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WASHINGTON, D.C. 20463

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March 5, 2007

MEMORANDUM

To: The Commissioners

Through: Patrina M. Clark *Just for PNC*
Staff Director

Margarita Maisonet *MM*
Chief Compliance Officer

From: Joseph F. Stoltz *JFS*
Assistant Staff Director
Audit Division

Wanda J. Thomas *WJT*
Deputy Assistant Staff Director

Henry Miller *HM*
Lead Auditor

Subject: Attachment to Report of the Audit Division on Kucinich for President, Inc.

AGENDA ITEM
For Meeting of: 03-08-07

SUBMITTED LATE

This document containing comments from the Office of General Counsel on the Audit Division's Report on Kucinich for President, Inc. should have been circulated as an attachment to Agenda Document 07-16. If you have any questions, please contact Henry Miller or Wanda Thomas at 694-1200.

Attachment:
Memorandum to Joseph F. Stoltz, Kucinich for President, Inc. – Final Audit Report



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

February 1, 2007

MEMORANDUM

TO: Margarita Maisonet
Chief Compliance Officer

Joseph F. Stoltz
Assistant Staff Director

THROUGH: Patrina M. Clark *PMC*
Staff Director

FROM: James A. Kahn *JK*
Deputy General Counsel

Thomasenia P. Duncan *TPD*
Associate General Counsel

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Assistant General Counsel
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Delanie DeWitt Painter *DDP*
Attorney

SUBJECT: Kucinich for President, Inc. -- Final Audit Report
(LRA #640)

I. INTRODUCTION

The Office of General Counsel has reviewed the Final Audit Report ("proposed Report") on Kucinich for President, Inc. ("KFP") that you submitted to this Office.¹ We concur with the findings in the proposed Report, but we have comments on the first two findings: Finding 1, which recommends a repayment determination of \$46,069 for matching payments received in excess of the candidate's entitlement and Finding 2., which recommends a repayment of \$135,518 for using public funds for continuing to campaign efforts after the Commission determined the candidate was no longer eligible to receive public funds for the purpose of seeking the 2004 Democratic party nomination. We will discuss both of these findings together

¹ The Office of General Counsel recommends that the Commission consider this document in Open Session. See 11 C.F.R. § 9007.1(e)(1).

as they both relate to the issue of how to treat contributions received by a candidate who continues to campaign after he is no longer eligible to receive public funds for his campaign. If you have any questions about our comments, please contact Delanie DeWitt Painter, the attorney assigned to this audit.

II. AUDIT DIVISION RECOMMENDS REPAYMENTS RELATED TO KUCINICH CAMPAIGNING AFTER CANDIDATE BECAME INELIGIBLE

As background for our comments, we first describe some key principles of the primary election public financing system. The overall purpose of the system is to provide public financing to candidates seeking the nomination as their party's candidate for the Office of President. Candidates participating in this system receive funds from two sources: contributions from individuals and public matching funds from the United States Treasury. These publicly-financed candidates have a status of either eligible to receive and spend matching funds for the purpose of seeking the nomination or no longer eligible ("ineligible"). Their status controls how that candidate may use contributions and matching funds. An eligible candidate may use both contributions and matching funds only for qualified campaign expenses for the purpose of seeking the party nomination. 11 C.F.R. §§ 9032.9, 9034.4(a)(1). The rule is different, however, once the candidate is no longer eligible. Generally, once a candidate becomes ineligible, the candidate's committee may use contributions and matching funds only to: 1) satisfy the debt from the period when the candidate was eligible; and 2) pay expenses necessary to wind down the campaign. 11 C.F.R. §§ 9032.9, 9034.4(a)(1) and (3), 9034.11. Any other expenses incurred after the candidate's date of ineligibility ("DOI") are not qualified campaign expenses. 11 C.F.R. §§ 9034.4(a)(3) and (b)(3). The Commission determines the candidate's date of ineligibility.

