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MEMORANDUM

AGENDA ITEM

To: The Commission

Through: Alec Palmer *AP*
Staff Director

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

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Assistant Staff Director
Audit Division

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Audit Manager

By: Robert Morcomb
Lead Auditor

Subject: Audit Hearing for the Republican Party of Orange County (Federal)
(A11-23)

For Hearing of 11-20-14

Attached for your information is a copy of the Draft Final Audit Report (DFAR) and Office of General Counsel legal analysis that was mailed to the Republican Party of Orange County (Federal) (RPOC) on June 20, 2014. Counsel representing RPOC responded to the DFAR on July 8, 2014, and requested a hearing before the Commission to present its case relative to DFAR Finding 4 (Use of Levin Fund Transfers). The hearing was granted on July 10, 2014, and has been scheduled for November 20, 2014.

Finding 4 is based on RPOC's failure to comply with 2 U.S.C. §441i(b)(2)(B)(iv),¹ 11 CFR §§300.31 and 300.34. The Federal Election Campaign Act ("Act") and related regulations require a state, district, or local committee of a party committee to raise all of the Levin funds that it expends. The committee must not use as Levin funds any funds transferred or otherwise provided to the committee by any state, district, local committee of a political party, or national committee of any political party. *Id.*

¹ This provision is now 52 U.S.C. §30125(b)(2)(B)(iv).

In the Interim Audit Report (IAR) presented to RPOC, Finding 4 noted that during fieldwork the Audit staff determined that RPOC made 23 transfers, totaling \$73,465, from its Levin account to its federal accounts and reported these transfers on Schedule H5 (Transfers of Levin Funds Received for Allocated Federal Election Activity). All of the Levin funds² expended by RPOC were received from the California Republican Party's (CRP) Levin account, which transferred \$74,132 to RPOC's Levin account as reimbursement of voter registration expenses. In the IAR, it was also noted that there is no prohibition on the CRP transferring Levin funds to local party committees under 11 CFR §102.6. However, there is a prohibition on the local committees using funds transferred by a state party committee, such as CRP, for either the federal or Levin shares of disbursements allocated between federal and Levin funds.³ In the IAR, the Audit staff asked RPOC to demonstrate that it solely raised the expended Levin funds. Absent such a demonstration, the Audit staff recommended that the Levin funds (\$73,465) transferred to its federal accounts be considered impermissible and refunded back to its Levin account.

In response to the IAR recommendation, RPOC added the \$73,465 on Schedule D (Debts and Obligations) of its 2013 November monthly report as a debt owed to its Levin account. However, RPOC contended that the Commission should not accept this finding. RPOC stated that it is a vendor to the CRP and is its agent in conducting voter registration activities in Orange County. RPOC contended that it operated under the CRP's "Operation Bounty" agreement by which it obtained and was compensated by the CRP on the basis of valid Republican voter registrations verified by the CRP. RPOC stated that the "Operation Bounty" program was a bona fide party building activity which engaged Republican volunteer groups and individual Republican activists in voter outreach. In addition, RPOC added that if the CRP was not able to utilize RPOC as its agent and vendor, it would have to seek alternative, mostly commercial vendors other than local or party committees, which do not offer the collateral party building benefits that the RPOC relationship promotes. RPOC stated that the Commission should allow it to accept and use Levin funds obtained in reimbursement through Operation Bounty as a matter of contract and agency law. Alternatively, RPOC noted that the Commission should not enforce 2 U.S.C. §441i(b)(2)(B)(iv)(I)⁴ because it feels such enforcement would violate the equal protection clause of the Fourteenth Amendment to the Constitution. RPOC believes this would discriminate against a political party and its members for engaging in voter registration political activity using Levin funds received in connection with its contract with the CRP. RPOC further added that such a decision would not apply to other vendors that contract to engage in voter registration activity payable with Levin funds. In conclusion, RPOC contended that CRP was given guidance by the Commission's Reports Analysis Division (RAD) on how to properly reimburse

² The Levin account had a beginning balance of \$10 from a prior period.

³ This matter was addressed in a Request for Commission Directive 69 Guidance involving the Democratic State Central Committee of California (LRA #819) dated April 22, 2011.

⁴ This provision is now 52 U.S.C. §30125(b)(2)(B)(iv)(I).

local committees for voter registrations submitted by RPOC under the Operation Bounty program.⁵

The Audit staff disagrees with RPOC's contentions. Although RPOC considers itself to be an agent and vendor to the CRP, RPOC is itself also a state, district or local party committee. The Act and Commission regulations prohibit the use of Levin funds received from another state or local party. 2 U.S.C. §441i(b)(2)(B)(iv),⁶ 11 CFR §§300.31 and 300.34. Even if RPOC's constitutional argument had merit, the Commission is not authorized to disregard a statutory provision simply because a committee contends that the statute is unconstitutional. RPOC maintained that the statute violates the Equal Protection Clause because it discriminates against state, district, or local political parties who are vendors, and who engage in voter registration activity using Levin funds. Contrary to RPOC's argument, the statute applies equally to all state, district, or local political parties and serves the reasonable and legitimate government interest of preventing circumvention of the soft money ban.

The DFAR concluded that RPOC did not comply with the Audit staff's IAR recommendation by demonstrating that it solely raised the expended Levin funds. RPOC improperly spent \$73,465 on Type I FEA – voter registration activities using Levin funds transferred from CRP. The DFAR further stated that while there is no prohibition on the CRP transferring Levin funds to local party committees under 11 CFR §102.6, there is a prohibition on local committees, such as RPOC, using funds transferred by a state party committee for either the federal or Levin shares of disbursements allocated between federal and Levin funds.

