FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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AGENDA ITEM

For Hearing of 11-2-15

MEMORANDUM

TO: The Commission

FROM: Lisa J. Stevenson
Deputy General Counsel - Law

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For Compliance Advice

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Attorney

SUBJECT: Oral Hearing on Gary Johnson 2012, Inc. (LRA 905)

I. INTRODUCTION

The oral hearing on the Commission's repayment determination for Gary Johnson 2012, Inc. ("the Committee") is scheduled for November 2, 2015 at 4:00 p.m. To assist the Commission in preparing for the hearing, the Office of the General Counsel ("OGC") is submitting this memorandum, which outlines the arguments raised in the Committee's request for administrative review.[1] If you have any questions, please contact Joshua Blume, the attorney assigned to this administrative review.

On July 6, 2015, the Commission determined that Gary Johnson ("the Candidate") and the Committee must repay $332,191 to the United States Treasury for primary matching funds spent on non-qualified campaign expenses. *See* Attachment 1 (Final Audit Report of the Commission on Gary Johnson 2012, Inc., approved July 6, 2015 (the "FAR")). The Committee seeks administrative review of the Commission's repayment determination and has requested this hearing. *See* Attachment 2 (Letter from Committee Regarding Repayment Determination for Gary Johnson 2012 Inc., dated September 4, 2015). The principal question presented by the Committee's challenge to the repayment determination is whether the Commission may use a mathematical formula set forth in 11 C.F.R. § 9038.2(b)(2)(iii) to calculate the repayment of public funds when the Committee has segregated accounts for public and private funds.

[1] OGC will provide the Committee with a copy of this memorandum prior to the oral hearing.

II. BASIS FOR THE COMMISSION'S REPAYMENT DETERMINATION

By way of background, as a publicly-financed committee for the 2012 presidential primary election, the Committee had two sources of financing for that election: (1) public matching funds from the United States Treasury, and (2) private contributions from individual contributors that were designated for the primary election. Based upon the Audit Division's review, the Committee deposited these funds into two separate accounts. The Committee deposited its public funds into its primary election account and it deposited its private contributions into its general election account. The Commission found in the FAR that the Committee spent a mixed pool of public and private primary funds in the amount of $1,199,701 on general election expenses. Thus, these were non-qualified campaign expenses. Under the Presidential Primary Matching Payment Account Act, 26 U.S.C. §§ 9031 et seq. (the "Matching Payment Act"),[2] and Commission regulations, committees are required to repay public funds that were used to defray non-qualified campaign expenses. 26 U.S.C. § 9038(b)(2); 11 C.F.R. § 9038.2(b)(2).

To calculate the amount the Committee must repay, the Commission used a formula set forth in the Commission's regulations for determining the fraction of total spending on non-qualified campaign expenses that may reasonably be attributed to the spending of public funds, as opposed to private contributions. 11 C.F.R. § 9038.2(b)(2)(iii) (the "repayment ratio"). Under this provision, the amount of repayment is in the same ratio to the total amount spent on non-qualified campaign expenses as the ratio of matching funds certified to the candidate bears to the candidate's total deposits. "Total deposits," for the purpose of applying this regulation, means "*all deposits to all candidate accounts* minus transfers between accounts, refunds, rebates, reimbursements, checks returned for insufficient funds, proceeds of loans, and other similar amounts." 11 C.F.R. § 9038.3(c)(2) (emphasis added). To calculate the total deposits, the Commission included the public funds and the private contributions designated for the primary election that were deposited both in the Committee's primary and its general election accounts.

The Commission adopted this repayment ratio to calculate the amount of public funds used to defray non-qualified campaign expenses in response to a decision of the United States Court of Appeals for the District of Columbia Circuit, *Kennedy for President Committee v. Federal Election Commission*, 734 F.2d 1558 (D.C. Cir. 1984). The *Kennedy* decision invalidated an earlier Commission regulation which presumed that 100 percent of a publicly-funded committee's spending on non-qualified campaign expenses was made with public funds. *Kennedy for President Cmte.*, 734 F.2d at 1559-60 ("The Commission's regulation, however, on its face and as applied to the Kennedy for President Committee in this case, indulges the unreasonable presumption that *all* unqualified expenditures are paid out of federal matching funds.") (emphasis in original). The *Kennedy* decision held that this approach was *ultra vires* because the controlling statute, 26 U.S.C. § 9038(b)(2), limits the repayment determination to the amount of public funds spent on non-qualified campaign expenses.

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[2] The Committee's Request for Administrative Review characterizes the Commission's action as inconsistent with the Federal Election Campaign Act of 1971, as amended. Attachment 2, at 1. However the Committee presumably intended to refer to the Matching Payment Act insofar as this is the relevant source of law for the repayment obligation.

At the same time, the *Kennedy* court noted that 26 U.S.C. § 9038(b)(2) delegates to the Commission the task of estimating the proportion of total spending for non-qualified purposes that is attributable to the use of public funds, but does not specify a particular method for doing so. Thus, the Commission has discretion to design an approach that will enable it to adhere to the statutory mandate as the *Kennedy* court conceived it. *Kennedy for President Cmte.*,734 F.2d at 1563.

Following the *Kennedy* decision, the Commission adopted the repayment ratio which the Committee now challenges in its application. In adopting the repayment ratio methodology, the Commission relied upon the Court's recognition that the repayment determination may never be perfectly accurate because, in practicality, public funds and private funds are "commingled in the candidate's coffers." *Kennedy for President Cmte.*, 734 F.2d at 1562. *See Explanation and Justification for Final Rule on Repayments by Publicly Financed Presidential Candidates*, 50 Fed. Reg. 9421 (Mar. 8, 1985) ("The use of such formulas is consistent with the [*Kennedy*] court's opinion, which does not require a mathematically precise determination of the amount of the Federal funds spent improperly but only a reasonable determination of the amount of Federal matching funds so used.").

The Commission has since applied the repayment ratio in several audit matters involving situations in which public funds and private funds were in different accounts. *See* Final Report of the Audit Division on LaRouche Democratic Campaign (approved May 17, 1990), at 8; Final Report of the Audit Division on Albert Gore, Jr. for President Committee, Inc. (approved July 13, 1989), at 11; Final Report of the Audit Division on the Tsongas Committee, Inc. (approved Dec. 16, 1994), at 65-66; Statement of Reasons, Senator Robert Dole and the Dole for President Committee (approved Feb. 6, 1992), at 24-25.

III. THE COMMITTEE SEEKS ADMINISTRATIVE REVIEW OF THE COMMISSION'S REPAYMENT DETERMINATION

The Committee's request for administrative review raises two issues it wishes to discuss at the oral hearing. First, the Committee argues that the Commission's application of the repayment ratio to the public and private primary funds in the Committee's segregated bank accounts is inconsistent with both the Matching Payment Act, specifically, 26 U.S.C. § 9038(b)(2), and the *Kennedy* decision. Attachment 2, at 1-4. Second, the Committee argues that the Commission's repayment determination is an inappropriately disproportionate response to a minor oversight of the Committee with respect to its published contribution solicitation language. Attachment 2, at 4. We summarize the Committee's contentions regarding each of these points below.

A. The Committee Contends that Applying the Repayment Ratio to Segregated Accounts Is Inconsistent with the Matching Payment Act

The Committee argues that the Commission's application of the repayment ratio to the segregated accounts is inconsistent with the Matching Payment Act. First, the Committee contends that the *Kennedy for President* decision interpreted 26 U.S.C. § 9038(b)(2) to require the

Commission to make a reasonable determination of the amount of public matching funds spent on non-qualified campaign expenses and to limit its repayment determination to that amount. Attachment 2, at 1; *Kennedy for President Cmte.*, 734 F.2d at 1561. The Committee argues further that the *Kennedy* decision is not authority for the proposition that public funds and private funds comprise a mixed pool as a matter of law, but rather the decision speaks only of making a reasonable estimate of the matching funds used in the context of the facts of that case – where the Kennedy for President committee's funds were mixed as a matter of fact. Attachment 2, at 2.

The Committee argues that the Commission's reliance upon a presumption that all funds belong to a mixed pool for the purpose of applying the repayment ratio does not result in a reasonable determination of the amount of matching funds used, and is therefore inconsistent with the *Kennedy* decision. Attachment 2, at 2. The Committee contends that only if the funds were in fact commingled would it be proper to include all of the total deposits in the repayment ratio, but that was not the case here. *Id.*

Second, the Committee argues that applying the presumption of commingling is inconsistent with 26 U.S.C. § 9038(b)(2) because that provision expressly limits the repayment obligation to amounts spent on non-qualified campaign expenses that were paid from the matching payment account. Attachment 2, at 3. In this context, the Committee refers to an argument that OGC made during the audit phase of this matter, wherein OGC argued that absent the Commission's application of the presumption, publicly-funded committees would be able to evade repayment obligations simply by segregating their private and public funds. *Id. See also* Office of the General Counsel Comments on Audit Division Recommendation Memorandum on Gary Johnson 2012, Inc. (LRA 905), at 6 (June 3, 2015). The Committee contends that while this argument is correct, it is inconsequential because section 9038(b)(2) does not address the spending of private funds on non-qualified campaign expenses. Attachment 2, at 3. Rather, the Committee contends that the Commission's action collapses the distinction between private and public funds. *Id.*

The Committee also argues that the only circumstance under which repayment is appropriate where only private primary contributions are spent on non-qualified campaign expenses is where the amount improperly spent exceeds a committee's deficit. *Kennedy for President Committee*, 734 F.2d at 1564-65 n.10. Here, because the FAR concludes that the Committee did not receive matching funds in excess of its entitlement and the Committee therefore had a deficit even when accounting for the spending of primary funds on non-qualified campaign expenses, the Commission may only pursue repayment based on 26 U.S.C. § 9038(b)(2), rather than on theories embodied in subsections (1) (receipt of matching funds exceeding entitlement) and (3) (repayment based on surplus funds). 26 U.S.C. § 9038(b)(1)-(3). However, subsection (2) allows only for recovery of public funds spent on non-qualified campaign expenses. Attachment 2, at 3.

