



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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SENSITIVE

MEMORANDUM

To: The Commission

Through: Alec Palmer *AP*
Staff Director

From: Patricia C. Orrock *PCO*
Chief Compliance Officer

Thomas E. Hintermister *TH*
Assistant Staff Director
Audit Division

Douglas A. Kodish *DK*
Audit Manager

Subject: Withdrawal and Resubmission - Draft Final Audit Report (DFAR) - Ted Cruz for Senate (A13-05)

This memorandum recommends that the Commission approve the revised Draft Final Audit Report for Ted Cruz for Senate (TCFS) on a 72- hour no objection basis (see attached). Please note that changes to the processing of this report were necessary due to the circumstances outlined below.

The original DFAR issued to TCFS on December 8, 2015, contained a finding for the Reporting and Disclosure of Candidate Loans. After the issuance of the DFAR, new information was provided by TCFS on January 14, 2016, via a miscellaneous report (Form 99) filed with the Commission, concerning the involvement of commercial lending. As a result, the DFAR finding was modified to include a recommendation for TCFS to disclose the necessary information concerning the commercial loans on Schedule C-1.

Upon its review of the revised DFAR and new information provided by TCFS, the Office of General Counsel issued a new legal analysis (LRA 976) and in response, the Audit Division reviewed the permissibility of commercial loans to TCFS under 11 CFR 100.83 and potentially excessive contributions from the Candidate's spouse under the joint account exception rule. The Audit Division staff has concluded that neither of these issues resulted from these loans.

Normally, under Directive 70, the Audit Division sends the DFAR to the Committee without Commission approval.¹ However, given the changes within the revised DFAR, the Audit Division recommends that the Commission approve the revised DFAR prior to it being sent to TCFS. Upon Commission approval, the Audit Division will send the revised DFAR to TCFS and proceed in accordance with Directive 70 (specifically, within 15 days of receiving the DFAR, TCFS may respond directly to the Commission with respect to any legal or factual issues raised in the revised DFAR and/or request an audit hearing).

Thereafter, the Audit Division will proceed with the Audit Division Recommendation Memorandum, Proposed Final Audit Report, and Final Audit Report of the Commission, as per Directive 70.

Recommendation:

The Audit Division recommends the Commission approve the revised DFAR of TCFS on a 72-hour no objection basis. Should an objection be received, it is recommended that the report be considered at the next regularly scheduled Executive Session, as TCFS will not have had an opportunity to respond to the additional finding outlined within the DFAR.

Attachments:

Revised Draft Final Audit Report of the Audit Division on Ted Cruz for Senate
Office of General Counsel, Legal Analysis, # 976
Office of General Counsel, Supplemental Comments on Legal Analysis #976

¹ The DFAR is circulated to the Commission on an informational basis.



Draft Final Audit Report of the Audit Division on Ted Cruz for Senate

(January 18, 2011 – December 31, 2012)

Why the Audit Was Done

Federal law permits the Commission to conduct audits and field investigations of any political committee that is required to file reports under the Federal Election Campaign Act¹ (the Act). The Commission generally conducts such audits when a committee appears not to have met the threshold requirements for substantial compliance with the Act. The audit determines whether the committee complied with the limitations, prohibitions and disclosure requirements of the Act.

Future Action

The Commission may initiate an enforcement action, at a later time, with respect to the matter discussed in this report.

About the Committee (p. 2)

Ted Cruz for Senate is the principal campaign committee for Ted Cruz, Republican candidate for the United States Senate from the state of Texas, and is headquartered in Austin, Texas. For more information, see the Campaign Organization Chart, p. 2.

Financial Activity (p. 2)

• Receipts	
○ Contributions from Individuals	\$ 12,044,368
○ Contributions from Political Committees	1,407,608
○ Transfers from Other Authorized Committees	175,347
○ Candidate Loans	1,430,000
○ Other Receipts	40,960
Total Receipts	\$ 15,098,283
• Disbursements	
○ Operating Disbursements	\$ 13,814,542
○ Candidate Loan Repayments	587,000
○ Contribution Refunds	192,327
○ Other Disbursements	25,000
Total Disbursements	\$ 14,618,869

Finding and Recommendation (p. 3)

- Reporting and Disclosure of Candidate Loans

¹ 52 U.S.C. §30111(b).

Draft Final Audit Report of the Audit Division on Ted Cruz for Senate

(January 18, 2011 – December 31, 2012)



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Part I

Background

Authority for Audit

This report is based on an audit of Ted Cruz for Senate (TCFS), undertaken by the Audit Division of the Federal Election Commission (the Commission) in accordance with the Federal Election Campaign Act of 1971, as amended (the Act). The Audit Division conducted the audit pursuant to 52 U.S.C. §30111(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 52 U.S.C. §30104. Prior to conducting any audit under this subsection, the Commission must perform an internal review of reports filed by selected committees to determine if the reports filed by a particular committee meet the threshold requirements for substantial compliance with the Act. 52 U.S.C. §30111(b).

Scope of Audit

Following Commission-approved procedures, the Audit staff evaluated various risk factors and as a result, this audit examined:

1. the receipt of excessive contributions and loans;
2. the receipt of contributions from prohibited sources;
3. the disclosure of contributions received;
4. the disclosure of individual contributors' occupation and name of employer;
5. the consistency between reported figures and bank records;
6. the completeness of records; and
7. other committee operations necessary to the review.