In response to the DFAR, RPOC contested Finding 4 and requested an opportunity for a hearing on this matter. RPOC stated that it agreed to list the expended Levin funds (\$73,465) as a federal account debt and will soon reduce or eliminate this debt with payments from RPOC's federal funds. RPOC stated that it understands the Audit Division's and General Counsel's positions that, as a political party committee, it is subject to the provisions of 2 U.S.C. §441i(b)(2) and 11 CFR §300.31. Further, RPOC provided the following for additional consideration. RPOC stated that there was no evidence of the circumvention of the soft money ban, the principal legal justification by Congress for the Levin interparty transfer ban. Also, RPOC stated that the Commission's acceptance that a state party committee may allocate and pay FEA Type I expenses between its federal and Levin accounts under 11 CFR §102.6 occurred long after the activity in question. RPOC stated that the CRP had obtained informal authorization to make the payments in question to RPOC and did not receive any warning at the time from RAD that the use of such funds would be treated differently.

With respect to the claim about the purported lack of a warning from RAD concerning the use of the funds received from CRP, the Commission should be aware that both CRP and RPOC were duly notified of the circumstances regarding the

⁵ This guidance was based on OGC's legal response to informal queries from RAD received on September 15, 2010 and December 13, 2000.

⁶ This provision is now 52 U.S.C. §30125(b)(2)(B)(iv).

transfers. In July 2011, notification was given to CRP after RAD received Commission guidance it sought under Directive 69. In addition, RPOC itself was put on notice regarding the funds it received from CRP more than a year prior starting with RFAI's sent to RPOC on June 2, 2010.

Documents related to this audit report can be viewed in the Voting Ballot Matters folder. Should you have any questions, please contact Robert Morcomb or Kendrick Smith at 694-1200.

Attachments:

- Draft Final Audit Report of the Audit Division on the Republican Party of Orange County (Federal)
- Office of General Counsel Legal Analysis, dated May 9, 2014
- RPOC Response to Draft Final Audit Report, dated July 8, 2014
- RPOC Additional Response to Draft Final Audit Report, dated July 16, 2014

cc: Office of General Counsel



Draft Final Audit Report of the Audit Division on the Republican Party of Orange County (Federal)

(January 1, 2009 - December 31, 2010)

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 Act (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.¹ 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 any of the matters discussed in this report.

About the Committee (p. 2)

The Republican Party of Orange County (Federal) is a local party committee headquartered in Tustin, California. For more information, see the chart on the Committee organization, p. 2.

Financial Activity (p. 2)

• Receipts	
○ Individual Contributions	\$ 299,234
○ Political Committee Contributions	81,000
○ Transfers from Affiliates	76,923
○ Transfers from Non-federal Accounts	230,078
○ Transfers from Levin Account	73,466
○ Loans Received	6,205
○ Offsets to Operating Expenditures	3,661
Total Receipts	\$ 770,567
• Disbursements	
○ Operating Expenditures	\$ 613,029
○ Federal Election Activity	149,571
○ Contribution Refunds	8,850
○ Loans Repaid	6,205
Total Disbursements	\$ 777,655
• Levin Receipts	\$ 74,132
• Levin Disbursements	\$ 73,465

Findings and Recommendations (p. 3)

- Misstatement of Financial Activity (Finding 1)
- Reporting of Debts and Obligations (Finding 2)
- Recordkeeping for Employees (Finding 3)
- Use of Levin Fund Transfers (Finding 4)

¹ 2 U.S.C. §438(b).

Draft Final Audit Report of the Audit Division on the Republican Party of Orange County (Federal)

(January 1, 2009 – December 31, 2010)



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Part I

Background

Authority for Audit

This report is based on an audit of the Republican Party of Orange County (Federal) (RPOC), 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 2 U.S.C. §438(b), which permits the Commission to conduct audits and field investigations of any political committee that is required to file a report under 2 U.S.C. §434. 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. 2 U.S.C. §438(b).

Scope of Audit

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

1. the disclosure of individual contributors' occupation and name of employer;
2. the disclosure of disbursements, debts and obligations;
3. the disclosure of expenses allocated between federal and non-federal accounts;
4. the consistency between reported figures and bank records;
5. the completeness of records;
6. the disclosure of independent expenditures; and
7. other committee operations necessary to the review.

Commission Guidance

Request for Early Commission Consideration of a Legal Question

Pursuant to the Commission's "Policy Statement Establishing a Program for Requesting Consideration of Legal Questions by the Commission," several state party committees unaffiliated with RPOC requested early consideration of a legal question raised during an audit. Specifically, the Commission addressed whether monthly time logs under 11 CFR §106.7(d)(1) were required for employees paid with 100 percent federal funds.

The Commission concluded, by a vote of 5-1, that 11 CFR §106.7(d)(1), does require committees to keep a monthly log for employees paid exclusively with federal funds. Exercising its prosecutorial discretion, however, the Commission decided it will not pursue recordkeeping violations for the failure to keep time logs or to provide affidavits to account for employee salaries paid with 100 percent federal funds and reported as such. Finding 3, Recordkeeping for Employees, of this audit report does not include RPOC employees paid with 100 percent federal funds and reported as such.