B. Committee Contends That the Repayment Determination Is Unreasonable Given that It Was Caused by the Committee's Minor Oversight

The Committee also argues that the Commission's repayment determination is unreasonable because the non-qualified campaign spending found in the Final Audit Report was caused by an alleged minor oversight on the Committee's part which resulted in erroneous designation language in its solicitations. Attachment 2, at 4. The Committee contends that it would not have incurred non-qualified campaign expenses if the solicitation language had been corrected because the funds identified as primary election funds would have been properly designated as general election funds instead. Attachment 2, at 4.

The Committee believes that the funds at issue would have been general election funds if had used the correct language in its solicitations. The Committee refers to language that it had included in its solicitations of contributions that had the effect of designating portions of each contribution toward the primary and the general elections, respectively. Throughout both election periods, this language indicated that the first $2,500 of each contribution would be considered as designated for the primary election. However, the Committee contends that it had intended to change this language so that only the first $250 of each contribution would be considered designated toward the primary election, and that during the election periods it acted in accordance with this understanding. *See* Statement of Reasons in Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA 905) (Nov. 14, 2013); Memorandum from Audit Division to the Commission on Audit Division Recommendation Memorandum on Gary Johnson 2012, Inc., at 2 (June 4, 2015). The Committee argues that the repayment determination represents a disproportionate response to the Committee's oversight and that section 9038 was not intended to be used as a remedy for violations of the disclaimer rules. Attachment 2, at 4.

Attachments

1. Final Audit Report of the Commission on Gary Johnson 2012, Inc., approved July 6, 2015.

2. Letter from Committee Regarding Repayment Determination for Gary Johnson 2012 Inc., dated September 4, 2015.

Final Audit Report of the Commission on Gary Johnson 2012, Inc

(April 1, 2011 – November 30, 2014)

Why the Audit Was Done

Federal law requires the Commission to audit every political committee established by a candidate who receives public funds for the primary campaign.[1] The audit determines whether the candidate was entitled to all of the matching funds received, whether the campaign used the matching funds in accordance with the law, whether the candidate is entitled to additional matching funds, and whether the campaign otherwise complied with the limitations, prohibitions, and disclosure requirements of the election law.

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 Campaign (p. 3)

Gary Johnson 2012, Inc is the principal campaign committee for Gary Johnson, a candidate for the Libertarian Party nomination for the office of President of the United States. The Committee is headquartered in Salt Lake City, Utah. For more information, see the chart on the Campaign Organization, p. 3.

Financial Activity (p. 4)

• **Receipts**	
o Contributions from Individuals	$ 2,249,318
o Matching Funds Received	510,261
Total Receipts	**$ 2,759,579**
• **Disbursements**	
o Operating Expenditures	$ 2,534,497
o Fundraising Disbursements	153,019
o Exempt Legal and Accounting Disbursements	28,130
Total Disbursements	**$ 2,715,646**

Commission Findings (p. 5)

- Net Outstanding Campaign Obligations (Finding 1)
- Amounts Owed to the U.S. Treasury (Finding 2)
- Use of General Election Contributions for Primary Election Expenses (Finding 3)
- Reporting of Debts and Obligations (Finding 4)

Additional Issue (p. 6)

- Extension of Credit by a Commercial Vendor

[1] 26 U.S.C. §9038(a).

Final Audit Report of the Commission on Gary Johnson 2012, Inc

(April 1, 2011 – November 30, 2014)

ATTACHMENT 1
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Part I
Background

Authority for Audit
This report is based on an audit of Gary Johnson 2012, Inc (GJ2012), undertaken by the Audit Division of the Federal Election Commission (the Commission) as mandated by Section 9038(a) of Title 26 of the United States Code. That section states, "After each matching payment period, the Commission shall conduct a thorough examination and audit of the qualified campaign expenses of every candidate and his authorized committees who received [matching] payments under section 9037." Also, Section 9039(b) of the United States Code and Section 9038.1(a)(2) of the Commission's Regulations state that the Commission may conduct other examinations and audits from time to time as it deems necessary.

Scope of Audit
This audit examined original and amended reports filed by GJ2012 before the audit notification letter was sent on December 3, 2012.[2] The audit also examined the original filings of the 2012 30 Day Post-General and Year-End reports. The following areas were covered by this audit:
1. the campaign's compliance with limitations for contributions and loans;
2. the campaign's compliance with the limitations for candidate contributions and loans;
3. the campaign's compliance with the prohibition on accepting prohibited contributions;
4. the disclosure of contributions received;
5. the disclosure of disbursements, debts and obligations;
6. the consistency between reported figures and bank records;
7. the accuracy of the Statement of Net Outstanding Campaign Obligations;
8. the campaign's compliance with spending limits;
9. the completeness of records; and
10. other campaign operations necessary to the review.

Inventory of Campaign Records
The Audit staff routinely conducts an inventory of campaign records before it begins audit fieldwork. GJ2012's records were materially complete and fieldwork commenced immediately.

Committee Structure
GJ2012 was the only campaign committee authorized by Gary Johnson, the Candidate, for the 2012 Presidential election. This committee conducted both primary and general election activity for the Candidate. GJ2012 opened two bank accounts: a primary account and a general account. In practice, GJ2012 deposited nearly all contributions

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[2] Amendments filed after December 3, 2012, were given a limited review to determine if issues noted in the Preliminary Audit Report were corrected by GJ2012.

received before the Candidate's nomination in the primary account, and most contributions received after the nomination in the general account. GJ2012 received matching funds for the primary campaign and this audit covered committee activity and information obtained to determine whether or not expenses were qualified campaign expenses defrayed in connection with the primary election.

Audit Hearing

GJ2012 requested an audit hearing. The request was granted and the hearing was held on May 13, 2015. At the hearing, GJ2012 addressed issues related to Findings 2, 3 and 4 (pp. 12 through 25), and the Additional Issue (p. 26).

Part II
Overview of Campaign

Campaign Organization

Important Dates	
• Date of Registration	April 22, 2011
• Date of Ineligibility[3]	May 5, 2012
• Audit Coverage	April 1, 2011 - November 30, 2014[4]
Headquarters	Salt Lake City, Utah
Bank Information	
• Bank Depositories	One
• Bank Accounts	One primary checking account and one general checking account
Treasurer	
• Treasurer When Audit Was Conducted	Chet Goodwin
• Treasurer During Period Covered by Audit	Elizabeth Hepworth (4/22/11 – 1/4/12) Chet Goodwin (1/5/12 – Present)
Management Information	
• Attended Commission Campaign Finance Seminar	No
• Who Handled Accounting and Recordkeeping Tasks	Paid Staff

[3] A threshold submission was submitted on April 26, 2012, and the Commission certified the Candidate as eligible to receive matching funds on May 24, 2012. The period during which the Candidate was eligible for matching funds ended on May 5, 2012, his date of ineligibility (DOI). However, GJ2012 submitted contributions for matching funds it had received before DOI. Due to the campaign's outstanding debt, GJ2012 was able to submit primary election contributions received after DOI for matching as well.

[4] The Audit staff conducted limited reviews of receipts and expenditures after December 31, 2012 to determine whether the Candidate was eligible to receive additional matching funds.

Overview of Financial Activity
(Audited Amounts)

Cash-on-hand @ April 1, 2011	**$ 0**
Receipts	
o Contributions from Individuals[5]	2,249,318
o Matching Funds Received[6]	510,261
Total Receipts	**$ 2,759,579**
Disbursements	
o Operating Expenditures	2,534,497
o Fundraising Disbursements	153,019
o Exempt Legal and Accounting Disbursements	28,130
Total Disbursements	**$ 2,715,646**
Cash-on-hand @ December 31, 2012	**$ 43,933**

[5] GJ2012 received approximately 24,500 contributions from more than 1,400 individuals.

[6] As of the Candidate's DOI (May 5, 2012), GJ2012 had received no matching funds. GJ2012 received 6 payments totaling $632,017 as of January 8, 2013.

Part III
Summaries

Commission Findings

Finding 1. Net Outstanding Campaign Obligations

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report.

The Commission approved a finding that the Candidate did not receive matching funds in excess of his entitlement. (For more detail, see p. 8.)

Finding 2. Amounts Owed to the U.S. Treasury

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion.

The Commission determined that $333,441 is payable to the United States Treasury. (For more detail, see p. 12.)

Finding 3. Use of General Election Contributions for Primary Election Expenses

During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent $12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff noted that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts.

The Commission approved a finding that GJ2012 used $12,936 in general election contributions for primary election expenses prior to the general election. (For more detail, see p. 20.)

Finding 4. Reporting of Debts and Obligations

During audit fieldwork, the Audit staff's review of GJ2012's disbursements indicated that debts from seven vendors totaling $407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of $447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P.

The Commission approved a finding that that GJ2012 did not disclose debts to nine vendors totaling $447,567, as required. (For more detail, see p. 22.)

Additional Issue

Extension of Credit by a Commercial Vendor

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON[7] made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect $1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. The Audit staff did not consider these documents sufficient to verify that other clients were subject to the same billing practices or that GJ2012 was regularly and timely billed for services rendered.

The Commission did not approve by the required four votes the Audit staff's recommended finding that NSON made a prohibited contribution to GJ2012. Pursuant to Directive 70,[8] this prohibited contribution is discussed in the "Additional Issue" section. (For more detail, see p. 26.)

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[7] NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

[8] Available at http://www.fec.gov/directives/directive_70.pdf

Summary of Amounts Owed to the United States Treasury

• Finding 2.A. (p. 14)	Payment of Non-Qualified Expenses with Primary Election Funds	$ 332,191
• Finding 2.B. (p. 18)	Receipt of Matching Funds Based on Ineligible Contributions	1,250
	Total Due U.S. Treasury	**$ 333,441**

Part IV
Commission Findings

Finding 1. Net Outstanding Campaign Obligations

Summary

The Audit staff's review of GJ2012's financial activity through November 30, 2014, and estimated winding down costs indicated that the Candidate did not receive matching fund payments in excess of his entitlement.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional bank statements and invoices to show actual winding down costs, and did not dispute the Net Outstanding Campaign Obligations calculations contained in the Preliminary Audit Report.