Part II

Overview of Campaign

Campaign Organization

Important Dates	
• Date of Registration	February 2, 2011
• Audit Coverage	January 18, 2011 - December 31, 2012
Headquarters	Austin, Texas
Bank Information	
• Bank Depositories	Three
• Bank Accounts	Seven Checking
Treasurer	
• Treasurer When Audit Was Conducted	Bradley S. Knippa
• Treasurer During Period Covered by Audit	Bradley S. Knippa
Management Information	
• Attended Commission Campaign Finance Seminar	Yes
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ January 18, 2011	\$ 0
Receipts	
○ Contributions from Individuals	12,044,368
○ Contributions from Political Committees	1,407,608
○ Transfers from Other Authorized Committees	175,347
○ Candidate Loans	1,430,000
○ Other Receipts	40,960
Total Receipts	\$ 15,098,283
Disbursements	
○ Operating Disbursements	13,814,542
○ Candidate Loan Repayments	587,000
○ Contribution Refunds	192,327
○ Other Disbursements	25,000
Total Disbursements	14,618,869
Cash-on-hand @ December 31, 2012	\$ 479,414

Part III Summary

Finding and Recommendation

Reporting and Disclosure of Candidate Loans

During audit fieldwork, the Audit staff reviewed loans from the Candidate to TCFS for calendar years 2011 and 2012. The Candidate made five loans in the amount of \$1,430,000 to TCFS. Two loans, totaling \$400,000, were made to TCFS for the runoff election and were repaid in full prior to the start of the audit. The remaining three loans, totaling \$1,030,000, were for the primary election; TCFS repaid the Candidate \$485,000 for these loans. However, the remaining outstanding balance of \$545,000 was reported as a loan payable to the Candidate and was not converted to a personal candidate contribution, as required. Subsequent to the exit conference (in April 2015), TCFS converted the \$545,000 to a personal candidate contribution. In response to the Interim Audit Report recommendation, Counsel for TCFS provided no additional comments regarding this matter.

After the Interim Audit Report, the Audit staff was made aware that TCFS failed to disclose that a \$1,064,000 of \$1,430,000 in Candidate loans previously reported were from commercial lenders, and it did not file the required Schedules C-1. The loans originated from a Citibank revolving line of credit for \$264,000, and from three Goldman Sachs margin loans totaling \$800,000. The remainders of the loan amount come from the Candidate's personal funds, totaling \$366,000. The Audit staff recommends TCFS amend the necessary reports to include corrected Schedules C and the appropriate Schedules C-1 to correctly disclose the source of funds loaned. (For more detail, see p. 4)

Part IV

Finding and Recommendation

Finding 1. Reporting and Disclosure of Candidate Loans

Summary

During audit fieldwork, the Audit staff reviewed loans from the Candidate to TCFS for calendar years 2011 and 2012. The Candidate made five loans in the amount of \$1,430,000 to TCFS. Two loans, totaling \$400,000, were made to TCFS for the runoff election and were repaid in full prior to the start of the audit. The remaining three loans, totaling \$1,030,000, were for the primary election; TCFS repaid the Candidate \$485,000 for these loans. However, the remaining outstanding balance of \$545,000 was reported as a loan payable to the Candidate and was not converted to a personal candidate contribution, as required. Subsequent to the exit conference (in April 2015), TCFS converted the \$545,000 to a personal candidate contribution. In response to the Interim Audit Report recommendation, Counsel for TCFS provided no additional comments regarding this matter.

After the Interim Audit Report, the Audit staff was made aware that TCFS failed to disclose that a \$1,064,000 of \$1,430,000 in Candidate loans previously reported were from commercial lenders, and it did not file the required Schedules C-1. The loans originated from a Citibank revolving line of credit for \$264,000, and from three Goldman Sachs margin loans totaling \$800,000. The remainders of the loan amount come from the Candidate's personal funds, totaling \$366,000. The Audit staff recommends TCFS amend the necessary reports to include corrected Schedules C and the appropriate Schedules C-1 to correctly disclose the source of funds loaned.

Legal Standard

A. Personal Funds. Personal funds of a candidate consist of assets, income, or jointly owned spousal assets. Assets are amounts derived from any asset that, under applicable state law, at the time the individual became a candidate, the candidate had legal right of access to or control over, and with respect to which the candidate had legal and rightful title or an equitable interest. Personal funds may also be income received during the current election cycle of the candidate, including salary and other earned income from bona fide employment and income from stocks or investments, including interest, dividends or proceeds from the sale of such stocks or investments. 11 CFR § 100.33.

B. Restriction on an Authorized Committee's Repayment of Personal Loans Exceeding \$250,000 Made by the Candidate to the Authorized Committee. Personal loans mean a loan or loans, including advance, made by a candidate, using personal funds, as defined in 11 CFR §100.33, to his or her authorized committee where the

proceeds of the loan were used in connection with the candidate's campaign for election. For personal loans that, in the aggregate, exceed \$250,000 in connection with an election, the authorized committee may:

- Repay the entire amount of the personal loans using contributions to the candidate or the candidate's authorized committee provided that those contributions were made on the day of election or before;
- May repay up to \$250,000 of the personal loans from contributions made to the candidate or the candidate's authorized committee after the date of the election; and
- Must not repay, directly or indirectly, the aggregate amount of the personal loans that exceeds \$250,000 from contributions to the candidate or the candidate's authorized committee if those contributions were made after the date of the election.