Part II

Overview of Committee

Committee Organization

Important Dates	
• Date of Registration	July 6, 1982
• Audit Coverage	January 1, 2009 - December 31, 2010
Headquarters	
Tustin, California	
Bank Information	
• Bank Depositories	Two
• Bank Accounts	Four Federal, Two Levin and Eight Non-federal
Treasurer	
• Treasurer When Audit Was Conducted	Mark W. Bucher
• Treasurer During Period Covered by Audit	Mark W. Bucher
Management Information	
• Attended Commission Campaign Finance Seminar	No
• Who Handled Accounting and Recordkeeping Tasks	Paid Company

Overview of Financial Activity (Audited Amounts)

Cash-on-hand @ January 1, 2009	\$ 6,092
Receipts	
○ Individual Contributions	299,234
○ Political Committee Contributions	81,000
○ Transfers from Affiliates	76,923
○ Transfers from Non-federal Accounts	230,078
○ Transfers from Levin Account	73,466
○ Loans Received	6,205
○ Offsets to Operating Expenditures	3,661
Total Receipts	\$ 770,567
Disbursements	
○ Operating Expenditures	613,029
○ Federal Election Activity	149,571
○ Contribution Refunds	8,850
○ Loans Repaid	6,205
Total Disbursements	\$ 777,655
Cash-on-hand @ December 31, 2010	(\$ 996)²
Levin Cash-on-hand @ January 1, 2009	\$ 10
Total Levin Receipts	\$ 74,132
Total Levin Disbursements	\$ 73,465
Levin Cash-on-hand @ December 31, 2010	\$ 677

² RPOC overdrawed its bank accounts in the amount of \$996. On January 12, 2011, RPOC's balance was no longer overdrawn.

Part III

Summaries

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

During audit fieldwork, a comparison of RPOC's reported financial activity with its bank records revealed a misstatement of receipts and disbursements for calendar year 2009. RPOC understated its receipts by \$17,420 and disbursements by \$17,420. The misstatements were due mainly to unreported transfers to and from non-federal accounts and unreported in-kind contributions. In response to the Interim Audit Report recommendation, RPOC amended its reports to materially correct the misstatements noted above. (For more detail, see p. 5.)

Finding 2. Reporting of Debts and Obligations

Audit fieldwork indicated that RPOC failed to report debts and obligations for 12 vendors totaling \$60,296 on Schedule D (Debts and Obligations). In response to the Interim Audit Report recommendation, RPOC amended its reports to materially include these debts and obligations. (For more detail, see p. 7.)

Finding 3. Recordkeeping for Employees

During audit fieldwork, the Audit staff determined that RPOC did not maintain monthly payroll logs, as required, to document the percentage of time each employee spent on federal election activity. For 2009 and 2010, the amount of payroll for which logs were required was \$187,281. RPOC reported these payroll disbursements as allocated between federal and non-federal funds.

After audit fieldwork, RPOC provided an affidavit that listed the time spent on federal election activities for each of its employees. In response to the Interim Audit Report recommendation, RPOC stated that, for all future payrolls, it will maintain monthly payroll logs and document the percentage of time each employee spends on federal and non-federal election activity. (For more detail, see p. 8.)

Finding 4. Use of Levin Fund Transfers

During audit fieldwork, a review of Levin fund activity determined that RPOC received \$74,132 from the California Republican Party's Levin account for reimbursement of voter registration expenses. RPOC then transferred \$73,465 from its Levin account to its federal accounts, as reimbursement for voter registration expenses. In accordance with 11 CFR §300.31(a), Levin funds expended must be raised solely by the committee that expends them. In response to the Interim Audit Report recommendation, RPOC disclosed \$73,465 on Schedule D of its 2013 November monthly report as a debt to its Levin account. (For more detail, see p. 9.)

Part IV

Findings and Recommendations

Finding 1. Misstatement of Financial Activity

Summary

During audit fieldwork, a comparison of RPOC's reported financial activity with its bank records revealed a misstatement of receipts and disbursements for calendar year 2009. RPOC understated its receipts by \$17,420 and disbursements by \$17,420. The misstatements were due mainly to unreported transfers to and from non-federal accounts and unreported in-kind contributions. In response to the Interim Audit Report recommendation, RPOC amended its reports to materially correct the misstatements noted above.

Legal Standard

A. Contents of Reports. Each report must disclose:

- the amount of cash-on-hand at the beginning and end of the reporting period;
- the total amount of receipts for the reporting period and for the calendar year;
- the total amount of disbursements for the reporting period and for the calendar year; and
- certain transactions that require itemization on Schedule A (Itemized Receipts) or Schedule B (Itemized Disbursements). 2 U.S.C. §434(b)(1), (2), (3), (4) and (5).

B. Definition of Contribution. Gift, subscription, loan, advance or deposit of money.

- a gift, subscription, loan, advance or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office is a contribution.
- the term anything of value includes all in-kind contributions.
- the provision of any goods or services without charge or at a charge that is less than the usual and normal charge for such goods or services is a contribution. 11 CFR §100.52(a) & (d)(1).

Facts and Analysis

A. Facts

During audit fieldwork, a comparison of RPOC's reported financial activity with its bank records revealed a misstatement of receipts and disbursements for calendar year 2009. The following chart details the discrepancies between RPOC's disclosure reports and its bank records. Succeeding paragraphs explain why the discrepancies occurred.

2009 Activity			
	Reported	Bank Records	Discrepancy
Beginning Cash-on-Hand @ January 1, 2009	\$6,092	\$6,092	\$0
Receipts	\$311,572	\$328,992	(\$17,420) Understated
Disbursements	\$303,419	\$320,839	(\$17,420) Understated
Ending Cash-on-Hand @ December 31, 2009	\$14,245	\$14,245	\$0

The understatement of receipts resulted from the following.