The Commission approved a finding that the Candidate did not receive matching funds in excess of his entitlement.

Legal Standard

A. Net Outstanding Campaign Obligations (NOCO). Within 15 days after the candidate's date of ineligibility (see definition below), the candidate must submit a statement of "net outstanding campaign obligations." This statement must contain, among other things:

- The total of all committee assets including cash on hand, amounts owed to the committee and capital assets listed at their fair market value;
- The total of all outstanding obligations for qualified campaign expenses; and
- An estimate of necessary winding-down costs. 11 CFR §9034.5(a).

B. Date of Ineligibility. The date of ineligibility is whichever of the following dates occurs first:

- The day on which the candidate ceases to be active in more than one state;
- The 30th day following the second consecutive primary in which the candidate receives less than 10 percent of the popular vote;
- The end of the matching payment period, which is generally the day when the party nominates its candidate for the general election; or
- In the case of a candidate whose party does not make its selection at a national convention, the last day of the last national convention held by a major party in the calendar year. 11 CFR §§9032.6 and 9033.5.

C. Definition of Non-Qualified Campaign Expense. A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see below).

D. Qualified Campaign Expense. Each of the following expenses is a qualified campaign expense.

- An expense that is:
  - o Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
  - o Made in connection with the candidate's campaign for nomination; and
  - o Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

E. Entitlement to Matching Payments after Date of Ineligibility. If, on the date of ineligibility (see above), a candidate has net outstanding campaign obligations as defined under 11 CFR §9034.5, that candidate may continue to receive matching payments for matchable contributions received and deposited on or before December 31st of the Presidential election year provided that he or she still has net outstanding campaign debts on the day when the matching payments are made. 11 CFR §9034.1(b).

F. Winding Down Costs. A primary election candidate who does not run in the general election may receive and use matching funds after notifying the Commission in writing of the candidate's withdrawal from the campaign for nomination or after the date of the party's nominating convention, if the candidate has not withdrawn before the convention. A primary election candidate who runs in the general election must wait until 31 days after the general election before using any matching funds for winding down costs, regardless of whether the candidate receives public funds for the general election. 11 CFR §9034.11(d).

Facts and Analysis

A. Facts

The Candidate's date of ineligibility (DOI) was May 5, 2012. The Audit staff reviewed GJ2012's financial activity through November 30, 2014, analyzed estimated winding down costs and prepared the Statement of Net Outstanding Campaign Obligations that appears on the following page.

Gary Johnson 2012, Inc
Statement of Net Outstanding Campaign Obligations
As of May 5, 2012
Prepared February 10, 2015

Assets		
Cash in bank	$ (10,856)[9]	
Total Assets		$ (10,856)
Liabilities		
Accounts Payable (AP) for Qualified Campaign Expenses as of 5/5/12	$ (1,268,352)	
AP (Primary Account) Billed Post-DOI	(713,952)	
Winding Down (WD) Costs (5/5/12 – 12/6/12)	0	
Actual WD Costs (12/7/12 - 11/30/14) [a]	(22,899)	
Estimated WD Costs (12/1/14 - 6/30/15) [b]	(112,268)	
Total Liabilities		$(2,117,471)
Net Outstanding Campaign Obligations (Deficit) as of May 5, 2012		$(2,128,327)

Footnotes to NOCO Statement:

[a] The General election was held on November 6, 2012. The winding down period began 31 days after the General election on December 7, 2012.

[b] Estimated winding down costs will be compared to actual winding down costs and adjusted accordingly.

Shown below are adjustments for funds received after the Candidate's DOI on May 5, 2012 through January 8, 2013, the date GJ2012 received its last matching fund payment.

Net Outstanding Campaign Obligations (Deficit) as of May 5, 2012		$(2,128,327)
Less: Contributions Received (May 6, 2012 to January 8, 2013)		1,216,661
Less: Matching Funds Received through January 8, 2013		632,017
Remaining Net Outstanding Campaign Obligations (Deficit) as of January 8, 2013[10]		**$ (279,649)**

As presented above, the Candidate has not received matching funds in excess of his entitlement.

[9] The primary election campaign's May 5, 2012 cash balance was negative due to short term use of funds from the general election account. See Finding 3 on p. 20 for more detail.

[10] GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Additional Issue on p. 26 for additional detail.

B. Preliminary Audit Report & Audit Division Recommendation
The Audit staff presented a preliminary NOCO statement and related work papers to GJ2012 representatives at the exit conference. The preliminary NOCO statement showed that GJ2012 was in a surplus position and GJ2012 would be required to repay some matching funds received to the U.S. Treasury.[11] The Audit staff requested that GJ2012 provide additional documentation after the exit conference to enable the Audit staff to update the NOCO statement as necessary. On January 24, 2014, and June 18, 2014, GJ2012 submitted additional invoices in support of debts incurred for primary election expenses. These additional invoices were mostly for interest owed on debts incurred in relation to the primary election that had not been paid, and one invoice previously not provided to the Audit staff for a debt incurred for fundraising activity in relation to the primary election. The Audit staff reviewed this documentation and revised the NOCO accordingly. As a result of this additional documentation, the revised NOCO indicated that the Candidate did not receive matching funds in excess of his entitlement.

The Audit staff recommended that GJ2012 demonstrate any adjustments it believes are required in connection with any part of the NOCO statement or provide any other additional comments.

C. Committee Response to Preliminary Audit Report
In response to the Preliminary Audit Report recommendation, GJ2012 did not dispute the NOCO calculations contained on the Preliminary Audit Report, however, provided additional bank statements and invoices to show actual and additional estimated winding down costs as well as additional accounts payable for qualified campaign expenses. These expenses have been incorporated into the revised NOCO that reflects a deficit of $279,649 as of November 30, 2014. The revised NOCO indicates that the Candidate did not receive matching funds in excess of his entitlement.[12]

D. Draft Final Audit Report
The Draft Final Audit Report acknowledged that GJ2012 submitted additional documentation and did not dispute the NOCO calculations.

E. Committee Response to the Draft Final Audit Report
In response to the Draft Final Audit Report, GJ2012 accepted the Audit staff's Net Outstanding Campaign Obligations calculations that show that the Candidate did not receive matching fund payments in excess of his entitlement.

F. Audit Hearing
GJ2012 did not address Finding 1 during the audit hearing.

[11] This NOCO was prepared on December 12, 2013, and contains the same figures as the NOCO prepared on May 8, 2013. The May 8, 2013 NOCO was included in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

[12] GJ2012 and its major vendor, NSON, are discussing the possibility of waiving the interest on debts not repaid. If this debt is forgiven, the NOCO will require an adjustment. See Additional Issue on p. 26 for additional detail.

Commission Conclusion
On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that the Candidate did not receive matching fund payments in excess of his entitlement.[13]

The Commission approved the Audit staff's recommendation.

Finding 2. Amounts Owed to the U.S. Treasury

Summary
During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements determined that primary election funds were spent on non-qualified campaign expenses and that matching funds were received for contributions that were not eligible to be matched.

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information, and disputed the Audit staff's conclusion.

The Commission determined that $333,441 is payable to the United States Treasury.

Legal Standard
A. Qualified Campaign Expense. Each of the following expenses is a qualified campaign expense.

- An expense that is:
  - Incurred by or on behalf of the candidate (or his or her campaign) during the period beginning on the day the individual becomes a candidate and continuing through the last day of the candidate's eligibility under 11 CFR §9033.5;
  - Made in connection with the candidate's campaign for nomination; and
  - Not incurred or paid in violation of any federal law or the law of the state where the expense was incurred or paid. 11 CFR §9032.9.
- An expense incurred for the purpose of determining whether an individual should become a candidate, if that individual subsequently becomes a candidate, regardless of when that expense is paid. 11 CFR §9034.4.
- An expense associated with winding down the campaign and terminating political activity. 11 CFR §9034.4(a)(3).

B. Definition of Non-Qualified Campaign Expense. .A non-qualified campaign expense is any expense that is not included in the definition of a qualified campaign expense (see above). These include, for example, but are not limited to:

[13] The Audit staff notes that in the response to the PAR and the DFAR, GJ2012 alluded to assets which have not yet been valued, and the possibility of debt settlement. The addition of assets and/or reduction of debt on the NOCO could result in the Candidate having received matching fund payments in excess of his entitlement.

- Excessive expenditures. An expenditure which is in excess of any of the limitations under 11 CFR §9035 shall not be considered a qualified campaign expense.
- General election and post-ineligibility expenditures. Except for winding down costs pursuant to 11 CFR §9034.4(a)(3) and certain convention expenses described in 11 CFR §9034.4(a)(6), any expenses incurred after a candidate's date of ineligibility, as determined under 11 CFR §9033.5, are not qualified campaign expenses. In addition, any expenses incurred before the candidate's date of ineligibility for goods and services to be received after the candidate's date of ineligibility, or for property, services, or facilities used to benefit the candidate's general election campaign, are not qualified campaign expenses.
- Civil or criminal penalties. Civil or criminal penalties paid pursuant to the Federal Election Campaign Act are not qualified campaign expenses and cannot be defrayed from contributions or matching payments. Any amounts received or expended to pay such penalties shall not be considered contributions or expenditures but all amounts so received shall be subject to the prohibitions of the Act.
- Payments to candidate. Payments made to the candidate by his or her committee, other than to reimburse funds advanced by the candidate for qualified campaign expenses, are not qualified campaign expenses.
- Lost, misplaced, or stolen items. The cost of lost, misplaced, or stolen items may be considered a nonqualified campaign expense. Factors considered by the Commission in making this determination shall include, but not be limited to, whether the committee demonstrates that it made conscientious efforts to safeguard the missing equipment; whether the committee sought or obtained insurance on the items; whether the committee filed a police report; the type of equipment involved; and the number and value of items that were lost. 11 CFR §9034.4(b).