If the aggregate outstanding balance of the personal loans exceeds \$250,000 after the elections, the authorized political committees must comply with the following conditions:

- If the authorized committee uses the amount of cash-on-hand as of the day after the election to repay all or part of the personal loans, it must do so within 20 days of the election.
- Within 20 days of the election date, the authorized committee must treat the portion of the aggregate outstanding balance of the personal loans that exceeds \$250,000 minus the amount of cash-on-hand as of the day after the election used to repay the loan as a contribution by the candidate.
- The candidate's principal campaign committee must report the transactions in paragraphs (c) (1) and (c) (2) of this section in the first report scheduled to be filed after the election pursuant to 11 CFR §104.5(a) or (b).
- This section applies separately to each election. 11 CFR §116.11(a), (b), (c) and (d).

C. Candidate as an Agent. Any candidate who receives a contribution, obtains a loan or makes any disbursement, in connection with his or her campaign shall be considered as having received such contribution, obtained such loan or made such disbursement as an agent of his or authorized committee(s). 11 CFR §101.2.

D. Reporting Loans. All loans received by a committee must be itemized and continuously reported until repaid. All repayments made on a loan must also be itemized. 11 CFR §104.3(a)(4)(iv) and (b)(4)(iii). 11 CFR §104.11.

E. Schedule C. Both the original loan and payments to reduce principal must be reported each reporting period until the loan is repaid. The committee must report the following:

- The source of the loan; and
- The type of loan the candidate received (i.e. bank loan, brokerage account, credit

- card, or home equity line of credit) either in the first box for endorsers and
- guarantors with a notation for loan type or in the box for "Loan Source" after the candidate's name. 11 CFR §104.3(d) and § 104.11.

F. Schedule C-1.

1. **Loans to Candidates.** When a candidate obtains a loan from an advance on the candidate's brokerage account, credit card, home equity line of credit or other line of credit for use in connection with the candidate's campaign, the candidate's principal campaign committee must disclose in the report, covering the period when the loan was obtained, the following information on Schedule C-1 or C-P-1:
 - The date, amount, and interest rate of the loan, advance, or line of credit;
 - The name and address of the lending institution; and
 - The type and value of collateral or other sources of repayment that secure the loan, advance, or line of credit, if any. 11 CFR §104.3(d)(4).
2. **Loans to Committees.** When a committee obtains a loan from a bank or other permissible lending institution it must also file Schedule C-1 with the first report due after a new loan or line of credit has been established. The committee must disclose the following information on Schedule C-1:
 - The date and amount of the loan;
 - The interest rate and repayment schedule of the loan, or on each draw of line of credit;
 - The type and value of collateral or other sources of repayment that secure the loan or the line of credit, and whether that security interest was perfected; and
 - An explanation of the basis upon which the loan was made, if not made on the basis of either collateral or other sources of repayment.
3. **Loan Agreement/Line of Credit-** The committee must also attach a copy of the loan agreement. In the case of a committee that has obtained a line of credit, a new Schedule C-1 must be filed with the next report whenever the committee draws on the line of credit. An authorized representative of the lending institution must sign the statement on Line I. 11 CFR §104.3(d)(1) and (3).

Facts and Analysis

A. Reporting of Candidate Loans

1. Facts

During audit fieldwork, the Audit staff reviewed five loans from the Candidate to TCFS totaling \$1,430,000. Two of these loans totaling \$400,000 were for the runoff election and were repaid to the Candidate before the audit commenced, leaving three loans to TCFS for the primary election totaling \$1,030,000. The following chart outlines the amounts and dates of these primary election loans and the repayments that TCFS has

made to the Candidate within 20 days of the primary election on May 29, 2012:

Date	Amount	Transaction	Running Balance
3/31/2012	\$70,000	Primary Loan	\$70,000
5/18/2012	\$400,000	Primary Loan	\$470,000
5/22/2012	\$560,000	Primary Loan	\$1,030,000
6/16/2012 ²	\$(235,000)	Loan Repayment	\$795,000
		Repayment Limit	(\$250,000) ³
		Primary Loan Balance to Report as Candidate Contribution	\$545,000

As noted above, the balances of the Candidate's loans for the primary election totaled \$795,000 on the twentieth day following the election. TCFS may repay up to \$250,000 of the personal loans for the primary election from contributions made to the Candidate after the date of the election. Also, TCFS was required to treat as a contribution the amount of \$545,000 (\$795,000 - \$250,000) which is equal to the outstanding balance of the Candidate primary loans less the repayment limit. TCFS was required to report the contribution of \$545,000 on the first report scheduled to be filed after the election (2012 July Quarterly). TCFS, however, continued to report the remaining balance as an outstanding primary loan from the Candidate on Schedule C (Loans) instead of converting the loan to a personal contribution from the Candidate on Schedule A, Line 11(d) (Contributions from the Candidate).

2. Interim Audit Report & Audit Division Recommendation

The Audit staff discussed the loans with TCFS at the exit conference and subsequently provided a detailed schedule outlining amounts loaned to TCFS, its repayments to the Candidate, and the loan balance outstanding. Counsel commented that TCFS should be allowed to pay off the balance of the loan and questioned the necessity of the loan conversion. However, in response to the exit conference, Counsel stated that TCFS reviewed the Audit staff's schedule of loans, compared it to its accounting records, and concluded that the schedule of loans was correct.