The Commission's determination that a candidate has become ineligible does not, however, mean that the candidate must abandon his campaign for the party's nomination. See 11 C.F.R. § 9034.4(a)(3); *LaRouche v. Federal Election Commission*, 28 F.3d 137 (D.C. Cir. 1994). The candidate may elect to continue to campaign but may no longer pay for that campaign with any matching funds. The candidate, however, may use contributions received after the candidate's date of ineligibility to continue to campaign.² 11 C.F.R. § 9034.4(a)(3). This is an exception to the general rule that candidates must use contributions received after the DOI to satisfy debt from the period of eligibility or pay winding down expenses. The regulations do not explicitly state how long a candidate may use those contributions to pay for continuing to campaign expenses. One of the questions at issue in this audit is whether those contributions may be used indefinitely to pay for expenses and debt arising out of the candidate's efforts to continue to campaign, or if and when the candidate must redirect those contributions to pay the debt from the period when the candidate was eligible. In other words, the issue here is whether and when the continuing to campaign exception ends.

² As ineligible candidates may use those contributions to continue to campaign while still receiving matching funds for those contributions, contributions are treated differently for candidates who continue to campaign than for those who withdraw. See 11 C.F.R. § 9034.4(a)(3).

KFP and the Audit Division disagree on the resolution of this issue. This disagreement is highlighted by the following facts. The candidate satisfied the eligibility requirements and received matching funds. The Commission determined that his date of ineligibility was March 4, 2004, after he received insufficient votes in two consecutive primary elections. He continued to campaign after his DOI through the date of the Democratic Party nomination on July 29, 2004. KFP contends that it should be able to continue to use all contributions received after the candidate's DOI to pay expenses and debt related to its continuing to campaign efforts, even after July 29, 2004, when the candidate's primary campaign was over, through December 31, 2004. The Audit Division, however, concludes that once the candidate was no longer campaigning, KFP had to redirect contributions it received to pay the debt from the period when the candidate was eligible. Thus, the auditors conclude that only those contributions received while the candidate was actually continuing to campaign, between the DOI and July 29, 2004, may be used to pay for KFP's continuing to campaign expenses. The auditors treated contributions KFP received after July 29, 2004 like contributions to other ineligible candidates in calculating the candidate's entitlement.

We concur with the Audit Division's approach for the reasons set forth below. Before we discuss those reasons, we address how the Audit Division's conclusion results in two separate bases for the Committee to repay matching funds to the United States Treasury.

First, the Audit Division recommends a repayment because the candidate received funds in excess of his entitlement (Finding 1.).³ The amount of private contributions available to pay debts from the candidate's period of eligibility affects the calculation of the candidate's entitlement. Specifically, the auditors subtracted \$269,682, the amount of contributions KFP received between July 30, 2004 and January 2, 2005, from KFP's net outstanding campaign obligations ("NOCO"), in effect reducing the remaining NOCO. The auditors, thus, treated contributions received after the candidate's campaign ended as used exclusively to satisfy debts from the candidate's period of eligibility. This reduced the candidate's entitlement and resulted in a recommended repayment determination of \$46,069 for matching funds received in excess of entitlement.

Second, the Audit Division recommends the Commission make a repayment determination because KFP used matching funds to pay expenses related to the candidate's continuing to campaign efforts (Finding 2.). The formula used to calculate the amount of funds containing matching funds that were used to pay for continuing to campaign expenses is straightforward. The auditors subtract the contributions dated and received after DOI and on or before July 29, 2004 from the continuing to campaign expenses paid. If the amount of continuing to campaign expenses is larger than the contributions, then the auditors will conclude that KFP paid the difference in expenses with funds containing matching funds. As the auditors conclude that contributions raised after July 29, 2004 must be used to satisfy the debt from the

³ A candidate is entitled to receive matching funds after DOI only to the extent the candidate has remaining net outstanding campaign obligations, expenses from the period while the candidate was eligible and winding down costs, on the date of payment, as reflected on the candidate's statement of net outstanding campaign obligations ("NOCO Statement"). See 11 C.F.R. § 9034.1.

candidate's period of eligibility, those contributions were not available to pay for continuing to campaign expenses.