C. Matching Funds Used for Non-Qualified Campaign Expenses. If the Commission determines that a campaign used matching funds for non-qualified campaign expenses, the candidate must repay the Secretary of the United States Treasury an amount equal to the amount of matching funds used for the non-qualified campaign expenses. 26 U.S.C. §9038(b)(2)(A).

D. Seeking Repayment for Non-Qualified Campaign Expenses. In seeking repayment for non-qualified campaign expenses from committees that have received matching fund payments after the candidate's date of ineligibility, the Commission will review committee expenditures to determine at what point committee accounts no longer contain matching funds. In doing this, the Commission will review committee expenditures from the date of the last matching funds payment to which the candidate was entitled, using the assumption that the last payment has been expended on a last-in, first-out basis. 11 CFR §9038.2(b)(2)(iii)(B).

E. Primary Winding Down Costs During the General Election Period. A primary election candidate who runs in the general election, regardless of whether the candidate receives public funds for the general election, must wait until 31 days after the general election before using any matching funds for winding down costs related to the primary election. No expenses incurred by a primary election candidate who runs in the general election prior to 31 days after the general election shall be considered primary winding down costs. 11 CFR §9034.11(d).

F. How to Determine Repayment Amount for Non-Qualified Campaign Expenses When Candidate in Surplus Position. If a candidate must make a repayment to the United States Treasury because his or her campaign used matching funds to pay for non-qualified campaign expenses, the amount of the repayment must equal that portion of the surplus that bears the same ratio to the total surplus that the total amount received by the candidate from the matching payment account bears to the total deposits made to the candidate's accounts. 11 CFR §9038.2(b)(2)(iii).

G. Bases for Repayment. The Commission may determine that certain portions of the payments made to a candidate from the matching payment account were in excess of the aggregate amount of payments to which such candidate was entitled. Examples of such excessive payments include, but are not limited to, the following:

- Payments or portions of payments made on the basis of matched contributions later determined to have been non-matchable 11 CFR §9038.2(b)(1)(iii).

H. Notification of Repayment Obligation. The Commission will notify a candidate of any repayment determinations as soon as possible, but no later than three years after the close of the matching payment period. The Commission's issuance of the audit report to the candidate (under 11 CFR §9038.1(d)) will constitute notification for purposes of this section. 11 CFR §9038.2(a)(2).

Facts and Analysis

A. Payment of Non-Qualified Expenses with Primary Election Funds

1. Facts

During an examination of disbursement records, the Audit staff identified \$1,199,701[14] in disbursements for general election expenses paid with primary election funds. Of this amount, disbursements totaling \$1,192,400 occurred during the period between the Candidate's DOI, May 5, 2012, and 31 days after the general election, December 7, 2012. During this period, expenses incurred are not considered primary winding down costs. Since these expenses are not related to the primary election of the Candidate, they are considered non-qualified campaign expenses.

In the post-election wind-down period, when wind-down expenses must be allocated between the primary and general election campaigns, \$7,301 was spent.[15] Since these

[14] The initial amount of non-qualified expenses was subsequently reduced to \$1,194,425 after the Audit staff calculated the matching funds cut-off date earlier (December 20, 2012) than had been previously calculated.

[15] The amount using an end date of December 20, 2012 (as explained in the previous footnote) is \$2,025.

amounts were not allocated between campaigns, these are also non-qualified expenses. Additionally, the accounting staff for GJ2012 stated that expenses identified by themselves, or by NSON, as general election expenses were paid from the general account, and expenses identified as primary expenses were paid from the primary account. Of the expenses identified by the Audit staff as non-qualified expenses, expenses totaling $1,191,856 were paid out of the general account.

After the Candidate's DOI, GJ2012 continued to raise funds to pay off the debt incurred during the primary election, as permitted by law. Approximately $1.2 million in private contributions designated for the primary election were deposited into GJ2012's general election account, and were used to pay general election expenses. The Audit staff determined the private contributions designated for the primary election using the same calculations as in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.

To determine which general election expenses were paid using the contributions designated for the primary election, the Audit staff followed the following procedures:

1. Used the list of primary and general contributions calculated for the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013.
2. Used GJ2012's disbursement database of disbursements from the primary election account. The dates from GJ2012's database were the check dates rather than the dates that the checks cleared the bank account. Any disbursements from the bank statements that were not in GJ2012's database were also included by the Audit staff in this review. The same procedure was followed for the review of the general election account.
3. For each day analyzed, the Audit staff first summed the three different types of receipts separately (primary contributions, general contributions and receipts of matching funds from the U.S. Treasury). Contributions were considered spent on a first-in, first-out (FIFO) basis. If multiple types of contributions were received on the same day, the contributions were applied to disbursements in the following order: primary, general, matching funds.
4. The last day that any primary election contributions submitted for matching funds were still in the general election account was December 20, 2012. Therefore, the calculation of non-qualified campaign expenses from that account ended on that date.

Following these procedures resulted in the most favorable repayment calculation for GJ2012.

Pursuant to 11 CFR §9038.2(b)(2)(iii)(B), calculation of non-qualified expenses from all of GJ2012's accounts would continue until no matching funds were left in any of the accounts. This "zero-out date" occurred on February 20, 2014. In order to completely and accurately calculate whether non-qualified expenses were paid with matching funds, the Audit staff needed information from GJ2012 about contributions received so that the amounts received for the primary and general elections could be accurately recorded. Although this information was requested, GJ2012 provided no contribution detail dated after December 31, 2012. In addition, although the Audit staff requested bank statements, no bank statements for the general account were received after the November 2013 statement. This type of information is regularly requested from committees that have received federal matching funds. Without these bank statements, the Audit staff does not know what expenditures have been made and cannot determine if these expenditures were for the primary or general election. Given the lack of documentation, the Audit staff was unable to verify the receipts or expenditures after December 31, 2012. However, the Audit staff was able to verify the date the last contribution submitted for matching funds was deposited to the general account. Thus, the Audit staff used December 20, 2012, as the cutoff date for examining the both accounts for non-qualified expenses.[16]

In accordance with 11 CFR §9038.2(b)(2)(iii), the ratio of repayment was calculated at 27.9053%.[17] This ratio applied to the non-qualified expenses equals a repayment amount of $334,780.[18]

2. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 demonstrate it did not make non-qualified expenses or provide any other additional comments it deemed necessary. It was further stated that, absent such evidence, the Audit staff would recommend that the Commission determine that $334,780[19] is repayable to the U.S. Treasury.

3. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report, GJ2012 counsel stated that since qualified campaign expenses exceeded the amount of matching funds received by $95,585, "...no matching funds were used to pay for non-qualifying campaign expenses...". In addition, GJ2012 claims that certain non-qualified campaign expenses totaling $1,220 identified by the Audit staff were paid solely with available general election funds. GJ2012 also states that expenses totaling $7,301 identified as being unallocated between primary and general activities were not paid with matching funds but solely with general election funds.

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[16] Audit staff's estimate of the additional amount of possible non-qualified expenses is $16,000, which would result in an additional repayment amount of about $4,450. The $16,000 estimate is based on the provided bank statements through November 2014, and assumes that all the expenses were paid using contributions to the primary election.

[17] Matching funds certified as of 90 days post-DOI divided by deposits for the Primary election as of 90 days post-DOI ($303,751/$1,088,509 = 0.279053).

[18] The ratio applied to the Audit staff's revised non-qualified expenses using an end calculation date of December 20, 2012 (as explained in footnote 14) is $333,307.

[19] See footnote 18.

In each of the instances noted above, GJ2012's calculation fails to apply the amount of private contributions received and applied towards remaining net outstanding campaign obligations after the Candidate's DOI. Pursuant to 11 CFR §9034.4, "...all contributions received by an individual from the date he or she becomes a candidate and all matching payments received by the candidate shall be used only to defray qualified campaign expenses...". Therefore, the Audit staff maintains that both the amount of private contributions and the amount of matching funds are applied to qualified campaign expenses. According to the Audit staff, this calculation continues to indicate that matching funds were part of GJ2012's account balance until February 20, 2014 and prior to that time the identified non-qualified campaign expenses for the general election were paid, in part, with primary election matching funds and are subject to repayment.

GJ2012's response also references newly discovered debts and other debts related to the Primary activity, including a $300,000[20] win bonus owed to NSON, and states that these debts should be included in the calculation. In doing so, GJ2012 asserts that this would move up the date on which Federal matching funds were no longer in the account, thereby reducing the repayment amount.[21] The Audit staff notes that debts are not part of the calculation of non-qualified expenses. Expenditures considered in a repayment determination under 11 CFR 9038.2(b)(2(ii) and (3) include all non-qualified and undocumented expenditures incurred and **paid** between the campaign's date of inception, and the date on which the candidate's accounts no longer contain any matching funds. Outstanding debts and newly discovered debts are not included in the repayment calculation.

Finally, GJ2012's response noted an expense incorrectly classified by Audit staff as a general election expense instead of a primary election expense. The amount of identified non-qualified campaign expense has been adjusted to be considered as a qualified campaign expense and accordingly, the Audit staff has reduced the total repayment amount by $1,116 ($4,000 x 27.9053%).

The Audit staff recommended that the Commission make a determination that $332,191 is repayable to the U.S. Treasury.

4. Draft Final Audit Report

The Draft Final Audit Report acknowledged GJ2012's arguments for recalculation of non-qualified expenses. The Audit staff disputed those arguments and recommended that the Commission make a determination that $332,191 is repayable to the U.S. Treasury.

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[20] GJ2012 further states that the bonus is a qualified campaign expense, however, pursuant to 11 CFR §9034.4(a)(5)(ii), monetary bonuses must be paid no later than thirty days after the date of ineligibility to be considered qualified campaign expenses. These bonuses have not been paid, therefore, the $300,000 bonus owed to NSON is a non-qualified campaign expense, and as such, is not reflected in the NOCO (Finding 1, p. 8).

