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Subject: Comments in Notice 2004-06 of Democracy 21, the Campaign Legal Ce nter and Center for Responsive Politics

Attached for filing are the comments of Democracy 21, the CampaignLegalCenterand the Center for Responsive Politics. All three commenters request the opportunity to testify.

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Thank you.

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 - Comments on Notice 2004-6 -- FINAL.DOC

 - 501cDearColleague.pdf

April 5, 2004

By Electronic Mail

Ms. Mai T. Dinh
Acting Assistant General Counsel
Federal Election Commission
999 E Street NW
Washington, DC 20463

Re: Comments on Notice 2004-6: Political Committee Status

Dear Ms. Dinh:

These comments are submitted jointly by Democracy 21, the Campaign Legal Center and the Center for Responsive Politics in response to the Commission's Notice of Proposed Rulemaking 2004-6, published at 69 Fed. Reg. 11736 (March 11, 2004), seeking comment on "whether to amend the definition of 'political committee' applicable to non-connected committees," *id.*, and other matters.

All three commenters have been actively engaged in the issues raised in this NPRM. On January 15, 2004, we filed a complaint with the Commission against three "section 527 groups," alleging that under existing law the groups are required to register as federal political committees and to comply with federal campaign finance laws for their spending, which is clearly for the purpose of influencing the 2004 federal elections. *See Democracy 21 et al. v. ACT et al.* (FEC) (filed January 15, 2003). We also filed extensive comments in two advisory opinion requests, AOR 2003-37 and AOR 2004-05, that raised related questions. We wrote the Commission on February 25, 2004 urging that the Commission in this rulemaking address the critical issue of the need to revise its allocation rules to conform with federal campaign finance laws. We wrote to the Commission again on March 16, 2004, urging that this rulemaking be bifurcated to focus on the most pressing violations of law now occurring in this election cycle.

All three commenters request the opportunity to testify at the hearing to be held by the Commission on these rules. Donald Simon, counsel to Democracy 21, will testify on behalf of that organization. Trevor Potter, chair and general counsel of the Campaign Legal Center, will testify on behalf of that organization. Lawrence Noble, executive director, and Paul Sanford, general counsel, of the Center for Responsive Politics, will both testify on behalf of that organization.

1. Introduction

Faced with specific violations of the campaign finance laws that are taking place in this election – the spending of tens of millions of dollars of soft money explicitly for the purpose of

influencing the presidential election by section 527 groups that are not registered as "political committees," and by political committees that are manipulating the current allocation rules to spend virtually unlimited amounts of soft money to influence federal elections – the Commission has failed to bring any enforcement action to date to stop these obvious circumventions of law. It has instead undertaken this expedited rulemaking proceeding to write new regulations.

But rather than focusing this rulemaking on the precise issues presented by the ongoing violations of the law, the Commission has instead chosen to broadly over-reach, by proposing new rules that extend far beyond what is necessary to deal with the immediate problems. In so doing, this rulemaking threatens to broadly sweep into "political committee" status a whole range of non-profit groups (and potentially other types of organizations) that have not been, and cannot be, subject to this kind of regulation. It also threatens to apply an inappropriate standard to the public communications of nonprofit groups for determining when their public communications must be funded with federally legal contributions.

Predictably, this overbroad rulemaking has generated enormous controversy, and predictably, the Commission is being told by a range of voices to do either nothing at all, or nothing now.

By letter to the Commission dated March 16, 2004, we expressed our deep concerns about the scope of this rulemaking. As we there noted, this rulemaking "is so lengthy, addresses so many issues, raises so many questions and proposes so many new rules that the Commission is unlikely to be able to conclude this matter by its mid-May deadline and promulgate new rules for the 2004 general elections."

The NPRM raises a large number of questions; many of them have been raised and left unresolved by the Commission in the past. *See, e.g.,* Notice 2001-3, "Definition of Political Committee," 66 Fed.Reg. 13681 (March 7, 2001). Others propose to extend the federal campaign finance laws in dramatically new and controversial directions, by wrongly suggesting, for instance, that the FEC could subject all section 501(c) organizations to a "promote, support, attack or oppose" standard for whether their public communications constitute "expenditures." *See* 69 at Fed.Reg. at 11741.

