outstanding campaign obligations. Based on this new information, the Audit Division recalculated the Committee's net outstanding campaign obligations based on a review through May 31, 2014, and has now concluded that the Committee does have remaining net outstanding campaign obligations.

² The Office of the General Counsel recommends that the Commission consider this document in Executive Session because the Commission may eventually decide to pursue an investigation of matters contained in the PAR. 11 C.F.R. §§ 2.4(a) and (b)(6).

To assist the Commission's understanding of the underlying basis for this finding, we recommend that the Audit Division revise the PAR to explain the developments in the audit with respect to the Committee submitting information showing additional net outstanding campaign obligations.³

III. AMOUNTS OWED TO THE U.S. TREASURY

This finding has two aspects. The first concerns the Committee's use of public funds for non-qualified campaign expenses,⁴ and the second concerns the Committee's receipt of public funds for contributions later determined to have been ineligible for matching.

Our comments focus upon the first of these two aspects. The finding raises a question as to whether the Committee used public funds to pay for non-qualified campaign expenses, and, if the Committee used public funds, how the Commission should calculate the portion of public funds for purposes of repayment. These questions are significant because the Commission can only seek a repayment for the portion that represents public funds when a committee spends its funds on non-qualified campaign expenses. *See Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558 (D.C. Cir. 1984).

We conclude that the Committee used public funds to pay for non-qualified campaign expenses. We also conclude that the Commission should use the formula found in the Commission regulations at 11 C.F.R. § 9038.2(b)(2)(iii) to calculate the portion of public funds used to pay for non-qualified campaign expenses. In performing the calculation, the Audit Division should include the primary election contributions that the Committee deposited into its general account, and exclude the general election contributions also deposited into that account. We start with background information about the Committee and the law.

A. Background Information

As a publicly-financed committee for the presidential primary election, the Committee had two sources of financing for that election: 1) public funds from the United States Treasury and 2) private contributions from individual contributors that were designated for the primary election. The Committee deposited these funds into two separate accounts. The Committee

³ The Committee had an opportunity to submit this information in the context of the entitlement proceeding, 11 C.F.R. § 9034.5(g)(2), but it failed to do so. *See Statement of Reasons in Support of Final Determination on Entitlement In the Matter of Governor Gary Johnson*, LRA # 905.

⁴ The Audit Division's conclusion that the Committee used public funds for non-qualified campaign expenses is based on the Audit Division's conclusion that public funds were used to pay for general election expenses. Since the conclusion that the Committee used public funds to pay for non-qualified campaign expenses is a basis for repayment, 11 C.F.R. § 9038.2(b)(2)(i)(A), we recommend that the Audit Division explain in the PAR how it determined that the disbursements were for general election expenses. We have a similar observation with respect to Finding 3, which discusses the Committee's use of general election contributions to pay primary election expenses. We recommend that the Audit Division explain why the expenses were considered primary election expenses.

deposited its public funds into its primary election account, and it deposited the private contributions at issue in this finding into its general election account.⁵ The PAR finds that the Committee spent \$1,199,701 in private contributions designated for the primary election⁶ on general election expenses.

The PAR concludes that the amount spent on general election expenses is a non-qualified campaign expense for the primary election. The PAR finds, therefore, that the Committee must repay a pro rata portion that represents the public funds it received from the United States Treasury. The Audit Division calculated the repayment amount to be \$334,780.

To calculate the amount the Committee must repay, the PAR uses a formula set forth in Commission regulations for determining the fraction of total spending on non-qualified campaign expenses⁷ that may reasonably be attributed to the spending of public funds, as opposed to private contributions. 11 C.F.R. § 9038.2(b)(2)(iii) (“repayment ratio formula”). Under this provision, the amount of repayment is in the same ratio to the total amount spent on non-qualified campaign expenses, as the ratio of matching funds certified to the candidate bears to the candidate’s total deposits.⁸ *Id.*

Total deposits is defined as “all deposits to all candidate accounts minus transfers between accounts, refunds, rebates, reimbursements, checks returned for insufficient funds,

⁵ To determine which contributions were designated for the primary election and which contributions were designated for the general election, the Audit Division used the written designation rule that the Committee used for its paper contribution solicitation forms and on its website contribution solicitation forms. This is the same designation rule that the Commission used to determine that the candidate was no longer entitled to public funds. *See Statement of Reasons In Support of Final Determination on Entitlement In the Matter of Governor Gary Johnson (LRA # 905), dated November 14, 2013, at 9.* We recommend that the Audit Division explain this in the PAR, which demonstrates that the Commission has taken a consistent approach between the entitlement proceedings and the audit.