[21] Non-qualified expenses paid after the candidate's accounts are presumed to have been purged of all matching funds are not subject to repayment since the candidate's accounts contained no matching funds.

5. Committee Response to the Draft Final Audit Report

In response to the Draft Final Audit Report, GJ2012 disputed the premise[22] for the Audit staff's calculation of amounts owed to the U.S. Treasury and stated that GJ2012 acted in good faith.

6. Audit Hearing

Counsel stated that if it were not for the failure to update the disclaimer on GJ2012's website, GJ2012 would have been compliant with the Matching Fund Act. Counsel stated that GJ2012 acted as it thought it was allowed to, allocating the first $250 from each contributor to the primary election and getting that amount matched, and allocating all subsequent amounts from each contributor to the general election.

Counsel presented a chart that showed that funds post-DOI were deposited first to the general election account, then the first $250 from each contributor was transferred to the primary election account, thus keeping matchable and non-matchable contributions separate. He further stated that he sees the Audit staff's calculations, based on commingled accounts, as an overbroad interpretation of the Kennedy case (Kennedy for President Committee v. Federal Election Commission (D.C. Cir. 1984)). Counsel explained that the accounts were separate, with all matching funds and primary contributions kept in one account, and all general contributions kept in another account. He stated that every expense that primary funds were used for was a qualified expense, and that the activity is clearly separated. Counsel further stated that the repayment ratio formula did not need to be applied in this case because the activity can clearly be seen, and that using the repayment ratio does not meet the purpose of the statute.

Counsel was also permitted to submit an additional statement after the audit hearing. This statement again addressed the legal premise for the method of calculation of repayment.[23]

Commission Conclusion

On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission make a determination that $332,191 is repayable to the U.S. Treasury.

The Commission approved the Audit staff's recommendation.

B. Receipt of Matching Funds Based on Ineligible Contributions

1. Facts

During an examination of receipts in audit fieldwork, the Audit staff identified five contributions designated to the general election totaling $8,000 that were submitted

[22] OGC has addressed GJ2012's arguments in its legal analyses on the DFAR and the Audit Division Recommendation Memorandum.

[23] As stated in footnote 22.

for matching funds. These contributions were ineligible to be matched for primary election funds. The amount of matching funds awarded for these ineligible contributions was $1,250.

2. Preliminary Audit Report & Audit Division Recommendation
The Audit staff presented this matter to GJ2012 representatives at the exit conference along with schedules detailing the finding. GJ2012 representatives did not comment on this finding. The Audit staff recommended that GJ2012 show that the contributions were not general election contributions or provide any other additional comments it deemed necessary. It was further stated that, absent such evidence, the Audit staff would make a recommendation that the Commission make a determination that $1,250 is repayable to the U.S. Treasury.

3. Committee Response to Preliminary Audit Report
In response to the Preliminary Audit Report recommendation, GJ2012 stated that it was investigating whether or not these contributions were "...accidentally attributed to the wrong spouse." If the Committee's investigation determines that the contributions were, in fact, ineligible, Counsel states that GJ2012 would refund the appropriate amount to the U.S. Treasury.

The Audit staff recommended that the Commission make a determination that $1,250 is repayable to the U.S. Treasury.

4. Draft Final Audit Report
The Draft Final Audit Report acknowledged that GJ2012 was investigating the ineligible contributions. The Audit staff recommended that the Commission make a determination that $1,250 is repayable to the U.S. Treasury.

5. Committee Response to the Draft Final Audit Report
In response to the DFAR, GJ2012 agreed with the Audit staff's calculation of matching funds received based on contributions ineligible to be submitted, and stated that they would repay this amount to the U.S. Treasury.

6. Audit Hearing
GJ2012 did not address this part of the finding during the audit hearing.

Commission Conclusion
On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission make a determination that $1,250 is repayable to the U.S. Treasury.

The Commission approved the Audit staff's recommendation.

Finding 3. Use of General Election Contributions for Primary Election Expenses

Summary
During audit fieldwork, the Audit staff's review of GJ2012's receipts and disbursements during the pre-DOI period indicated that GJ2012 spent $12,396 in general election receipts on primary election expenses prior to the Candidate's DOI.

In response to the Preliminary Audit Report, GJ2012 stated that the use of general election receipts for primary election expenses was an advance against anticipated matching funds. The Audit staff noted that short-term advances against matching funds must come from a qualified financial institution, and be secured by certified matching funds amounts.
The Commission approved a finding that GJ2012 used $12,936 in general election contributions for primary election expenses prior to the general election.

Legal Standard
Receipt of General Election contributions before the date of the Primary Election.
(1) If the candidate, or his or her authorized committee(s), receives contributions that are designated for use in connection with the general election pursuant to 11 CFR §110.1(b) prior to the date of the primary election, such candidate or such committee(s) shall use an acceptable accounting method to distinguish between contributions received for the primary election and contributions received for the general election. Acceptable accounting methods include, but are not limited to:
(i) The designation of separate accounts for each election, caucus or convention; or
(ii) The establishment of separate books and records for each election.

(2) Regardless of the method used under paragraph (e)(1) of this section, an authorized committee's records must demonstrate that, prior to the primary election, recorded cash-on-hand was at all times equal to or in excess of the sum of general election contributions received less the sum of general election disbursements made. 11 CFR §102.9(e).

Facts and Analysis

A. Facts
During audit fieldwork, the Audit staff reviewed available receipt and disbursement records to determine what contributions, if any, were designated per contributor solicitation devices to the general election and then spent by GJ2012 on primary election expenses prior to the primary election date (May 5, 2012). Committees are not permitted to spend funds designated to the general election for primary election expenses prior to the primary election date. If general election funds are held in the primary election account, the general election funds should be held in reserve and not spent for primary election purposes.

Prior to the primary election, GJ2012 received a total of $22,396 designated to the general election that was deposited in the primary election account. The Audit staff determined the private contributions designated for the general election using the same calculations as were employed in the Statement of Reasons In Support of Final Determination of Entitlement in the Matter of Governor Gary Johnson (LRA #905), dated November 14, 2013. Of this amount, a total of $10,000 was deposited to the general election account by September 6, 2011. Beginning on February 21, 2012, GJ2012 did not maintain enough contributions designated to the primary election to pay for all of its primary expenditures, and used contributions designated to the general election to make up the difference. The Audit staff's review identified $12,396 in contributions designated to the general election that were spent on primary election expenses prior to the primary election date. These expenditures were identified as primary election expenses as they were bank fees incurred prior to the Candidate's DOI and payments on invoices submitted for various services incurred in connection with the Candidate's campaign for nomination. In addition, no invoices for any services rendered in conjunction with the general election were received prior to the payment of these expenses.

B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the payments made using general election funds for primary election expenses prior to the candidate's DOI for the audited cycle. GJ2012 representatives did not comment on this finding.

The Audit staff recommended that GJ2012 provide documentation to demonstrate that general election contributions were not used to fund primary election activity. In accordance with 11 CFR §102.9, documentation should demonstrate that an acceptable accounting method was used. Absent such a demonstration, GJ2012 was to provide any additional comments it considered necessary with respect to this matter.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 stated that the $12,396 was treated as an advance against anticipated matching funds from the general election contributions to the primary election.

To the extent that GJ2012 is characterizing the advance of general election funds as a loan to the primary account, it is noted that regulations specify that such loans or advances must come from a qualified financial institution, which the general account is not. It is also noted that short term loans to Presidential primary committees were obtained in the past, however, these loans were secured by matching fund amounts certified and expected to be received by the committees and occurred only when the Presidential Campaign fund was in a shortfall position. Matching funds for GJ2012 were not certified until May 25, 2012 and the Presidential Campaign fund was not in a shortfall position in 2012. In no instances were general election contributions permitted to be used for primary election expenditures.

GJ2012 stated that they "...used an acceptable accounting method in accordance with 11 CFR §102.9," and that there were separate accounts for primary and general election contributions. As explained in the "Committee Structure" section on pages 1 and 2 of this report, in practice, GJ2012 deposited nearly all receipts before DOI in its designated primary account and nearly all receipts after DOI in its designated general account. GJ2012 further stated that Audit staff based its calculation on cash on hand and did not take into account the delay in deposits collected through credit card processors. These would be considered received, but would not be in GJ2012's bank account immediately.

In fact, as this is a common occurrence with campaign committees, the Audit staff took this deposit delay into account. The Audit staff used GJ2012's contributions database for this calculation, which uses the date of contribution rather than the date of deposit.

D. Draft Final Audit Report
The Draft Final Audit Report acknowledged GJ2012's statement that the use of general election contributions was treated as an advance against anticipated matching funds, but the Audit staff disputed that an advance from general election contributions rather than from a lending institution was allowable.

E. Committee Response to the Draft Final Audit Report
In response to the Draft Final Audit Report, GJ2012 requested that the arguments made in response to the Preliminary Audit Report be reconsidered and requested an audit hearing to present its arguments.

F. Audit Hearing
During the audit hearing, Counsel agreed that GJ2012 did use general election contributions for primary election expenses. However, Counsel stated that these were only to cover short term gaps in cash flow and it would have been a burden to seek outside funds for such short term matters. Counsel stated that the finding lacks context, and that it seems unreasonable and not the intent of the Act to force committees to engage in commercial transactions in order to cover such short term cash flow issues. Counsel emphasized that these were short-term loans only, and stated that he thought that it would be easy to tell if any committee was abusing this leeway.

Commission Conclusion
On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that GJ2012 used $12,936 in general election contributions for primary election expenses prior to the general election.

The Commission approved the Audit staff's recommendation.

Finding 4. Reporting of Debts and Obligations

Summary
During audit fieldwork, the Audit staff's review of GJ2012's disbursements indicated that debts from seven vendors totaling $407,455 were not disclosed on Schedule D-P (Debts and Obligations), as required.

In response to the Preliminary Audit Report, GJ2012 submitted additional invoices for debts to two vendors that were not previously disclosed to Audit staff. This resulted in a total of $447,567 in debts owed to nine vendors that were not disclosed on Schedule D-P as required. GJ2012 amended its reports to materially correct the disclosure of debts and obligations on Schedule D-P.