Using this approach, the Audit Division concludes that KFP paid \$454,015 more for continuing to campaign expenses than it received in contributions during the period while the candidate continued to campaign between March 5, and July 29, 2004. According to the Audit staff, most of this amount was both incurred and paid before July 29, 2004, but \$30,171 was incurred before July 29, 2004 and paid after that date. Because the auditors are not including any contributions received after July 29, 2004 in this calculation, it would not matter under their approach if KFP subsequently received sufficient contributions to pay the \$30,171 before making those payments. The Audit staff's analysis considered only the contributions KFP had available to pay expenses during the continuing to campaign period prior to July 29, 2004. The auditors conclude that these expenses were paid with funds that contained matching funds and recommend a *pro rata* repayment of \$135,518.⁴

III. REPAYMENTS ARE WARRANTED

This Office concurs that repayments are warranted on both bases. We recognize, however, that there are arguments on both sides of the issue. We begin with two points that suggest that KFP could continue to use contributions for continuing to campaign expenses indefinitely. First, the regulations do not explicitly provide any end date when contributions may no longer be used exclusively to pay continuing to campaign expenses. See 11 C.F.R. § 9034.4(a)(3)(ii). Arguably, this means that ineligible candidates who continue to campaign may use all contributions dated after DOI to pay for continuing to campaign expenses and debts for those expenses even after the candidate is no longer continuing to campaign without affecting entitlement or resulting in non-qualified campaign expenses.

Second, the 1991 Explanation and Justification for section 9034.4(a)(3)(ii) stated that the "new provisions reflect the Commission's intention to treat candidates who continue to campaign as fairly as those who withdraw as of the date of ineligibility." Explanation & Justification for 11 C.F.R. § 9034.4(a)(3), 58 Fed. Reg. 35898, 35905 (Jul. 29, 1991). The Commission stated that it had revised the section "to allow a candidate to use post-ineligibility contributions to continue campaigning after the date of ineligibility without such activity resulting in a repayment of funds in excess of entitlement or a repayment of funds used for nonqualified campaign expenses." *Id.* This language, arguably, supports allowing a candidate to use contributions for continuing to campaign expenses indefinitely because allowing the candidate to use the contributions indefinitely would reduce the likelihood of potential repayment obligations for using matching funds to pay continuing to campaign debt or receiving funds in excess of entitlement.

⁴ The pro rata repayment of \$135,518 represents the amount of matching funds used for these expenses, and was calculated by multiplying the total expenses of \$454,015 by the repayment ratio of 29.8488%. See 11 C.F.R. § 9038.2(b)(2)(iii).

A. Exception Ends When Candidate's Campaign Ends

This Office understands the arguments that suggest that KFP should be allowed to use the contributions indefinitely for continuing to campaign expenses. We believe, however, that the conclusion most consistent with the regulatory structure of the matching funds program is that once the campaign ends, the continuing to campaign exception ends as well. This means that after this point in time, all contributions and matching funds must be considered to be available only to retire debt from the period of eligibility and pay winding down expenses. As a practical matter, no primary candidate could continue to campaign for the primary after the date of the party nomination. Thus, it makes sense to limit the incurrence of continuing to campaign expenses to the period when the candidate actually is continuing to campaign. It is less clear, however, whether the exception allowing candidates to use contributions received after DOI to pay for continuing to campaign expenses and related debts should also end when the campaign does.

If the use of contributions to pay continuing to campaign expenses ends when the campaign ends, all candidates are treated consistently during the winding down period after their campaigns have ended regardless of whether they continued to campaign or not. For all candidates, there are significantly different requirements for the calculation of entitlement and use of funds between the period of eligibility and the time when their campaigns end and the winding down period begins. For the period of eligibility, all candidates are entitled to matching funds based on contributions that are matchable, 11 C.F.R. § 9034.1(a), and they must use their contributions and public funds for qualified campaign expenses or expenses incurred in connection with seeking the nomination. 11 C.F.R. 9034.4(a). When the candidates are no longer eligible, however, the candidates' entitlement is based on matchable contributions *and* a showing that the candidates have net outstanding campaign obligations from their period of eligibility. 11 C.F.R. § 9034.1(b). When the candidates are no longer eligible, they must use their contributions and public funds for net outstanding campaign obligations from the period of eligibility and winding down expenses. 11 C.F.R. §§ 9032.9, 9034.4(a)(1) and (3), 9034.11.