Counsel further stated that TCFS will report the loan balance of \$545,000 as a contribution from the Candidate per 11 CFR §116.11 (c). Counsel also noted that the Candidate may wish to note on the report his belief that the statute establishing limits on the amount of personal debt that may be repaid to a candidate, is unconstitutional.

Subsequent to the exit conference, TCFS disclosed the conversion of the loan to a contribution by the Candidate on Schedule A of its 2015 April Quarterly report. TCFS also informed the audit staff that it reserves the right to challenge the constitutionality of this provision of the law. Per 11 CFR §116.11 (c)(3), the Audit staff considered the disclosure of the Candidate contribution to the 2012 primary election as untimely.

² Single payment made within the 20 day period after the primary election.

³ In accordance with 11 CFR §116.11(b)(2), the Candidate was repaid a total of \$250,000 for the primary election loans with contributions made to the TCFS after the May 29, 2012 primary date.

The Interim Audit Report recommended that TCFS provide any comments it deemed relevant with respect to this matter.

3. Committee Response to Interim Audit Report (Report)

In response to the Interim Audit Report recommendation, Counsel for TCFS provided no additional comments regarding this matter. In response to the initial Draft Final Audit Report, Counsel reiterated that it had no comments and stated that no hearing was being requested⁴.

B. Disclosure of Candidate Loans

1. Facts

During audit fieldwork, the disclosure of loans from the Candidate were reviewed, and based upon documentation available at that time, the Audit staff found no reasonable basis to believe there was a material loan disclosure problem (all loans were disclosed as personal, none were disclosed as commercial loans). However, subsequent to the issuance of the Interim Audit Report to TCFS, the Audit staff became aware that most of the money loaned by the Candidate to TCFS came from borrowed funds. Specifically, of the \$1,430,000 disclosed on TCFS's Schedule C, \$1,064,000 was obtained from the commercial lenders. One of the loans in the amount of \$264,000 came from a Citibank revolving line of credit and \$800,000 came from three Goldman Sachs margin loans. Only \$366,000 appears to have come from the Candidate's personal funds. Moreover, Schedules C-1 should have been filed which would have disclosed the terms of the loans and other loan details.

As the facts concerning the disclosure of loans became known, TCFS filed a Miscellaneous Text Report, Form 99, and disclosed some but not all of the required loan information. After reviewing this filing, the Commission's Reports Analysis Division requested TCFS file the necessary Schedules C and C-1.⁵ To date, TCFS has not amended their reports to disclose the additional information. Accordingly, the Audit staff recommends that TCFS correctly file the necessary information on Schedules C and C-1.

⁴ A Draft Final Audit Report was issued to TCFS in December 2015, prior to the Audit Staff being made aware of commercial loans to TCFS originated by the Candidate.

⁵ These schedules are defined under the Legal Standards section of this report beginning on page 5.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20461

MEMORANDUM

TO: Patricia C. Orrock
Chief Compliance Officer

JAN 10 2017

Thomas E. Hintermister
Assistant Staff Director

FROM: Adav Noti *AN*
Associate General Counsel
Policy Division

Lorenzo Holloway *LH*
Assistant General Counsel
for Compliance Advice

Joshua Blume *JB*
Attorney

SUBJECT: Resubmitted Draft Final Audit Report – Ted Cruz for Senate (LRA # 976)

I. INTRODUCTION

The Office of General Counsel has reviewed this resubmitted Draft Final Audit Report (“DFAR”) on the Ted Cruz for Senate committee (the “Committee”). The DFAR contains one finding, Reporting and Disclosure of Candidate Loans, upon which we comment. We also comment upon the Audit Division’s decision to revise and resubmit the DFAR, with which we agree. If you have any questions, please contact Joshua Blume, the attorney assigned to this audit.

II. RESUBMISSION OF DFAR

Before addressing the substantive legal issues presented by the DFAR, we address a procedural issue raised by the submission of this DFAR, which is actually a revised version of a previous DFAR. The Audit Division revised the DFAR to include new information received at the Audit Division Recommendation Memorandum (“ADRM”) stage of the audit. The ADRM is specifically designed, pursuant to Directive 70, as a vehicle for the Audit Division to make recommendations regarding any new legal or factual issues that are raised after the DFAR has

been prepared and served upon the audited committee. Here, however, new factual issues were raised by the Committee following its receipt of the original DFAR, and, as discussed below, these factual issues in turn raise new legal questions. In light of this unusual posture, the procedural issue we address is whether the next step of the audit should be to proceed immediately to the ADRM stage of the audit, or whether, given the number and complexity of the issues raised, the Committee ought to be provided with a copy of the revised DFAR and an opportunity to respond to it. We believe that the appropriate course of action is to revise the DFAR and allow the Committee to respond to it.

The prior version of the DFAR, which the Committee received, concluded that Senator Cruz (the "Candidate") failed to convert the balance of certain outstanding loans exceeding \$250,000 that he made to his authorized committee to contributions in accordance with 11 C.F.R. § 116.11(c). The Audit Division has now revised this version and expanded the finding to include a failure-to-report aspect because the Committee revealed for the first time that a portion of the Candidate's loans that had been reported as loans from personal funds were not in fact derived from personal funds, but instead derived from borrowing from financial institutions.