⁶ Since the general election account included both primary and general election contributions, we recommend that the Audit Division revise the PAR to explain the methodology that the Audit Division used to arrive at the conclusion that the Committee used primary contributions to pay general election expenses.

⁷ We agree with the Audit Division’s conclusion that the payment of general election expenses with primary election funds is a non-qualified campaign expense. *See* 11 C.F.R. § 9034.4(b)(3). The Presidential Matching Payment Account Act (“Matching Payment Act”), 26 U.S.C. §§ 9031 et seq., defines a “qualified campaign expense” as “a purchase, payment, distribution, loan, advance, deposit, or gift of money or of anything of value” that a candidate or his or her authorized committee incurs in connection with that candidate’s campaign for nomination for election, and which does not involve a violation of Federal or State law. 26 U.S.C. § 9032(9). *See also* 11 C.F.R. § 9032.9. If the Committee incurred expenses for the general election, then those expenses were not incurred in connection with the candidate’s campaign for the nomination.

⁸ Both the amount of matching funds certified and total deposits are determined as of 90 days following the candidate’s date of ineligibility. So, for example, if a candidate had matching funds certified to him or her of \$200,000 as of 90 days following the date of ineligibility, the candidate’s total deposits as of that time totaled \$1,000,000, and the candidate spent \$50,000 on non-qualified campaign expenses, then the candidate would be required to repay 20 percent ($\$200,000/\$1,000,000$) of the \$50,000 spent on such expenses, or \$10,000, to the U.S. Treasury.

proceeds of loans and other similar amounts.” 11 C.F.R. §§ 9038.2(b)(2)(iii)(A); 9038.3(c)(2). To calculate the total deposits, the Audit Division included the public funds and the private primary contributions deposited both in the Committee’s primary and its general election accounts, but excluded the Committee’s private general election contributions deposited into its general election account.

B. The Committee Used Public Funds To Defray Non-Qualified Campaign Expenses

We concur that the Committee used public funds to pay non-qualified campaign expenses. Although under one view the Committee could be said to have used only its private primary contributions to defray the non-qualified campaign expenses, the 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 (D.C. Cir. 1984). The Commission has historically and consistently interpreted the public funds and private primary contributions as commingled even if a committee has more than one account and the public funds are held separate from the private primary contributions. The Commission has stated that it considers all funds in a publicly funded committee’s accounts to be commingled. *See* Final Rule and Explanation and Justification Regarding Public Financing of Presidential Primary and General Election Candidates, 56 Fed. Reg. 35898, 35905 (July 29, 1991) (citing *Kennedy for President Committee*, 734 F.2d 1558, 1565 n.11); Final Report of the Audit Division on Larouche Democratic Campaign (approved May 17, 1990), at 8 (rejecting committee argument that no repayment required because segregated federal funds account not used); Final Report of the Audit Division on Albert Gore, Jr. for President Committee, Inc. (approved July 13, 1989), at 11 (separate bank account for deposit of matching funds would still require repayment); Final Report of the Audit Division on The Tsongas Committee, Inc. (approved Dec. 16, 1994), at 65-66 (rejecting argument that *Kennedy* decision disallows repayment determination where specific account used did not contain matching funds); Statement of Reasons, Senator Robert Dole and the Dole for President Committee, Inc. at 24-25 (approved Feb. 6, 1992) (rejecting argument that expenditures of third party on behalf of committee causing committee to exceed spending limitations not subject to repayment because third party never received public funds, and stating “[o]rdinarily, federal matching funds and private contributions are commingled in a committee’s accounts”).

If the Commission did not consider funds held in separate accounts to be commingled for purposes of repayment, then a committee would be able to avoid the application of the theory of a “commingled pool of federal and private monies” and a possible repayment obligation simply by depositing its public funds and its private contributions into separately dedicated accounts. Committees that did so would be able to claim that they spent only their private primary contributions, and not their public funds, on non-qualified campaign expenses. The Commission has consistently rejected such an approach, as reflected in the audits cited above.

In light of the Commission’s consistent approach to this issue and the adverse consequences of not applying the theory of a “commingled pool of federal and private monies” to all of the Committee’s accounts that maintained public funds and private contributions for the

primary election, we conclude that the Committee used public funds to pay for the non-qualified campaign expenses. The Commission, therefore, may seek a repayment of public funds that were used to defray non-qualified campaign expenses. *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558 (D.C. Cir. 1984).