The underlying goal of these regulations is to have all candidates treated in the same manner regardless of whether they continued to campaign. Explanation & Justification for 11 C.F.R. § 9034.4(a)(3)(ii), 58 Fed. Reg. 35898, 35905 (Jul. 29, 1991) (The "Commission's intention [is] to treat candidates who continue to campaign as fairly as those who withdraw as of the date of ineligibility.") After their campaigns are over, all ineligible candidates should have their entitlement calculated in the same manner and all candidates should use their contributions and matching funds only to pay net outstanding campaign obligations remaining from their period of eligibility or to wind down their campaigns. Within this framework, we recognize that limiting the use of contributions to the period while the candidate is actually continuing to campaign simply delays the use of contributions to pay net outstanding campaign obligations and winding down expenses until the active campaign actually ends.

To maintain the consistent treatment between candidates, the use of contributions for continuing to campaign expenses should end when the party nominates its candidate. The Commission considers the date of nomination as the last possible date that a primary campaign

can end. Thus, the date of nomination is the crucial turning point.⁵ This date determines when a candidate may use matching funds to pay for winding down expenses. A primary candidate who does not run in the general election may receive and use matching funds for winding down costs after the date he or she has notified the Commission in writing that the candidate has withdrawn, or after the date of the party's nominating convention if the candidate has not withdrawn before the convention. 11 C.F.R. § 9034.11(d). The winding down period cannot begin until after the end of the campaign, either by withdrawal or the party convention. Moreover, the regulatory history of section 9034.4(a)(3) states that a candidate "is not eligible to receive matching funds for winding down costs until the candidate is no longer continuing to campaign." 58 Fed. Reg. 35905. Because both matching funds and contributions are ordinarily used to pay winding down expenses and debt from the period of eligibility, 11 C.F.R. § 9034.4(a)(1) and (3), contributions should be redirected to pay for these expenses at the same time that the candidate can receive and use matching funds to pay for these expenses. The same date, therefore, that marks the end of the campaign and the beginning of the winding down period should also mark the end of the continuing to campaign period and the beginning of the period when private contributions can no longer be used exclusively for continuing to campaign, but must be used to pay for debts from the period of eligibility.

B. Candidate Should Use Contributions to Pay NOCO after Campaign Ends

KFP should be required to redirect contributions to pay its debt from the period of eligibility because the use of contributions in this manner is an important component of debt retirement and entitlement in the primary election public financing system. This point is demonstrated in *LaRouche v. Federal Election Commission*, 28 F.3d 137 (D.C. Cir. 1994) ("*LaRouche*"). In *LaRouche*, the candidate campaigned after he became ineligible and received contributions while he continued to campaign.⁶ The Commission interpreted its regulations to require that those contributions be used to satisfy the debt from the candidate's period of eligibility. In contrast, the *LaRouche* campaign argued that the Commission's interpretation would limit *LaRouche*'s ability to continue to campaign and would frustrate the purpose of the public financing system to facilitate and broaden public debate.

The court rejected *LaRouche*'s arguments, reasoning that under the regulations, the Commission could terminate entitlement to additional matching payments as soon as the candidate had received sufficient public funds *and* private contributions to satisfy the debt from the candidate's period of eligibility, regardless of whether the candidate had actually paid all his debts or not. 28 F.3d 137, 140. The fact that the court rejected the *LaRouche* Committee's policy arguments and concluded that the Commission could terminate additional matching fund

⁵ Similarly, the Commission considers the date of nomination as the turning point in its "bright line" rules for allocating various types of expenses between a party nominee's primary and general campaigns. See 11 C.F.R. § 9034.4(e).

⁶ *LaRouche* was a candidate in 1988 and the activity at issue in this case pre-dated the Commission's 1991 rulemaking that created the continuing to campaign exception. See Explanation & Justification for 11 C.F.R. § 9034.4(a)(3), 58 Fed. Reg. 35898, 35905 (Jul. 29, 1991).

entitlement once the candidate had sufficient public funds and private contributions to satisfy its debts from the period of eligibility demonstrates that private contributions play an important role in retiring debt and in calculating entitlement. Given the important role that contributions received play in satisfying debts from the period of eligibility and in the calculation of entitlement, contributions should be redirected to paying that debt as soon as the candidate is no longer continuing to campaign.