While Directive 70 is silent on the issue of whether the Committee should be given an opportunity to respond to the revised DFAR, allowing the Committee to respond is consistent with the directive's underlying principle of providing full and fair notice to audited committees of potential findings.¹ Furthermore, because Directive 70 contemplates that any significant factual or legal issues that arise from the DFAR will be addressed at the subsequent ADRM stage --- in which the audited committee does not participate --- the DFAR represents the final opportunity for the Commission to obtain the Committee's views on the new information prior to considering the ADRM. See Commission Directive No. 70, Apr. 26, 2011, at 3.

¹ In two previous audits, those of the Los Angeles County Democratic Central Committee ("LACDCC") and of the Canseco for Congress ("Canseco") committee, the Audit Division, either at the Commission's behest, in the former case, or upon its own initiative, in the latter case, revised its audit report in the light of new information. In the case of the LACDCC,

_____ However, there were no changes to the findings in the report. _____

_____ The LACDCC also submitted comments in response to the Proposed Final Audit Report ("PFAR"). See Comments in Response to [PFAR] on [LACDCC] (A09/07) from Stephen J. Kaufman, dated Oct. 17, 2012. In the Canseco matter, the Audit Division resubmitted the DFAR after correcting certain factual errors and revising its calculations but, again, did not alter the substance of the findings or present any new legal issues. _____

III. REPORTING AND DISCLOSURE OF CANDIDATE LOANS

This finding pertains to loans totaling \$1,430,000 that Candidate made to the Committee. Although at an earlier stage of this audit, the Candidate averred that all of the loans derived from his personal funds as that term is defined in 11 C.F.R. § 100.33, in fact \$1,064,000 of the \$1,430,000 in loans derived instead from the proceeds of funds that the Candidate borrowed from two financial institutions. Specifically, to finance his campaign the Candidate borrowed approximately \$800,000 from Goldman Sachs in the form of a "margin loan"² and approximately \$264,000 from Citibank in the form of revolving credit. The remaining \$366,000 came from the Candidate's personal funds.

The Audit Division concludes that the Candidate and the Committee breached two regulations connected with the Candidate's loans. First, the Candidate and the Committee failed to convert the amount of the loans exceeding \$250,000 that remained unpaid more than twenty days after the general election to contributions and to report them as such. *See* 11 C.F.R. § 116.11(c). Second, the Audit Division concludes that the Candidate and the Committee failed to report properly that portion of the loans derived from the aforementioned borrowing from financial institutions, which, based on the Candidate's prior representation, had previously been disclosed as personal. *See* 11 C.F.R. § 104.3(d) (prescribing rules for reporting loans from financial institutions).

Our comments below address three issues: (1) whether the new loan information affects the Audit Division's previous conclusion that the Candidate should have converted his personal loans to contributions and disclosed them as such; (2) whether the loans from Goldman Sachs and Citibank were impermissible contributions; and (3) whether the Candidate's spouse made a contribution because the assets used to secure one of the loans were jointly held by the Candidate and his spouse.

A. The New Loan Information Does Not Affect the Prior Finding Made Under 11 C.F.R. § 116.11

First, the requirement that a Candidate convert outstanding loan balances exceeding \$250,000 to contributions applies only to the Candidate's "personal loans," which are defined in the applicable regulation to include loans made by candidates to their committees with personal funds as that term is defined in 11 C.F.R. § 100.33, as well as loans made by other entities to a candidate's authorized committee that are endorsed or guaranteed by the candidate, or are otherwise secured by the candidate's personal funds. 11 C.F.R. § 116.11(a). Given that the

² *See* Office of Investor Education and Advocacy, U.S. Securities Exchange Commission, SEC Pub. No. 156, Investor Bulletin: Understanding Margin Accounts 1, 3 ("A "margin account" is a type of brokerage account in which the broker-dealer lends the investor cash, using the account as collateral, to purchase securities. . . . In addition to purchasing securities, some brokers may allow you to use margin loans for a variety of personal or business financial purposes, such as buying real estate, paying off personal credit, or providing capital. Using margin loans for non-securities purposes DOES NOT change the way these loans work. These loans are still secured by the securities in your margin account and thus subject to the same risks associated with purchasing securities on margin described above.") (emphasis in original).

candidate borrowed some of the funds that he loaned to the Committee; this raises a question as to whether these portions of the Candidate's loans to the Committee may still be deemed the "personal loans" of the Candidate and therefore subject to the rule.

We conclude that the Candidate's loans to the Committee were "personal loans" of the Candidate for the purpose of applying section 116.11(c). The relevant part of the definition of "personal loans" in section 116.11(a) includes two elements: (1) loans made by other entities to a candidate's authorized committee; (2) that are either endorsed or guaranteed by the candidate or are secured with or by the candidate's personal funds.

The Candidate's loan from Goldman Sachs satisfied these two elements. First, the Committee received the loan. Although Goldman Sachs loaned funds directly to the Candidate rather than to the Committee, the Federal Election Campaign Act of 1971, as amended ("FECA") and Commission regulations provide that candidates who accept loans of funds from third parties for use in connection with their elections accept such loans as agents of their authorized committees. *See* 52 U.S.C. § 30102(e)(2); 11 C.F.R. § 102.7(d). *See also* Advisory Opinion 1985-33 (Collins) (receipt by candidate of loans from third party for use in campaign reportable by authorized committee and itemized as loans from lender to committee rather than from candidate to committee). Second, the Goldman Sachs loan was secured by the Candidate's personal property in the form of his investment assets, for this is the nature of the margin loan.