• Under reporting of receipts	\$ 10,631
• In-kind contribution, not reported as a receipt	10,000 ³
• In-kind rent for December, not reported as a receipt	3,904
• Duplicate reported receipt (in-kind contribution)	(5,000) ⁴
• Unexplained difference	(2,115)
Net Understatement of Receipts	<u>\$ 17,420</u>

The understatement of disbursements resulted from the following.

• In-kind contribution, not reported as a disbursement	\$ 10,000
• Disbursements not reported	9,382
• In-kind rent for December, not reported as a disbursement	3,904
• Disbursements over-reported	(866)
• Duplicate reported disbursement (in-kind contribution)	(5,000)
Net Understatement of Disbursements	<u>\$ 17,420</u>

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff provided RPOC's treasurer with workpapers detailing the misstatements. The treasurer asked general questions regarding the reporting requirements.

The Interim Audit Report recommended that RPOC amend its disclosure reports to correct the misstatement of its receipts and disbursements for 2009.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, RPOC amended its reports to materially correct the misstatements.

³ This was a partial payment for a fundraising event.

⁴ RPOC originally reported this as a loan and repayment. It was later reported as an in-kind contribution.

Finding 2. Reporting of Debts and Obligations

Summary

Audit fieldwork indicated that RPOC failed to report debts and obligations for 12 vendors totaling \$60,296 on Schedule D (Debts and Obligations). In response to the Interim Audit Report recommendation, RPOC amended its reports to materially include these debts and obligations.

Legal Standard

A. Continuous Reporting Required. A political committee must disclose the amount and nature of outstanding debts and obligations until those debts are extinguished.

2 U.S.C. §434(b)(8) and 11 CFR §§104.3(d) and 104.11(a).

B. Separate Schedules. A political committee must file separate schedules for debts owed by and to the committee with a statement explaining the circumstances and conditions under which each debt and obligation was incurred or extinguished.

11 CFR §104.11(a).

C. Itemizing Debts and Obligations.

- Once it has been outstanding 60 days from the date incurred, a debt of \$500 or less must be reported on the next regularly scheduled report.
- A debt exceeding \$500 must be disclosed in the report that covers the date on which the debt was incurred. 11 CFR §104.11(b).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff reviewed disbursement records and disclosure reports for proper reporting of debts and obligations. This review identified debts owed to 12 vendors totaling \$60,296 that RPOC failed to report on Schedule D. Of these debts, \$48,636 was incurred during the audit period and \$11,660 was incurred prior to the audit period and remained outstanding as of the beginning of the audit period. It should be noted that RPOC did disclose debts owed to some of these vendors during the audit period. However, the debt amounts identified by the Audit staff above were not included in the debt amounts reported.

B. Interim Audit Report & Audit Division Recommendation

At the exit conference, the Audit staff discussed the reporting of debts and obligations with RPOC's treasurer and provided schedules detailing the transactions requiring disclosure. The treasurer had no comments on this matter.

The Interim Audit Report recommended that RPOC amend its disclosure reports to correctly include debts and obligations of \$60,296 on Schedule D.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, RPOC amended its reports to materially include these debts and obligations. In addition, RPOC stated that it has tightened procedures for reporting accounts payable. RPOC also added that staff and

board members have been informed that all its obligations need to be reported to the treasurer at the time they are incurred.

Finding 3. Recordkeeping for Employees

Summary

During audit fieldwork, the Audit staff determined that RPOC did not maintain monthly payroll logs, as required, to document the percentage of time each employee spent on federal election activity. For 2009 and 2010, the amount of payroll for which logs were required was \$187,281. RPOC reported these payroll disbursements as allocated between federal and non-federal funds.

After audit fieldwork, RPOC provided an affidavit that listed the time spent on federal election activities for each of its employees. In response to the Interim Audit Report recommendation, RPOC stated that, for all future payrolls, it will maintain monthly payroll logs and document the percentage of time each employee spends on federal and non-federal election activity.

Legal Standard

Maintenance of Monthly Logs. Party committees must keep a monthly log of the percentage of time each employee spends in connection with a federal election.

Allocations of salaries, wages, and fringe benefits are to be undertaken as follows:

- Employees who spend 25 percent or less of their compensated time in a given month on federal election activities must be paid either from the federal account or be allocated as administrative costs;
- Employees who spend more than 25 percent of their compensated time in a given month on federal election activities must be paid only from a federal account; and,
- Employees who spend none of their compensated time in a given month on federal election activities may be paid entirely with funds that comply with State law. 11 CFR §106.7(d)(1).

Facts and Analysis

A. Facts

During fieldwork, the Audit staff reviewed payroll disbursements totaling \$187,281.⁵ RPOC did not maintain any monthly payroll logs or equivalent records to document the percentage of time each employee spent in connection with federal election activity. These logs are required to document the proper allocation of federal and non-federal funds used to pay employee salaries and wages. This entire amount (\$187,281) represents payroll disbursements allocated between federal and non-federal funds during the audit period. RPOC had no employees paid exclusively from a non-federal account.

RPOC's staffing consisted of eight individuals all of whom were hired via an employment company. In its reports, RPOC disclosed the purpose of the payroll expenditures as "Leased Employees." In addition, RPOC included a statement in its

⁵ This total does not include payroll for employees paid with 100 percent federal funds (see Part I, Background, Commission Guidance, Request for Early Commission Consideration of a Legal Question, page 1).

reports noting that the time spent on federal election activity and federal campaigns was tracked on a monthly basis and no employee spent 25 percent or more of their compensated time on federal election activity. RPOC did not maintain a monthly time log to support its statement above and as required by 11 CFR §106.7(d)(1).