The Commission approved a finding that that GJ2012 did not disclose debts to nine vendors totaling $447,567, as required.

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. 52 U.S.C. §30104(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, except reoccurring administrative expenses (such as rent) shall not be reported as a debt before the payment due date. 11 CFR §104.11(b).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff used available disbursement records to reconcile the accounts[24] of GJ2012's vendors.[25] These vendors provided GJ2012 with various campaign management services such as fundraising, accounting, clerical and administrative staff, and travel arrangements.

The Audit staff identified debts to seven of GJ2012's vendors totaling $407,455 that were not reported on Schedule D-P as required. Of these debts, $300,000 was owed to NSON for a bonus after the Candidate received the nomination as the Libertarian Party candidate for the Presidential general election. This bonus was incurred, per contract, as of the date of nomination, May 4, 2012, and should have been reported on the 2012 June Monthly report, covering the time period from May 1, 2012 through May 31, 2012.

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[24] The reconciliation consisted of calculating invoiced and paid amounts for individual reporting periods in the 2011-2012 campaign cycle. The Audit staff then determined whether any outstanding debts were correctly disclosed on Schedule D-P. Each debt amount was counted once, even if it required disclosure over multiple reporting periods.

[25] The Audit staff restricted this review to only primary campaign debts, as per the scope of this Audit.

It should be noted that GJ2012 was invoiced for half of this debt ($150,000) on December 21, 2012, and reported it on the 2012 Year-End report. However, the Audit staff maintains the debts should have been reported as debt for the entire amount based on the date and terms of the contract. The remaining reportable debts of $107,455 were for smaller amounts to all six vendors identified by the Audit staff.

B. Preliminary Audit Report & Audit Division Recommendation
The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the unreported debts for each reporting period covered by the audit. In response to the exit conference, GJ2012 submitted one additional invoice for the other half of the bonus referenced in the "Facts" section above. This invoice was dated January 1, 2013. As of the date the Preliminary Audit Report was sent to GJ2012, this $150,000 had not been disclosed on any reports filed with the Commission.

The Audit staff recommended that GJ2012 provide documentation demonstrating that these expenditures did not require reporting on Schedule D-P. Absent such documentation, the Audit staff recommended that GJ2012 amend its reports to disclose the outstanding debts.

C. Committee Response to Preliminary Audit Report
In response to the Preliminary Audit Report recommendation, GJ2012 amended its reports and submitted additional invoices and documentation for other previously undisclosed debts. Adjustments made by the Audit staff based on the additional documentation provided reduced the original determination of debts and obligations not timely reported amount by $7,758.

GJ2012 submitted additional invoices from two new vendors that were not previously provided to the Audit staff, nor disclosed on Schedule D-P, for debts incurred within the audit period totaling $47,870. In combination with the seven vendors noted in the Preliminary Audit Report, the Audit staff has thus identified nine vendors that GJ2012 owed $447,567 that was not reported on Schedule D-P as required. GJ2012 filed amendments that materially corrected these omissions.

In its initial response to the Preliminary Audit Report, GJ2012 disputed that the $300,000 owed to NSON for a bonus was not timely reported. GJ2012 states that the NSON contract "...specifically states that invoices are due and payable upon receipt," and that the vendor not invoicing timely does not create a reportable debt, since the campaign would not be able to base the debt reporting on an invoice.

Pursuant to 11 CFR §104.11(b), "[a] debt or obligation, including a loan, written contract, written promise or written agreement to make an expenditure...shall be reported as of the date on which the debt or obligation is incurred..." GJ2012 made a written agreement on October 14, 2011, that NSON would be owed a bonus of "$300,000 for receiving any party nomination as either VP or President." Thus, this debt was incurred on the date of the Candidate's nomination by the Libertarian Party at its convention on May 5, 2012, and should have been reported as a debt or obligation on Schedule D-P on the June Monthly Report that covered May 1, 2012 through May 31, 2012, regardless of when it was invoiced.

In a supplemental response to the Preliminary Audit Report, GJ2012 stated that it has deferred to Audit staff's judgment that the $300,000 win bonus should be reported as of the date of the Candidate's nomination, despite not having been invoiced.[26] GJ2012 filed amendments to its reports to report this obligation as of May 2012.

D. Draft Final Audit Report
The Draft Final Audit Report acknowledged that GJ2012 filed amendments to materially correct its reporting of debts and obligations.

E. Committee Response to the Draft Final Audit Report
In response to the Draft Final Audit Report, GJ2012 discussed its method of accounting, in which GJ2012 "re-allocated payments" in December of 2014 to pay off $171,000 of the $300,000 win bonus within the 30-day regulatory requirement, so that the $171,000 would be considered a qualified expense.[27] GJ2012 also requested an audit hearing to address this matter.

F. Audit Hearing
During the audit hearing, Counsel stated that GJ2012 had amended its reports to correctly report debts and obligations, and that there were no further substantive comments regarding this finding.

Commission Conclusion
On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that GJ2012 did not disclose debts to nine vendors totaling $447,567, as required.

The Commission approved the Audit staff's recommendation.

[26] GJ2012 further stated that they, "in conjunction with NSON, reallocated prior payments to NSON to this earlier Primary expenditure to ensure that payments were made on a First in-First out basis." The Audit staff believes that GJ2012 cannot reallocate these payments in such a manner. It appears that GJ2012 has decided to apply this procedure in an attempt to reduce the amount of repayment to the U.S. Treasury as detailed in Finding 2. However, this "re-allocation" of payments would still not result in the win bonus being paid within the statutory 30 day period (see footnote 20 for additional detail), so this remains a non-qualified expense regardless of the accounting convention used. In fact, to alter the accounting method to pay this debt off would result in additional non-qualified expenses paid using matching funds, which would actually result in an even larger repayment to the U.S. Treasury.

[27] This argument pertains to the calculations in Finding 2 of non-qualified expenses, not to the substance of Finding 4.

Part V
Additional Issue

Extension of Credit by a Commercial Vendor

Summary

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that NSON[28] made a prohibited contribution to GJ2012 by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect $1,752,032 from GJ2012 for services rendered.

In response to the Preliminary Audit Report, GJ2012 presented an affidavit from the proprietor of NSON and redacted contracts to dispute the Audit staff's suggestion that NSON made a prohibited contribution to GJ2012. The Audit staff did not consider these documents sufficient to verify that other clients were subject to the same billing practices or that GJ2012 was regularly and timely billed for services rendered.

The Commission did not approve by the required four votes the Audit staff's recommended finding that NSON made a prohibited contribution to GJ2012. Pursuant to Directive 70,[29] this prohibited contribution is discussed in the "Additional Issue" section.

Legal Standard

A. Contribution defined. A gift, subscription, loan (except when made in accordance with 11 CFR §100.72 and §100.73), advance, or deposit of money or anything of value made by a 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 usual and normal charge for a service is the commercially reasonable rate that one would expect to pay at the time the services were rendered.

The provision of services at a charge less than the usual and normal charge results in an in-kind contribution. The value of such a contribution would be the difference between the usual and normal charge for the services and the amount the political committee was billed and paid. 11 CFR §100.52(a) and (d).

B. Corporate Contributions Impermissible. A corporation is prohibited from making any contribution in connection with a federal election. 52 U.S.C. §30118(a).

C. Definition of Commercial Vendor. A commercial vendor is any person who provides goods or services to a candidate or political committee and whose usual and

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[28] NSON is a registered corporation in the state of Utah that also does business as Political Advisors. GJ2012 reported disbursements to Political Advisors, but all contracts and invoices were received from NSON.

[29] Available at http://www.fec.gov/directives/directive_70.pdf

normal business involves the sale, rental, lease or provision of those goods or services. 11 CFR §116.1(c).

D. Extension of Credit by Commercial Vendor. A commercial vendor, whether or not it is a corporation, may extend credit to a candidate or political committee provided that:

- The credit is extended in the vendor's ordinary course of business (see below); and
- The terms of the credit are similar to the terms the vendor observes when extending a similar amount of credit to a nonpolitical client of similar risk. 11 CFR §116.3(a) and (b).

E. Definition of Ordinary Course of Business. In determining whether credit was extended in the ordinary course of business, the Commission will consider whether:

- The commercial vendor followed its established procedures and its past practice in approving the extension of credit;
- The commercial vendor received prompt, full payment if it previously extended credit to the same candidate or political committee; and
- The extension of credit conformed to the usual and normal practice in the commercial vendor's industry or trade. 11 CFR §116.3(c).

Facts and Analysis

A. Facts

During audit fieldwork, the Audit staff's review of GJ2012's disbursements suggested that GJ2012 accepted a prohibited contribution that NSON made by extending credit beyond its normal course of business and not making commercially reasonable attempts to collect $1,752,032 from GJ2012 for services rendered relating to the primary election.[30]

On October 14, 2011, GJ2012 entered into a contract with NSON to manage the campaign. NSON handled fundraising, press and media relations, creative advertising, and all administrative functions of the primary election campaign. Disbursements to NSON totaled 86% of the total of all disbursements by GJ2012, and 89% of GJ2012's outstanding debt as of December 31, 2012 was owed to NSON. From April 21, 2011 through December 21, 2012, NSON invoiced GJ2012 $2,198,204 for campaign management expenses, including fundraising, clerical work, and travel arrangements. As of March 31, 2013, $1,752,032 had been outstanding more than 120 days, and $936,247 remains outstanding. To date, GJ2012 has only made payments of $1,261,957 for the $2,198,204 invoiced by NSON.

The terms of the contract between GJ2012 and NSON stated that:

> NSON may assess a carrying charge of eighteen percent (18%) per annum on payments not made within thirty (30) days of the date of the invoice. NSON may, at its sole discretion and without notice, suspend its services hereunder should Client not pay in

[30] Audit staff restricted this review to only primary campaign services, as per the scope of this audit.