C. The Commission Should Use the Repayment Ratio to Calculate the Public Funds Portion of Non-Qualified Campaign Expenses, And the Ratio Should Include Primary Contributions And Exclude General Contributions

Because the Committee used public funds to pay for non-qualified campaign expenses, the Audit Division's use of the repayment ratio to calculate the amount of public funds that must be repaid is appropriate. See 11 C.F.R. § 9038.2(b)(2)(iii) (mandating use of repayment ratio formula to determine amount of public funds to be repaid where public funds spent on non-qualified campaign expenses).⁹

It is OGC's opinion that the Audit Division correctly included the primary election contributions deposited into the general election account and correctly excluded the general election contributions deposited into the same account from the calculation for the following reasons.

Although section 9038.2(b)(2)(iii)(A) defines "total deposits" for the purpose of calculating the repayment amount as, in pertinent part, "all deposits to all candidate accounts," we believe that in the context of the facts presented in this case, "all deposits" should be interpreted to encompass private primary contributions deposited into a general election account. The facts presented here are unusual in that the Committee deposited nearly all of its private primary contributions received after May 2012 into a general election account, rather than the primary account that contained public funds, or a separate primary private account.

These facts, however, do not change the purpose of the repayment process: to recapture public funds used for non-qualified campaign expenditures. 11 C.F.R. § 9038.2(b)(2); see also Comments of Office of the General Counsel on Proposed Audit Report on Dole for President, Inc. – Media Advertisements and Other Expenses Paid for by the Republican National Committee, Repayment Ratio and Winding-Down Costs (LRA # 467) (Oct. 27, 1998), in Final Audit Report on Dole for President, Inc. (approved June 3, 1999), at 84. If the private

⁹ The Audit Division's cover memorandum to the draft PAR indicates that the Audit Division used the last day any primary contributions submitted for matching were still in the Committee's general election account, or December 20, 2012, as the date on which calculation of non-qualified campaign expenses ended. See Cover Memorandum to PAR on Gary Johnson 2012, Inc., page 3, point 4. However, the Commission is required to review committee expenditures from the date of the last matching fund payment to which the candidate was entitled to determine the point in time at which the Committee's accounts no longer contain matching funds themselves, rather than the primary contributions upon which the award of matching funds is based. 11 C.F.R. § 9038.2(b)(2)(iii)(B). In arriving at this date, the Commission is to assume that the last payment has been expended on a last-in-first-out basis. *Id.* We, therefore, recommend that the PAR be revised to include discussion of how this aspect of the regulation was applied here, or explain why this requirement was not followed in this case.

contributions for the primary election were not included in the repayment ratio formula calculation simply because the Committee deposited them in another account opened for a different election, then the accuracy of the repayment ratio formula calculation would be compromised in that it would fail to include *all* of the financing available to the Committee for the primary election.

These same considerations warrant excluding the general election contributions deposited in the same account from the total deposits used in the repayment ratio calculation. Although section 9038.2(b)(2)(iii)(A) does not explicitly exclude general election funds properly deposited into general election accounts from the total deposits that must be included in the repayment ratio formula, we believe this exclusion is required by the general principle that primary and general elections are separate, and thus, general election contributions are not available to be spent on primary election expenses.¹⁰ See Explanation and Justification for Final Rule Regarding Public Financing of Presidential Primary and General Election Candidates, 64 Fed. Reg. 61777, 61778-79 (Nov. 15, 1999). Consequently, including general election deposits in the formula would distort the accuracy of the repayment ratio formula calculation for a publicly-financed primary election committee.

IV. REPORTING OF DEBTS AND OBLIGATIONS; EXTENSION OF CREDIT BY A COMMERCIAL VENDOR

In the cover memorandum under the PAR's summary of Finding 4, the Audit Division discusses using two different sets of invoices from a commercial vendor, NSON,¹¹ including a set sent out immediately when the debts were incurred and another set that was sent in December 2012. We understand that the Audit Division considered one set of invoices in connection with the analysis for Finding 4 and that it considered the other set of invoices in connection with the analysis for Finding 5. We recommend that the Audit Division explain, in the cover memorandum to the Commission, why it used two different sets of invoices for the two findings.

¹⁰ In general, candidates who are candidates for the general election, and their authorized committees, may spend funds representing contributions made with respect to the general election on primary election debt. 11 C.F.R. § 110.1(b)(3)(iv). However, presidential candidates who are publicly financed are required to use primary election funds only for expenses incurred in connection with primary elections, and to use general election funds only for general election expenses. See Explanation and Justification for Final Rule Regarding Public Financing of Presidential Primary and General Election Candidates, 64 Fed. Reg. 61777, 61778-79 (Nov. 15, 1999). This limitation exists for publicly-funded candidates in order to effectuate the spending limits for both the primary and the general election. *Id.*

¹¹ The PAR notes 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 notes that although the Committee reported disbursements to this entity as disbursements to Political Advisors, the entity billed the Committee as NSON.