B. Interim Audit Report & Audit Division Recommendation

At the exit conference and during audit fieldwork, the Audit staff discussed the payroll recordkeeping matter with RPOC's treasurer. At the exit conference, the treasurer provided an affidavit from RPOC's chairman that listed the time spent on federal election activities for its employees. This document, however, did not resolve the recordkeeping finding because RPOC provided the affidavit only after being notified of the recordkeeping requirement during the audit.

The Interim Audit Report recommended that, for all future payrolls, RPOC implement a plan to maintain monthly payroll logs to track the percentage of time each employee spends on federal election activity.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, RPOC stated that, for all future payrolls, it will maintain monthly payroll logs and document the percentage of time each employee spends on federal and non-federal election activity. RPOC stated that it will document the amount of hours spent on federal and non-federal election activity on a semi-monthly basis in a spreadsheet log.

Finding 4. Use of Levin Fund Transfers

Summary

During audit fieldwork, a review of Levin fund activity determined that RPOC received \$74,132 from the California Republican Party's Levin account for reimbursement of voter registration expenses. RPOC then transferred \$73,465 from its Levin account to its federal accounts, as reimbursement for voter registration expenses. In accordance with 11 CFR §300.31(a), Levin funds expended must be raised solely by the committee that expends them. In response to the Interim Audit Report recommendation, RPOC disclosed \$73,465 on Schedule D of its 2013 November monthly report as a debt to its Levin account.

Legal Standard

A. Expending of Levin Funds. Levin funds expended or disbursed by any State, district or local committee must be raised solely by the committee that expends or disburses them. Consequently, funds from national party committees, other State, district and local committees and Federal candidates or officeholders, may not be accepted as Levin funds. 11 CFR §§300.31(a) and 300.34(b). This includes any entity directly or indirectly established, financed, maintained or controlled by any national, State, district or local committee of a political party. 2 U.S.C. §441i(b)(2)(B)(iv).

B. Levin Fund Transfers. A State, district, or local committee of a political party must not use any Federal funds transferred to it from or otherwise accepted by it from any other State, district, or local committee as the Federal component of an expenditure or

disbursement for Federal election activity under 11 CFR §300.32. A State, district, or local committee of a political party must itself raise the Federal component of an expenditure or disbursement allocated between federal funds and Levin funds under 11 CFR §§300.32 and 300.33. 11 CFR §300.34(a).

Levin funds must be raised solely by the State, district, or local committee of a political party that expends or disburses the funds. A State, district, or local committee of a political party must not use as Levin funds any funds transferred or otherwise provided to the committee by any State, district, or local committee of a political party of the national committee of any political party. 11 CFR §300.34(b).

Facts and Analysis

A. Facts

During the audit period, RPOC made 23 transfers, totaling \$73,465, from its Levin account to its federal accounts and reported these transfers on Schedule H5 (Transfers of Levin Funds Received for Allocated Federal Election Activity). All of the Levin funds expended by RPOC⁶ (\$73,465) were received from the California Republican Party's Levin account, which transferred \$74,132 to RPOC's Levin account.

While there is no prohibition on the California Republican Party (CRP) transferring Levin funds to local party committees under 11 CFR §102.6, there is a prohibition on local committees using funds transferred by a state party committee for either the federal or Levin shares of disbursements allocated between federal and Levin funds.⁷ As such, RPOC did not meet the requirement that the Levin funds must be raised solely by the committee that expends or disburses the funds.

B. Interim Audit Report & Audit Division Recommendation

At the entrance and exit conferences, the Audit staff discussed this matter with RPOC's treasurer. The treasurer had no comments regarding this matter.

The Interim Audit Report recommended that RPOC demonstrate that it solely raised the expended Levin funds. Absent such demonstration, it was recommended that RPOC refund its Levin account \$73,465 from its federal account and provide evidence of this refund.

C. Committee Response to Interim Audit Report

In response to the Interim Audit Report recommendation, RPOC added the Levin fund transfers (\$73,465) to its Schedule D on the 2013 November monthly report, as a debt owed to its Levin account.⁸

However, RPOC contends that the Commission should not accept this finding. RPOC stated that it is a vendor to CRP and its agent in conducting voter registration activities in

⁶ RPOC had a beginning cash balance of \$10 in its Levin account that was not transferred from the California Republican Party.

⁷ This matter was addressed in a Request for Commission Directive 69 Guidance involving the Democratic State Central Committee of California (LRA #819) dated April 22, 2011.

⁸ As of April 30, 2014, this amount remains outstanding on Schedule D and the reported cash-on-hand balance is \$3,802.

Orange County. RPOC noted that it has operated under the CRP's "Operation Bounty" agreement by which RPOC is compensated by the CRP on the basis of valid Republican voter registrations it obtains and which the CRP verifies as valid voter registrations throughout each election cycle. RPOC stated that, for the 2010-2011 election cycle, this included registrations obtained outside the Federal Election Activity (FEA), Type II⁹ period, as well as, registrations obtained during the FEA, Type II period. RPOC stated that it received consideration in the form of payment per valid registration to defray its cost in obtaining, processing, verifying and submitting the voter registrations to CRP through the Operation Bounty program. RPOC contends that without the Operation Bounty reimbursement, it would be less likely and able to conduct effective voter registrations using the volunteer resources of Republican volunteer organizations, groups and activists. Further, RPOC stated that the Operation Bounty program is a bona fide party building program, which engages Republican volunteer groups and individual Republican activists in voter outreach, voter communication and spreading the Republican identification and brand in the community. It further added that if the CRP was not able to utilize the RPOC as its agent and vendor, CRP would have to seek alternatives, such as commercial vendors, which do not offer the collateral party building benefits that the RPOC-CRP relationship promotes.