The Citibank loan, unlike the Goldman Sachs loan, does not appear to have been secured by the Candidate's personal property. Nevertheless, the candidate as the borrower is, according to his contract with Citibank, personally liable for the loan. As a matter of law, he promised to repay the loan in exchange for the bank's promise to pay him the loan proceeds. The Commission's intent in promulgating section 116.11(a) was to ensure that loans for which the candidate is personally liable are subject to the regulation.³ Thus neither the new information about the true nature of the Goldman Sachs loan nor that about the Citibank loan requires the Audit Division to revise its conclusion regarding the Committee's compliance with the terms of 11 C.F.R. § 116.11.

B. The Audit Division Should Apply 11 C.F.R. § 100.83 to Determine Whether Goldman Sachs and Citibank Made Impermissible Contributions

Since Goldman Sachs and Citibank were the actual sources for a portion of the loans, the second question raised is whether the loans were impermissible contributions from Goldman

³ *See* Explanation and Justification for Interim Final Rules on Increased Contribution and Coordinated Party Expenditure Limits for Candidates Opposing Self-Financed Candidates, 68 Fed. Reg. 3970, 3973 (Jan. 27, 2003) ("This definition [of "personal funds" in section 116.11(a)] ensures that loans to authorized committees that are used in connection with the candidate's campaign for election, for which the candidate is personally liable, are subject to the provisions of 11 C.F.R. 116.11."). *See also* E&J, discussion at 3974 (stating "[t]he definition of "personal loans" in new 11 CFR 116.11(a) is based on a broad interpretation of the opening phrase "[a]ny candidate who incurs personal loans" in [52 U.S.C. 30116(j)] to mean loans made by candidates to their authorized committees" and rejecting alternative interpretation of definition to mean loans made to candidates.).

Sachs and Citibank. The FECA and Commission regulations define the term "contribution" to include loans to candidates or committees. See 52 U.S.C. § 30101(8)(A)(i); 11 C.F.R. § 100.52(b). As the FECA and Commission regulations also prohibit corporations from making contributions, 52 U.S.C. § 30118(a); 11 C.F.R. § 114.2(b), the loans to the Candidate would therefore be impermissible, unless an exception were to apply. Here, FECA and Commission regulations exempt from the definition of "contribution" loans by banks and certain other types of financial institutions to candidates or their authorized committees when the loans meet certain criteria. See 52 U.S.C. § 30101(8)(B)(vii); 11 C.F.R. §§ 100.82, 100.83.

The exemption criteria that apply to traditional bank loans differ from, and are more stringent than, the criteria that apply to brokerage loans and lines of credit to candidates. Compare 11 C.F.R. § 100.82(a), with § 100.83(a); see also Brokerage Loans and Lines of Credit, 67 Fed. Reg. 38353 (June 4, 2002) (noting that "conventional bank loans" are subject to § 100.82 and lines of credit are subject to § 100.83).⁴ Accordingly, it is necessary to determine which regulation applies to each loan. Based upon our review of the terms of the loan agreements in each case, we conclude that both the Goldman Sachs margin loan and the Citibank revolving credit loan are best viewed as lines of credit. That a margin loan appears to function in this manner is indicated by the definition of "margin account," a type of account used in connection with margin loans. The margin account is "[a] brokerage account that allows an investor to buy or sell securities on credit, with the securities usu[ally] serving as collateral for the broker's loan."⁵ *Account -- margin account*, Black's Law Dictionary (10th ed. 2014). The terms of the Account Agreement indicate that when a margin loan is used to pay for securities,⁶ the securities purchased serve as the collateral.

And the Citibank revolving line of credit is a "line of credit" because it allowed the Candidate to borrow amounts needed at any time, up to a maximum amount.

Accordingly, the Audit Division should apply the criteria set forth in 11 C.F.R. § 100.83(a) to determine whether the loans were impermissible contributions. See 11 C.F.R. § 100.82(f) (providing that § 100.82 does not apply to loans governed by § 100.83).

⁴ Specifically, whereas traditional bank loans must bear the usual and customary interest rate of the lending institution for the category of loan involved; be made on a basis that assures repayment; be evidenced by a written instrument; and be subject to a due date or amortization schedule, 11 C.F.R. § 100.82(a), a brokerage loan or line of credit need only be made in accordance with applicable law and under commercially reasonable terms by a person who makes such loans in the normal course of that person's business, 11 C.F.R. § 100.83(a).

⁵ See also 15 U.S.C. § 78g(a) (requiring Board of Governors of Federal Reserve System to promulgate rules and regulations governing the extension of credit in connection with margin accounts).

⁶ As noted in footnote 2, *supra*, some brokerage firms may permit borrowers to borrow on margin for a purpose not related to the purchasing of securities. This appears to have been the case here. While the language of the agreement speaks of using the margin loan to purchase securities, we are assuming, in the absence of information indicating otherwise, that the securities in the investment account served as the collateral even if the loan was not used to purchase additional securities.