> full any amount invoiced. NSON further reserves the right, at its sole discretion to withhold from Client any instruments of NSON's services pending payment on Client's account.

NSON had not assessed any interest charges as of March 31, 2013. During audit fieldwork, GJ2012 did not provide Audit staff with documentation of attempts by NSON to collect on the outstanding debt.

B. Preliminary Audit Report & Audit Division Recommendation

The Audit staff presented this matter to GJ2012 representatives at the exit conference and provided schedules detailing the extensions of credit for primary election expenses. Audit staff requested that GJ2012 provide evidence that NSON made commercially reasonable attempts to collect the outstanding amount. In response to the exit conference, on January 17, 2014, GJ2012 submitted an accounts receivable aging schedule for other clients of NSON to show that credit was extended on similar terms to other committees, a copy of a lawsuit filed by NSON in the state of Utah against another client, and a bill dated December 31, 2013, for $245,527 in interest on the outstanding debts from GJ2012 to show that NSON was attempting to collect on the outstanding debt. The aging schedule detailed the outstanding amounts from nine clients, including another political committee also associated with the Candidate. Six of these clients had debt outstanding more than 300 days, and 84% of the total debt outstanding on the aging schedule was owed by the political committee.

GJ2012 quoted an NSON response to a query the Committee had made to this vendor,

> Ongoing attempts have been made and continue to be made to collect the outstanding debt owed from the Gary Johnson 2012 campaign. These include support and help with continued solicitation for donations. Any and all other legal remedies are and will be considered to satisfy the obligation.

The Audit staff reviewed the documentation submitted in response to the exit conference. Although GJ2012 provided an internally generated aging schedule and a copy of a lawsuit filed, GJ2012 did not provide any contracts with, or invoices to, other clients of NSON. As such, the Audit staff could not verify with a reasonable certainty that NSON's contract with GJ2012 was offered on the same terms or pursued in the same manner as other NSON clients, political or non-political.

In addition, on June 18, 2014, GJ2012 submitted several new invoices for interest charged by NSON on debts outstanding from January 2014 through June 2014.

The Audit staff recommended that GJ2012 provide documentation, to include statements from this vendor that demonstrates the credit extended was in the normal course of business and did not represent an excessive in-kind contribution by the vendor. The information provided may include examples of other non-political customers/clients of similar size and risk for which similar services were provided and similar billing arrangements were used. Also, Audit staff recommended that GJ2012 provide information concerning the presence of safeguards such as billing policies for similar non-political clients and work, advance payment policies, and debt collection policies and practices to show that this was normal business practice for NSON or provide additional explanation about the situation.

C. Committee Response to Preliminary Audit Report

In response to the Preliminary Audit Report recommendation, GJ2012 provided additional information about the business practices of NSON. In an affidavit, Ron Nielson, the proprietor of NSON, stated that his company did not extend credit to GJ2012 that it would not have extended to a similar non-political campaign. Mr. Nielson stated that NSON exercises discretion in the assessing and collecting of finance charges in order to collect on the principal, and that NSON has previously waived finance charges in favor of collecting on the principal. In addition, Mr. Nielson stated that NSON has engaged in discussions with GJ2012 to accept campaign assets in lieu of payment.

GJ2012 also submitted redacted contracts that NSON used for other political and non-political campaigns. The non-redacted portions of these contracts are substantially similar to the one signed by GJ2012. Counsel for GJ2012 further states that NSON acted according to normal and usual practice in the industry, and that NSON and its competitors frequently extend credit to clients seeking similar services in anticipation that doing so would enable the clients to raise funds.

In addition, Counsel for GJ2012 stated that NSON and GJ2012 were negotiating for the acceptance of campaign assets in lieu of payments owed, and that NSON may waive interest fees "as is routine in such matters."[31]

The NSON contracts provided by GJ2012 are redacted to the extent that the Audit staff cannot verify whether or not the clients are political or non-political. Since the nature of these entities cannot be verified, the Audit staff does not find these contracts to be adequate evidence that credit was extended to GJ2012 in the same way as other political and non-political clients.

Furthermore, documentation provided by GJ2012 to show that NSON attempted to collect on outstanding debts did not show that "NSON regularly invoiced GJ2012 for all services...". In fact, GJ2012 was not invoiced for services in some cases until months or even more than a year after the services were performed. NSON did not submit invoices for interest due on amounts owed until December 31, 2013, more than a year after the Candidate's date of ineligibility, for invoices that had been outstanding for thirteen (13) to twenty-two (22) months. In addition, no documentation such as invoices to other non-political clients has been presented to show that NSON has also treated the collection of amounts due by non-political clients in the same manner.

Pursuant to 11 CFR §9034.5(c), Presidential campaigns are required to report on the NOCO all capital assets whose purchase price exceeded $2,000, and other assets whose value exceeds $5,000, and maintain a list of these items. GJ2012 did not disclose any

[31] If GJ2012 and NSON come to an agreement to settle the Committee's debts for less than has been billed, GJ2012 will need to file a debt settlement plan and seek Commission review of this settlement, pursuant to 11 CFR §116.7.

assets on the NOCO statements submitted when applying for matching funds, nor were any lists provided to the Audit staff during fieldwork. The Audit staff requests that GJ2012 submit documentation for any assets owned and not previously disclosed to the Commission.

The Audit staff notes that NSON had billed GJ2012 $345,333 in interest as of October 15, 2014, and the Audit staff has estimated that $85,893 in additional interest will be billed by NSON to GJ2012 by June 30, 2015. Both of these amounts are reflected in the NOCO in Finding 1 of this report.

If GJ2012 and NSON come to a mutual agreement on debts less than the amounts owed and the debt settlement plan is reviewed and approved by the Commission, then the lower amount owed would necessarily reduce the total liabilities on the NOCO statement and likely result in the receipt of matching funds in excess of the Candidate's entitlement. Further repayment may also result if GJ2012 discloses newly-discovered assets.[32]

D. Draft Final Audit Report

The Draft Final Audit Report acknowledged that GJ2012 submitted redacted contracts between NSON and other clients, and an affidavit from Ron Nielson, proprietor of NSON that stated his company did not extend credit to GJ2012 that it would not have extended to a similar non-political campaign. Mr. Nielson stated that NSON exercises discretion in the assessing and collecting of finance charges in order to collect on the principal, and that NSON has previously waived finance charges in favor of collecting on the principal. In addition, Mr. Nielson stated that NSON has engaged in discussions with GJ2012 to accept campaign assets in lieu of payment.

E. Committee Response to the Draft Final Audit Report

In response to the Draft Final Audit Report, GJ2012 stated that NSON should not be forced to reveal the names of its clients, and that it is in the normal course of business for an entity to be late in billing. GJ2012 further stated that it could not value the assets referred to in their response to the Preliminary Audit Report at this time, and that it will not pursue debt settlement until after the audit is completed. In its response to the Draft Final Audit Report, GJ2012 also requested an audit hearing to present the Committee's arguments.

F. Audit Hearing

During the audit hearing, Counsel stated that GJ2012 does not believe that there was any extension of credit by NSON outside its normal course of business. Counsel stated that the language of the contract stated that NSON *may* assess interest charges, not that the company *must* assess those charges. Counsel further stated that vendors regularly use the threat of interest charges as leverage and do not always assess those charges. In addition, Counsel stated that there is nothing that says a vendor must sue in order to get paid. In fact, it would not be in the vendor's best interest to litigate, as it might damage its reputation and may lead to a difficulty in finding or keeping other clients. Counsel stated

[32] Also note the repayment amount for non-qualified expenses identified in Finding 2 would also require adjustment.

that any vendor would work with their client in order to seek payment without litigation, and stated that there have been conversations between NSON and GJ2012 in order to resolve the outstanding payments. Counsel also stated that part of the attempt to settle the outstanding debts hinges on intangible assets for which GJ2012 does not yet have a value. Counsel stated that GJ2012 could not value the assets until after the audit and repayment process is over, because over time, the assets lose value, and they may also lose value if GJ2012 must make a large repayment to the U. S. Treasury.

Counsel addressed the Audit staff's assertion in the Draft Final Audit Report that it is unable to determine whether the contracts between NSON and other clients indicate that NSON contracted with other political and non-political clients in the same manner, because the client names have been redacted. Counsel stated that the fact that these contracts are all substantially similar shows that NSON contracted in the same manner with all its clients. Counsel further stated that it would not be reasonable to breach confidentiality with those clients to reveal their names so that the Audit staff can verify that the provided contracts are with both political and non-political clients.

Commission Conclusion
On June 18, 2015, the Commission considered the Audit Division Recommendation Memorandum in which the Audit staff recommended the Commission find that NSON made a prohibited contribution to GJ2012 by extending credit beyond the normal course of business and not making commercially reasonable attempts to collect $1,752,032 from GJ2012 for services rendered.

The Commission did not approve, by the required four votes, the Audit staff's recommendation. Some Commissioners voted to approve the Audit staff's recommendation. Others did not, stating that they deemed the affidavit from Mr. Nielson, contracts showing substantially similar terms offered to other clients, accounts receivable aging schedules for both GJ2012 and other clients, and invoices for interest charged by NSON on outstanding debt sufficient to document that the billing practices were normal and usual.

This contribution is discussed in the "Additional Issue" section pursuant to Commission Directive 70.[33]

[33] Available at http://www.fec.gov/directives/directive_70.pdf.

September 4, 2015

SENT VIA EMAIL AND FIRST CLASS MAIL
Federal Election Commission
Audit Division
Mr. Tom Hintermister
999 E Street NW
Washington, DC 20463
audit@fec.gov

RE: Repayment Determination for Gary Johnson 2012 Inc

Dear Mr. Hintermister:

Pursuant to 11 C.F.R. § 9038.2(c)(2), I am writing to dispute the repayment determination in the Commission's Final Audit Report ("FAR") on Gary Johnson 2012 Inc ("GJ2012" or "Committee").

I. Request for a Hearing Before the Commission

The Committee requests an opportunity to address the Commission to discuss the issues raised in this submission, and any others that may be relevant to the Committee's repayment obligation.