RPOC contests whether this finding should be approved by the Commission on both statutory and constitutional grounds. RPOC stated that it is not prohibited from using non-federal funds transferred by a State, local or district committee of a political party to reimburse its federal account for a portion of expenses for voter registration conducted outside the FEA, Type II period as set forth in Commission regulation 11 CFR §300.32(b)(1)(i). Also, a State, local or district committee of a political party is not prohibited from paying vendors other than another State, local or district committee of a political party using Levin funds for voter registration activity during the FEA, Type II period under 11 CFR §300.32(b)(1)(i).

In conclusion, RPOC stated that the Commission should allow it to accept and use Levin funds obtained in reimbursement through Operation Bounty as a matter of contract and agency law. Alternatively, RPOC also noted that the Commission should not enforce 2 U.S.C. §441i(b)(2)(iv)(I) because it feels such enforcement would violate the equal protection clause of the Fourteenth Amendment to the United States Constitution. RPOC believes this would discriminate against a political party and its members for engaging in voter registration political activity using Levin funds received in connection with its contract with the CRP. RPOC further added that such a decision would not apply to other vendors that contract to engage in voter registration activity payable with Levin funds.

⁹ The Audit staff believes RPOC is actually referring to FEA, Type I. These are voter registration activities conducted by a state or local political party committee within a period starting 120 days before the date of a scheduled federal election and ending on the date of the election. The FEA, Type I periods were 2/08/10 – 6/08/10 for the 2010 CA Primary election and 7/05/10 – 11/02/10 for the 2010 General election.

RPOC stated that guidance provided by the Commission's Reports Analysis Division and the CRP Final Audit Report of the Commission both confirm payments to local committees for voter registration activities were within the statute and the regulations. The Audit staff does not dispute this fact. CRP transferred Levin funds to RPOC, which is not prohibited by the Act. However, RPOC used the transferred funds for Type I FEA - voter registration activities, which is not permitted under 11 CFR §300.31(a). This is the distinction between the activities performed by these two committees.

Based on the above, the Audit staff considers that RPOC improperly spent \$73,465 on Type I FEA - voter registration activities using Levin funds transferred from CRP.



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

May 9, 2014

MEMORANDUM

TO: Patricia C. Orrock
Chief Compliance Officer

Thomas E. Hintermister
Assistant Staff Director
Audit Division

FROM: Lisa J. Stevenson *LJ Stevenson*
Deputy General Counsel - Law

Lorenzo Holloway *LH*
Assistant General Counsel
Compliance Advice

Margaret J. Forman *MJF*
Attorney

SUBJECT: Proposed Draft Final Audit Report on the Republican Party of Orange County
(Federal) (LRA 909)

I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("DFAR") on the Republican County of Orange County (Federal) ("RPOC"). The DFAR contains four findings: Misstatement of Financial Activity (Finding 1); Reporting of Debts and Obligations (Finding 2); Recordkeeping for Employees (Finding 3); and Use of Levin Fund Transfers (Finding 4). We concur with the findings and comment only on the Use of Levin Fund Transfers (Finding 4) below. If you have any questions, please contact Margaret J. Forman, the attorney assigned to this audit.

II. A STATE PARTY MAY NOT USE LEVIN FUNDS TRANSFERRED FROM ANOTHER STATE PARTY

In Finding 4 of the proposed DFAR, the Audit Division determined that RPOC received \$74,132 from the California Republican Party's (CRP's) Levin account for reimbursement of RPOC's voter registration expenses, and then transferred \$73,465 from its Levin account to its federal accounts as reimbursement for the voter registration expenses.¹ Since the Federal Election Campaign Act, as amended (the "Act"), requires that state party committees raise all of the Levin funds that it expends, 2 U.S.C. § 441i(b)(2)(B)(iv), the Audit Division recommended that RPOC demonstrate that it solely raised the expended Levin funds, or refund to its Levin account \$73,465 from its federal account. In response to the Interim Audit Report recommendation, RPOC added \$73,465 in Levin fund transfers on Schedule D of its 2013 November monthly report as a debt to its Levin account, apparently because it did not have the cash reserves to make the refund.

Although the RPOC indicates its intent to refund its Levin account in accordance with the recommendation in the proposed DFAR, it "contends that the Commission should not accept [the Use of Levin Fund Transfers] Finding ... and instead should not penalize the Committee." Correspondence from the Republican Party of Orange County to Mr. Robert Morcomb, Federal Election Commission (Nov. 22, 2013) at 2. RPOC asserts two reasons in support of its position. First, RPOC states that it is the California Republican Party's "agent and vendor" for party building activities, asserting that "the Commission should allow the RPOC to accept and use Levin funds obtained in reimbursement under the 'Operation Bounty' contract between the RPOC and the California Republican Party as a matter of contract and agency law." *Id.* at 2-3. In support of its position, RPOC states that a committee may use non-federal funds transferred to it by another State, local or district committee of a political party for part of the expenses associated with voter registration, which are conducted outside the Federal election activity ("FEA") period in 11 CFR § 300.32(b)(1)(i), and that a State, local or district committee of a political party may pay vendors that are not a State, local or district committee of a political party with Levin funds for voter registration activity during the FEA period under 11 CFR § 300.32(b)(1)(i). *Id.* at 3. Second, RPOC states that the Commission should not enforce the statutory prohibition against using Levin funds from any other State, local or district committee of any State party because it would violate the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution. *Id.* at 3.