C. We Lack Sufficient Information at This Time to Determine Whether the Candidate's Spouse Made a Contribution Through the Use of the Goldman Sachs Account

The final issue is whether the Candidate's spouse contributed to the campaign because the spouse jointly held the securities that were used as collateral for the margin loan. See 11 C.F.R. § 100.52(b)(4) (spouse not considered contributor to campaign if value of candidate's share of jointly owned property equals or exceeds amount of loan used for campaign). The candidate's share of assets that a candidate jointly owns with his or her spouse is normally determined by the instrument of conveyance or ownership of the asset; however, if the instrument of conveyance or ownership does not allocate a specific share of the asset to the candidate, then a value equivalent to one-half of the value of the asset is imputed to the candidate as his or her share.⁷ See 11 C.F.R. § 100.33(c). In the context of a joint bank account, however, the Commission deems all of the funds in an account held jointly with a spouse to be the candidate's personal funds if the state law governing such accounts provides that both spouses owning the account have equal and complete access to its funds.⁸ See Addendum to Legal Analysis on Proposed Interim Audit Report on Friends for Menor (LRA 732) – Contributions from Personal Funds in Jointly Held Bank Accounts (July 2, 2008) ("joint bank account exception"). See also OGC Comments on Bauer for President 2000, Inc. – Proposed Audit Report (LRA #543), May 6, 2002, at 5-6.

This issue presents a number of legal and factual issues that we are not able to resolve at this time.⁹ Having said this, we are also aware of the time-sensitivity of this audit. Given its age

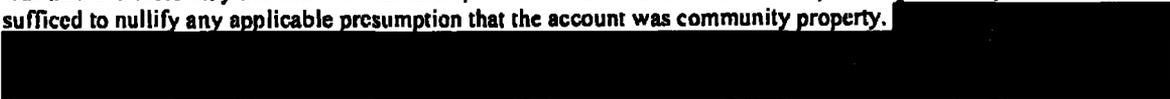
⁷ We asked the Audit Division whether the Candidate in fact used more than 50 percent of the value of the margin account as collateral for the margin loan. Our understanding from the auditors is that for most of the time the Candidate's use of the margin account for this purpose did not exceed 50 percent, but that it did exceed 50 percent once for a period of two to three days. On this occasion, the Candidate used 76 percent. If the general rule imputing one-half of the value of the joint asset to each spouse were to be applied to these facts, then the spouse would have made a contribution on this one occasion. 11 C.F.R. § 100.33(c)(2). This result would obtain regardless of the fact that Texas is a community property jurisdiction. See Candidate's Use of Property in which Spouse has an Interest, 48 Fed. Reg. 19019, 19020 (Apr. 27, 1983) ("This 50% rule would apply in community property states, as well as in non-community property states."). *But see infra*, n.9.

⁸ The distinction between joint bank accounts and other assets jointly held has been made for many years. See OGC Memorandum to Commission on Revision of Regulations Pertaining to Candidate's Use of Property in Which Spouse Has an Interest, Agenda Doc. # 81-181, Oct. 30, 1981, at 7 n.3. The Commission has continued to apply this distinction in enforcement and audit matters. See MURs 2292 and 3505. See also OGC Comments on Bauer for President 2000, Inc. – Proposed Audit Report (LRA #543), May 6, 2002, at 6 (discussing history of joint bank account exception).

⁹ One legal issue involves whether the joint bank account exception, which appears to have been applied in the past to traditional checking or savings accounts, also would apply to the funds in the margin account. Based upon our review, we are inclined toward the conclusion that the exception could apply because the funds in the account are held by the spouses in a similar manner to the manner in which spouses hold funds in a traditional joint bank account – here, as joint tenants with right of survivorship. See OGC Comments on Bauer for President 2000, Inc. – Proposed Audit Report (LRA # 543), May 6, 2002, at 6. Further, Texas law defines a "joint account" as an account payable on request to one or more of two or more parties – a factor deemed relevant in the Menor matter. See Vernon's Texas Statutes and Codes Annotated ("V.T.C.A."), Estates Code, § 113.004(2); Addendum to Legal

and its current procedural posture, we invite the Audit Division to decide, at its discretion, whether it wishes to seek the additional information described in footnote 8 from the Committee or from other sources to determine whether the Candidate's spouse made a contribution.

Analysis on Proposed Interim Audit Report on Friends for Menor (LRA 732), at 2. Nevertheless, even if the joint bank account exception could theoretically apply to the funds in the margin account, we lack sufficient factual information to resolve the ultimate question. This is because the state of Texas treats property acquired during the life of a marriage as community property, and, further, provides for subtypes of community property, namely, "sole management" and "joint management" community property. See, V.T.C.A., Family Code, §§ 3.001-3.003 (defining "separate property" specifically; defining "community property" as all property other than separate property acquired by either spouse during marriage, and announcing rebuttable presumption that property acquired during marriage is community property); see also V.T.C.A., Family Code, §§ 3.101-3.102 (providing for sole management of separate property, and classifying community property as sole or joint management). At this juncture, we lack sufficient information about the specific sources of the funds that compose the margin account that would enable us to classify it definitively as sole management or joint management, or some other type of community property, or indeed as separate property. We do not know, for example, whether the funds representing investments in the margin account were funds generated solely by one spouse before or during the marriage, or whether they were acquired by the spouses during the marriage. Further complicating the matter is that under Texas law, parties to joint accounts do not own the accounts equally, but only in proportion to the net contributions by each party to the sums on deposit unless there is clear and convincing evidence otherwise. V.T.C.A., Estates Code, § 113.102. We do not know whether the spouses had a different intent, or whether they purported to alter any putative joint community property regime governing the margin account, and, if so, whether such an alteration would have been legally effective. See V.T.C.A., Family Code, § 3.102(c). That the spouses designated the account in the Account Agreement as a joint tenancy account with right of survivorship even though a "community property" designation was also available may indicate such an intent, however we are uncertain whether, under Texas law, that would have sufficed to nullify any applicable presumption that the account was community property.





FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

February 24, 2017

MEMORANDUM

TO: Patricia C. Orrock
Chief Compliance Officer

Thomas E. Hintermister
Assistant Staff Director

FROM: Adav Noti *AN*
Associate General Counsel
Policy Division

Lorenzo Holloway *job for lh*
Assistant General Counsel
for Compliance Advice

Joshua Blume *jb*
Attorney

SUBJECT: Supplemental Comments on Resubmitted Draft Final Audit Report – Ted Cruz for Senate (LRA # 976)

I. INTRODUCTION

The Office of General Counsel issued comments on a resubmitted Draft Final Audit Report (“DFAR”) on the Ted Cruz for Senate committee (the “Committee”): Following the submission of those comments, the Audit Division performed an additional analysis relating to one issue addressed in our comments and, as a result of this analysis, we are submitting these supplemental comments for the Audit Division’s consideration. The additional analysis and these ensuing supplemental comments relate to the issue of whether the Candidate’s spouse made a contribution to the Committee when the Candidate utilized part of the value of a

Goldman Sachs margin account jointly owned by the Candidate and his spouse as the basis for a loan to the Committee.

II. NO FINDING THAT THE SPOUSE MADE A CONTRIBUTION WOULD BE MADE EVEN IF 50 PERCENT RULE WERE TO APPLY

The Candidate borrowed approximately \$800,000 from Goldman Sachs using the value of a margin account that he owned jointly with his spouse. This raises the question whether the Candidate's spouse contributed to the campaign because the spouse jointly held the securities that were used as collateral for the margin loan. *See* 11 C.F.R. § 100.52(b)(4) (spouse not considered contributor to campaign if value of candidate's share of jointly owned property equals or exceeds amount of loan used for campaign). The candidate's share of assets that a candidate jointly owns with his or her spouse is normally determined by the instrument of conveyance or ownership of the asset; however, if the instrument or conveyance or ownership does not allocate a specific share of the asset to the candidate, then a value equivalent to one-half of the value of the asset is imputed to the candidate as his or her share. *See* 11 C.F.R. § 100.33(c). In the context of a joint bank account, however, the Commission deems all of the funds in an account held jointly with a spouse to be the candidate's personal funds if the state law governing such accounts provides that both spouses owning the account have equal and complete access to its funds.¹ *See* Addendum to Legal Analysis on Proposed Interim Audit Report on Friends for Menor (LRA 732) – Contributions from Personal Funds in Jointly Held Bank Accounts (July 2, 2008) ("joint bank account exception"). *See also* OGC Comments on Bauer for President 2000, Inc. – Proposed Audit Report (LRA #543), May 6, 2002, at 5-6.

In our previous comments, we raised a question with the Audit Division concerning whether it should obtain additional information from the Committee to resolve the question of whether a spousal contribution was made based upon an analysis that assumed that the joint bank account exception would apply. Following receipt of our comments, we met with the auditors, at which time the auditors advised us of the results of an analysis we had requested that it perform under 11 C.F.R. § 100.33(c). This analysis imputed half the value of the account to the candidate and to the spouse respectively and compared the candidate's hypothesized 50 percent share of the account to the values of the loans obtained using the margin account as collateral. 11 C.F.R. § 100.52(b)(4). The auditors indicated that there was one occasion during which an amount exceeding 50 percent of the value of the account was utilized in this manner, thereby potentially resulting in an excessive contribution by the spouse under this analysis. On this occasion, however, the Committee apparently repaid the loan amount that might, under the 50 percent analysis, have included an excessive spousal contribution to the candidate in fewer than

¹ The distinction between joint bank accounts and other assets jointly held has been made for many years. *See* OGC Memorandum to Commission on Revision of Regulations Pertaining to Candidate's Use of Property in Which Spouse Has an Interest, Agenda Doc. # 81-181, Oct. 30, 1981, at 7 n.3. The Commission has continued to apply this distinction in enforcement and audit matters. *See* MURs 2292 and 3505. *See also* OGC Comments on Bauer for President 2000, Inc. – Proposed Audit Report (LRA #543), May 6, 2002, at 6 (discussing history of joint bank account exception).

60 days. As a result, the Audit Division would not include a finding on this issue in the DFAR based on the 50 percent analysis.

We concur with this approach, because the return of the potentially excessive contribution included in the loan occurred within a period of time that, by analogy, is allotted to treasurers in receipt of facially excessive contributions to refund contributions pursuant to 11 C.F.R. § 103.3(b)(3): that is, a period of fewer than 60 days. Thus, any excessive contribution that would have resulted from an application of the 50 percent rule would not have resulted in a finding that the spouse made a contribution. Because no finding would result even using the application of section 100.33 that would be least advantageous to the Committee, we do not deem it necessary to consider this issue further.