II. The Commission's Presumption of Commingling is Inconsistent with FECA and with the Holding in *Kennedy*

In the FAR, the Commission adopted the Audit Division's finding that $332,191 was repayable to the U.S. Treasury for federal matching funds spent on non-qualified campaign expenses. It arrived at this figure by applying its repayment ratio to Committee expenditures on such expenses from both of the Committee's back accounts. Since only one of the Committee's bank accounts ever contained federal matching funds, this methodology is not consistent with the Federal Election Campaign Act ("FECA"), or with *Kennedy for President Committee v. FEC*, 734 F.2d 1558 (D.C. Cir. 1984), and must be rejected.

A. The Court in *Kennedy* did not Hold that all Private Primary and Federal Matching Funds are Commingled as a Matter of Law

In *Kennedy*, the court held that the Commission has a duty to determine the amount of federal matching funds spent on non-qualified campaign expenses, and to limit any repayment obligation to that amount. *Kennedy*, 734 F.2d 1558. The court acknowledged that it may be difficult to determine precisely what amount of matching funds, as opposed to primary funds, was spent on non-qualified campaign expenses, and therefore left it to the Commission to choose a method to estimate that amount. *Id.* at 1563. However, the Commission's discretion in this matter is limited to those methods that produce a *reasonable* estimate of the amount. *Id.* Although the difficulty in determining the amount of matching funds improperly spent may be caused in part by the commingling of primary and matching funds, the court did not hold, as the Office of General Counsel ("OGC") concluded, in its March 18, 2015, memo ("DFAR Memo"), that all primary and matching funds are considered commingled "as a matter of law." DFAR Memo at 2. This is not supported by the language of the opinion, and in fact clearly violates the court's express limitation of the Commission's discretion in choosing a method to estimate the amount of matching funds improperly spent. 734 F.2d at 1563.

In *Kennedy*, the court concerned itself with the specific facts of the case before it, and did not reach or even consider the issue of whether all primary funds and matching funds of all committees must always be deemed commingled. The court talks only about how the committee in that case, Kennedy for President Committee, handled its finances, and does not generalize the analysis to all committees that receive matching funds. *See* 734 F.2d at 1562, 1564, 1565 n.11. Indeed, it would have been entirely unreasonable of the court to do so, given the huge variety in how different committees manage their finances, and in how much information the Commission will have about those finances when conducting an audit. A repayment determination cannot be conducted using a one-size-fits-all methodology, with the Commission pre-determining the facts before knowing what they are. Rather, it must be a case-by-case analysis based on the facts as they are discovered and the information available to the Commission at the time.

In the instant case, documents create by Audit Division staff in the ordinary course of the audit – as opposed to an idiosyncratic and impracticable analysis that worried the court in *Kennedy* – clearly demonstrate that the federal matching funds that the Committee received were only ever kept in the Committee's primary account, and that only a maximum of $2,510 in non-qualified campaign expenses could possibly have been paid for with those matching funds. *See* FEC Calculation of Unqualified Expenses spreadsheet. This is information already available at no extra cost, and that can hardly be considered suspect, since it was Audit Division staff that prepared it. Nonetheless, the Commission has chosen to ignore it and rely instead on the statutorily unsupported presumption of commingling. The result is a determination that $332,191 in matching funds was improperly spent – which is simply factually erroneous – well over a hundred times as much as the FEC's own analysis says could actually have been spent.[1]

The Committee does not object to the Commission's use of the repayment ratio in determining a repayment obligation, but rather to the way that the ratio was improperly applied to both sets of Committee accounts, instead of only that set which actually contained federal matching funds and from which payments for non-qualified campaign expenses were paid. If matching funds had in fact been commingled with the re-designated primary funds (those originally segregated as general election contributions), then those primary funds should of course be included in the analysis. But if, as in the instant case, there is clear evidence that those funds were not commingled, then there is no reasonable option but to exclude them. The Commission cannot simply opt to ignore evidence that contradicts the results of its chosen method of estimation. Such a method can only be reasonable – and therefore consistent with the requirements of *Kennedy* – if it takes those, and all

[1] The Committee also notes that in its June 3, 2015 memo ("ADRM Memo"), OGC stated that the Commission has "continuously considered a publicly-funded committee's public and private funds to be commingled as a matter of law under the authority of the *Kennedy* decision." ADRM Memo at 3 n.3. This may well be the case, but simply the fact that the Commission has been consistent in its interpretation of *Kennedy* tells us nothing about the validity of that interpretation. If the Commission was wrong when it first interpreted the case – as we maintain it was – then it is just as wrong today when it repeats that interpretation.

other relevant facts into account. If the Commission refuses to do so in this case, its final determination cannot be considered valid.

B. The Commission's Presumption of Commingling is Unreasonable in Section 9038(b)(2) Repayment Cases

In its ADRM Memo, OGC raises a second argument for treating all primary and matching funds as commingled: if there were no such presumption in place, committees could simply segregate their matching funds in a separate account, spend primary funds on non-qualified campaign expenses, and escape a repayment obligation by claiming, accurately, that no matching funds were spent improperly. ADRM Memo at 6. This argument does not in and of itself justify a presumption of commingling. 26 U.S.C. § 9038(b) gives three bases for repayment of matching funds: (1) when a committee receives more matching funds than it was entitled to, (2) when a committee spends matching funds on non-qualified campaign expenses, and (3) when a committee is in a surplus position after the end of the matching funds period.

In the hypothetical OGC presents, it is true that a committee would be able to avoid repayment under section 9038(b)(2), but this is entirely proper. In *Kennedy*, the court made clear that the manner in which primary funds are spent has almost no bearing on a committee's obligations with regard to matching funds. 734 F.2d at 1564, nn.8-9. Section 9038(b)(2) provides for repayment when "any amount of any payment made to a candidate from ***the matching payment account*** was used for any purpose other than . . . [qualified campaign expenses]" (emphasis added). This section makes no mention of private primary funds, or how a committee may spend them. In *Kennedy*, the court explicitly stated that treating primary funds like matching funds in the way the Commission does would be "absurd and utterly dissolve[] the distinction, recognized by statute, between expenses paid out of matching funds and expenses paid out of private contributions." 734 F.2d at 1564 n.9 (internal citation omitted).

There is only one situation where section 9038 would provide for repayment when only primary funds were spent on non-qualified campaign expenses: if, but for the primary funds improperly spent, a committee would be in a surplus position, then repayment of some portion of matching funds would be available under section 9038(b)(3), and potentially 9038(b)(1) as well.

Though the Commission may consider this bad policy, the court in *Kennedy* held that repayments of matching funds are simply not appropriate where only private primary contributions were spent on non-qualified campaign expenses, except in the narrow case where the amount improperly spent exceeds the committee's deficit. 734 F.2d at 1564-65, n.10. The Commission is bound by the law as interpreted by the courts, and therefore must act consistently with this ruling.

In the instant case, the Commission has acknowledged that "the [Committee] did not receive matching fund payments in excess of [its] entitlement," FAR at 12 (footnote omitted), and also that the Committee is in a deficit position, even when accounting for the primary funds spent on non-qualified campaign expenses. *See* FAR at 10. Therefore, the Commission cannot pursue repayment under section 9038(b)(1) or (b)(3). The only alternative is 9038(b)(2), which is strictly limited to matching funds spent on non-qualified campaign expenses; the manner in which primary funds have been spent is therefore not relevant in determining the Committee's repayment obligation. Any analysis which treats all Committee accounts as commingled runs directly counter to this imperative, and must be rejected.

Therefore, the Commission must apply the repayment ratio to only those accounts which actually contained matching funds and could have spent them on non-qualified campaign expenses – which we know in this case can only be the primary account. Doing otherwise could not result in a reasonable estimation of the amount of matching funds spent on non-qualified campaign expenses, as required by *Kennedy*.

C. The Commission's Analysis is Unreasonable in this Case given the Committee's Good Faith Attempt to Comply with its Intended Disclaimer

The Commission should reject the repayment determination adopted in the FAR because the highly particularized facts of the instant case clearly demonstrate that such a repayment obligation is a disproportionate penalty to what is, at root, a very minor error with respect to disclaimer language.

The instant case is not a situation like the one imagined by OGC, where a committee is secretly attempting to circumvent the restrictions on its use of matching funds by using primary funds in their place. If a committee did attempt to abuse the leeway that OGC fears section 9038(b)(2) offers, it would be easily identified during an audit. The Committee is not such an actor, and cannot equitably be treated like one.

The Committee only ever acted based on a good faith belief that the primary funds it was spending were actually general funds – a belief it maintained until after the election, when the Commission made the determination to the contrary. But for the oversight in updating its disclaimer language after the primary election, those funds would in fact have been general funds, and spending them in the way the Committee did would have been entirely proper and permissible.

Section 9038 was not intended as a remedy for violations of the disclaimer rules. Requiring the Committee to repay such a huge amount, with money it does not have, based on an ex post re-classification of campaign funds – and a repayment determination in violation of FECA and relevant case law – is a clearly unjust result that the Commission must reject.

III. Conclusion

The Commission's policy of treating all of a committee's private primary funds and federal matching funds as commingled, regardless of how the committee actually managed these funds, violates the Commission's statutory obligation to reasonably estimate the amount of matching funds – and matching funds alone – that were spent on non-qualified campaign expenses, as set forth in the *Kennedy* decision.

The Commission may not ignore clear evidence that primary and matching funds were not commingled, regardless of the policy or enforcement ends it seeks to achieve. Similarly, the Commission may not rely on section 9038(b)(2) as justification to presumptively treat all primary and matching funds as commingled, because even in the contrived scenario presented by OGC, an appropriate repayment obligation is only achieved by not treating all funds as commingled.

Finally, irrespective of the approach the Commission decides to adopt going forward, the repayment obligation in the FAR must be rejected due to the facts and circumstances in this case showing that such an amount is wholly disproportionate to the inadvertent Committee error – identified long after the campaign ended – that the Committee properly operated under.

Sincerely,
/s/
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