We disagree with both of RPOC's arguments. First, while the RPOC may be an agent or vendor to the CRP, RPOC is itself also a State, district, or local party committee. The Act and Commission's regulations prohibit the use of Levin funds received from another state or local party.² The ability to use Levin funds is subject to a number of conditions described at 2 U.S.C. § 441i(b)(2)(B). Among these is a requirement that no person donate more than \$10,000 in Levin funds to a State, district, or local committee of a political party in a calendar year.

¹ Voter registration activities conducted by a state or local political party committee within a period starting 120 days before the date of a scheduled federal election and ending on the date of the election are considered so-called "Type I" Federal election activity. *See* 2 U.S.C. § 431(20)(A)(i).

² There is no prohibition against a state or local party committee making or receiving transfers of Levin funds. The prohibition pertains to the use of such funds.

2 U.S.C. § 441i(b)(2)(B)(iii); *see* 11 C.F.R. § 300.31(d)(1)-(2). Additionally, and to prevent circumvention of the \$10,000 contribution limitation, another requirement is that “the amounts expended or disbursed are made solely from funds raised by the State, local, or district committee which makes such expenditure or disbursement, and do not include any funds provided to such committee from ... any other State, local, or district committee of any State party[.]”

2 U.S.C. § 441i(b)(2)(B)(iv)(I). The RPOC, therefore, may not spend Levin funds transferred to it from the CRP. *Id.*; *see* 11 C.F.R. § 300.31(a) (Levin fund expended or disbursed by any State, district, or local committee must be raised solely by the committee that expends or disburses them); *Explanation and Justification for 11 CFR 300.31 Receipt of Levin Funds*, 67 Fed. Reg. 49064, 49094 (Jul. 29, 2002) (“Paragraph (a) states as a general proposition a key point in the statute: a State, district, or local political party committee that spends Levin funds must raise those funds solely by itself.”); *see* 11 C.F.R. § 300.34(b) (Levin funds must be raised solely by the State, district or local committee of a political party that expends or disburses the funds. A State, district, or local committee of a political party must not use as Levin funds any funds transferred or otherwise provided to the committee by ... [a]ny other State, district, or local committee of any political party, any officer or agent acting on behalf of such a committee, or any entity directly or indirectly established, financed, maintained or controlled by such a committee”).

Congress generally intended to prevent circumvention of the soft money ban when it passed restrictions prohibiting national party committees from soliciting, receiving, directing or spending any funds not subject to the limitations, prohibitions, and reporting requirements of the Act. *See McConnell v. FEC*, 540 U.S. 93, 95-96 (2003); 2 U.S.C. § 441i(a)(1). Congress predicted that the ban on the national committees’ receipt and use of soft money could shift the focus to state party committees. *Id.* at 97-98. Therefore, Congress also placed a restriction on state party committees’ ability to use of soft money contributions to influence Federal elections. 2 U.S.C. § 441i(b)(1). There is an exception to this restriction: the Levin Account. The Levin Account allows state party committees to pay for Federal election activity with a mix Federal and nonfederal funds, but there is a \$10,000 contribution limitation to the Levin Account. 2 U.S.C. §§ 441i(b)(1)(A) and (B). “Without the ban on transfers of Levin funds among state committees, donors could readily circumvent the \$10,000 limit on contributions to a committee’s Levin account by making multiple \$10,000 donations to various committees that could then transfer the donations to the committee of choice.” *McConnell v. FEC*, 540 U.S. at 171-172. Therefore, the RPOC must only use Levin funds it raises itself, in order to comply with the overall statutory scheme, as intended by Congress, to prevent circumvention of the soft money ban.

Second, the RPOC also asserts that enforcement of this statutory provision would violate the Equal Protection Clause of the Fourteenth Amendment to the U.S. Constitution. The RPOC’s argument rests on the proposition that enforcement of the Levin fund restrictions would discriminate “against a political party and its members for engaging in voter registration political activity using Levin funds received in connection with its contract with the California Republican Party that is not applied to other vendors that contract to engage in voter registration activity that is payable with Levin funds, without constitutional justification.” Correspondence from the Republican Party of Orange County at 3. RPOC, therefore, urges the Commission not to enforce this statutory prohibition.

Even if RPOC's constitutional argument had merit, which it does not, the Commission is not authorized to disregard a statutory provision simply because a committee contends that the statute is unconstitutional. *Johnson v. Robison*, 415 U.S. 361, 368 (1974) (noting that adjudication of constitutionality is generally outside administrative agency's authority); *Robertson v. FEC*, 45 F.3d 486, 489 (D.C. Cir. 1995) ("It was hardly open to the Commission, an administrative agency, to entertain a claim that the statute which created it was in some respect unconstitutional."); *Meredith Corp. v. FCC*, 809 F.2d 863, 872 (D.C. Cir. 1987) (noting the "well known principle that regulatory agencies are not free to declare an act of Congress unconstitutional").

Even if the Commission had such authority to determine the constitutionality of a statutory provision, the statute at issue here is plainly constitutional.³ The RPOC maintains that the statute violates the Equal Protection Clause because it discriminates against state, district, or local political parties who are vendors, and who engage in voter registration activity using Levin funds. Correspondence from the Republican Party of Orange County at 3. Yet, contrary to RPOC's argument, the statute applies equally to all state, district, or local political parties and serves the reasonable and legitimate government interest of preventing circumvention of the soft money ban, discussed *supra*.

