FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

MEMORANDUM

JAN 10 2017

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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.

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[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, [redacted] However, there were no changes to the findings in the report. [redacted] 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. [redacted]

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

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[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. [redacted] 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. [redacted] 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).

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[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 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.[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

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[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. [redacted]

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February 24, 2017

MEMORANDUM

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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.