C. This Office Concurs with Audit Approach and Potential Repayments

After considering the arguments on both sides of the issue, this Office concludes that KFP must redirect contributions to pay for its debt from the period of eligibility and winding down expenses when the winding down period begins in order to preserve public matching funds and avoid disparately increasing any candidate's entitlement. With respect to the entitlement issue in Finding 1., the Audit staff notes in the proposed Report that allowing candidates to use all funds dated and received after DOI exclusively to pay for continuing to campaign debt could, in effect, create additional entitlement for candidates who continue to campaign. Generally, candidates use the commingled pool of contributions and matching funds received after DOI to pay their net outstanding campaign obligations. A candidate's remaining entitlement is calculated by subtracting contributions and matching funds received on or after DOI from their net outstanding campaign obligations. 11 C.F.R. § 9034.1(b). Thus, a candidate who continues to campaign could have a larger entitlement than other ineligible candidates who have the same amount of net debts outstanding and contributions received during the winding down period if the contributions received during the winding down period are not used to reduce the candidate's net outstanding campaign obligations in calculating remaining entitlement. *See LaRouche v. Federal Election Commission*, 28 F.3d 137 (D.C. Cir. 1994). The less contributions that are available to pay debts and winding down expenses means more matching funds must be used to pay those expenses.⁷

With respect to Finding 2., the Audit Division recommended a *pro rata* repayment of \$135,518 for funds containing matching funds used to pay for continuing to campaign expenses. *See* 11 C.F.R. § 9034.4(a)(3)(ii). The Audit staff's analysis considered only contributions dated and received between DOI and July 29, 2004 as available to pay for expenses incurred during the continuing to campaign period.⁸ Most of the expenses at issue in Finding 2. were actually paid

⁷ On the other hand, a candidate who continues to campaign could decrease his entitlement. That candidate may be more likely to raise more funds than if that candidate had stopped campaigning. This assumes that the candidate would use at least some of the additional funds raised to pay for debts from the period of eligibility, which would reduce NOCO and remaining entitlement.

⁸ The auditors are not considering contributions received after July 29, 2004 to be available to pay for continuing to campaign expenses, even for expenses paid after that date. Consequently, expenses incurred during the continuing to campaign period could be treated differently depending on when they are billed and paid. This approach, in effect, forces candidates to pay beforehand or as soon as they are billed (if the bill arrives while they are still campaigning), or to delay paying debts for continuing to campaign expenses that they have not paid by the date of nomination until after their accounts no longer contain matching funds in order to avoid making non-qualified campaign expenses. This could create substantial delays in payment of vendors by candidates who

prior to July 29, 2004. As KFP had not received sufficient contributions to pay for all of those expenses when it paid them, it must have used some amount of matching funds to make those payments. The use of public matching funds for the continuing to campaign expenses was not a qualified campaign expense and thus, the *pro rata* portion of the funds representing the matching funds must be repaid. This analysis is consistent with the analysis of a similar issue in a previous election cycle. See Statement of Reasons – Keyes 2000, Inc. (approved Mar. 4, 2004) (Repayment for the *pro rata* amount spent in excess of funds during the continuing to campaign period). Although it is possible that KFP had received sufficient additional contributions to pay for the \$30,171 that was incurred before July 29, 2004 but paid later, any contributions KFP received after July 29, 2004 were not available to pay for continuing to campaign expenses, but rather, should have been used to pay debts from the period of eligibility. Further, any payments made for continuing to campaign expenses after July 29, 2004 would be non-qualified because the continuing to campaign exception had ended and the winding down period had begun. During the winding down period, all contributions and matching funds are considered commingled in a mixed pool, see *Kennedy for President v. Federal Election Commission*, 734 F.2d 1558, 1562 (DC Cir 1984) and any payment would contain some amount of matching funds as long as KFP's accounts still contain any matching funds. See 11 C.F.R § 9038.2(b)(2)(iii)(B).

Finally, we note that the discussion on page 13 (Finding 2.) of the proposed Report is confusing because it discusses the same issue of entitlement that is the basis of Finding 1. We suggest that this paragraph be revised to clarify the basis for the repayment by adding an explanation that the repayment is based on the contributions received during the continuing to campaign period, and stating that any contributions received after July 29, 2004 were not available to pay for continuing to campaign expenses.

continue to campaign, which could, in turn, create a disincentive for those vendors to provide goods and services to future candidates who continue to campaign.