³ In the context of the First Amendment, the U.S. Supreme Court has recognized the constitutionality of the transfer restrictions involving Levin Funds as "justifiable anticircumvention measures," even though these restrictions created some burdens on associational freedoms. *McConnell v. FEC*, 540 U.S. 93, 171 (2003).

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Attorneys and Counselors at Law

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July 8, 2014

BY ELECTRONIC MAIL AND U.S. MAIL

Federal Election Commission
Audit Division
Kendrick Smith
999 E Street, NW
Washington, DC 20463
EM: Audit@fec.gov; Ksmith@fec.gov

Re: Draft Final Audit Report (DFAR) – Republican Party of Orange County (Federal)

Dear Mr. Smith:

The Republican Party of Orange County (Federal) (RPOC) contests Finding No. 4 in the DFAR and requests an opportunity for a hearing on this matter. Due to the impending 2014 election schedule, RPOC respectfully requests that any such hearing be held after the November 2014 general election.

RPOC notes that it agreed to list as a federal account debt the \$73,465 in Levin Fund disbursements noted in the DFAR, and will soon reduce or eliminate that debt with payments from the RPOC's federal funds. RPOC understands the Audit Division's and General Counsel's positions that as a political party committee, it is subject to the provisions of 2 USCA 441i(b)(2) and 11 CFR 300.31(a), RPOC further notes that:

- (1) There is no evidence whatsoever of circumvention by any donor to RPOC of the \$10,000 Levin Fund limits, the principal legal justification by Congress, accepted by the Supreme Court in *McConnell v. Federal Election Commission*, 530 U.S. 93, 171 (2003) for the Levin interparty transfer ban. Indeed, the DFAR at p. 10, fn. 6 and 8, notes that RPOC had raised little if any Levin funds other than the CRP payments for voter registrations;
- (2) The RPOC provided Republican voter registrations to the California Republican Party for "fair (equal) consideration" pursuant to the Operation Bounty voter registration agreement noted in the DFAR at pp. 10-11, not as a general transfer or subvention of RPOC's operating funds. RPOC finds it anomalous that a state party committee would be permitted to transfer Levin funds to a subordinate party

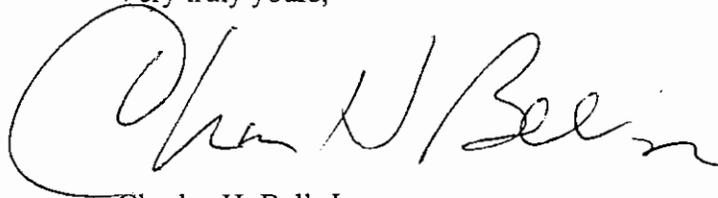
Federal Election Commission
Audit Division
Kendrick Smith
EM: Audit@fec.gov; Ksmith@fec.gov
July 8, 2014
Page 2

committee but the subordinate party committee would be precluded from actually using the Levin funds for “Levin” purposes.¹

- (3) RPOC notes that the Commission’s apparent acceptance of the concept that a state party committee may allocate and pay FEA Type 1 expenses between its federal and Levin accounts under 11 CFR 102.6 (in April 2011) occurred long after the activity in question here. RPOC understood from CRP that the CRP had obtained informal authorization to make the payments in question to RPOC (among others), and did not receive any warning at the time from RAD that the use of such funds would be treated differently.

RPOC will ask the Commission to consider alternatives to enforcement action in light of the arguments made in its November 22, 2013 letter to the Audit Division and the foregoing information and comments.

Very truly yours,

A handwritten signature in cursive script, appearing to read "Charles H. Bell, Jr.", written in black ink.

Charles H. Bell, Jr.
Counsel to RPOC (Federal)

¹ The General Counsel’s Analysis may have misunderstood RPOC’s equal protection argument. The argument was premised on the different treatment accorded subordinate party committees that engage in FEA, Type 1 activity acting as vendors to state party committees, than accorded non-political party commercial vendors that provide voter registration services to state party committees.

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July 16, 2014

BY ELECTRONIC MAIL AND U.S. MAIL

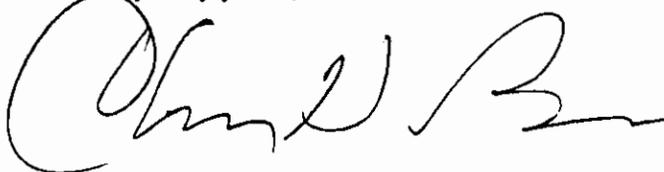
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Re: Draft Final Audit Report (DFAR) – Republican Party of Orange County (Federal)

Dear Mr. Smith:

This is to clarify the July 8, 2014 response to the Audit Division's DFAR at page 2 where we noted that RPOC "did not receive any warning at the time from RAD that the use of such funds would be treated differently" (referring to the CRP's informal advice at the time from the Commission. RPOC received RFAs from the Commission related to the Levin fund issue, which identified the Levin fund receipts and included a statement that the problem could be resolved by transfers-out. As RPOC's Form 99 submissions in response to the RFAs in September 2010 and January 2011 stated, RPOC believed the transfers were permissible. RPOC does not recall any further response from the Commission to the Form 99 responses it filed.

Very truly yours,

A handwritten signature in black ink, appearing to read "Charles H. Bell, Jr.", written in a cursive style.

Charles H. Bell, Jr.
Designated Counsel to RPOC (Federal)