This overbroad approach in the NPRM, as we previously stated, is a "recipe for failure" because it "is likely to result in agency gridlock and inaction." This is especially true in the context of this *expedited* rulemaking. In trying to resolve too much, too fast, the Commission runs the serious risk of resolving too little, too slowly, or indeed, nothing at all.

As we stated in our March 16 letter, the Commission should instead focus and prioritize this rulemaking. It should do so in light of the most apparent and serious problems that have become manifest in this election cycle. As an enforcement agency with the mission of ensuring compliance with the campaign finance laws, the Commission should deploy its energies and resources to those topics that most clearly and immediately threaten to subvert adherence to the law. While a number of the issues raised in the NPRM are important to the long-term scope and

structure of the campaign finance laws, they are not problems that require urgent resolution on an expedited basis for this election cycle.

But if the Commission is not prepared to enforce the existing law based on the existing regulations (a position with which we disagree), and instead contends that new regulations are necessary in order to enforce the law, the Commission must take two steps now:

First, and most importantly, the Commission must revise its fundamentally flawed allocation rules for non-connected committees, 11 C.F.R. §§ 106.1, 106.6, and make those revised rules effective immediately.

This is an issue apart from all of the others. There is no conceivable justification for allowing the current, fundamentally flawed, allocation regulations to continue as they are, and thereby to allow massive circumvention of the campaign finance laws.

History threatens to repeat itself. The virtually unrestricted flow of soft money through the political parties into federal elections was made possible by the Commission's allocation rules, which the Supreme Court described as "FEC regulations [that] permitted more than Congress, in enacting FECA, had ever intended." *McConnell v. FEC,* 540 U.S. ___,157 L.Ed.2d. 491, 548, n. 44 (2003). The Court found that the FECA "was subverted by the creation of the FEC's allocation regime," *id.,* which allowed the parties "to use vast amounts of soft money in their efforts to elect federal candidates." *Id.* at 548. The Court flatly stated that the Commission's allocation rules "invited widespread circumvention" of the law. *Id.* at 550.

Once again, the Commission's allocation rules "invite[] widespread circumvention" of the law and permit "more than Congress, in enacting FECA, had ever intended," this time through non-connected committees instead of through party committees. For instance, America Coming Together (ACT), a political committee with a nonfederal account, is claiming that those allocation rules allow it to fund *with 98 percent soft money* its massive partisan voter mobilization activities which are obviously and openly targeted to, and intended to, influence the 2004 presidential election. As we have previously demonstrated, ACT and its donors have made publicly clear that their overriding purpose is to mobilize voters to defeat President Bush in the 2004 election.[1]

That the Commission's rules can so easily and blatantly be manipulated to permit the virtually unrestricted use of soft money by a political committee for federal electoral purposes makes clear that the rules do not comport with the Federal Election Campaign Act (FECA), and that the Commission must modify those rules immediately to staunch the improper flow of soft money into federal campaigns. The proposed rule to require a minimum federal percentage for the funding of allocated activities, and to set that minimum at a level of 50 percent or higher for multi-state activities such as those undertaken by ACT, is, with an important modification, the correct and necessary first step to address this problem.

Second, a small number of self-declared "political organizations" – those entities registered under section 527 of the tax code as "organized and operated primarily" for the

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1 See Comments of Democracy 21 et al. on AOR 2004-05 (filed Feb. 12, 2004) at 12-17.

purpose of influencing candidate elections, 26 U.S.C. § 527(e)(1) – are spending millions of dollars on broadcast ads attacking or supporting the presidential candidates, but claiming that they do not have to register as political committees and comply with federal campaign finance laws because their ads do not use "express advocacy." The Media Fund is one such section 527 group that clearly illustrates this form of circumvention.

If the Commission believes that its current rules defining "political committee" do not cover section 527 groups, it should immediately promulgate a revised rule which does cover these groups, and make that rule effective immediately. A section 527 group that is spending millions of dollars for the self-declared purpose of promoting or attacking presidential candidates *must* be treated as a political committee.

The Commission must act now on these two problems, and make its revised regulations effective immediately. These revisions are required in order to correct longstanding misinterpretations of FECA by the Commission.

The Supreme Court decision in the *McConnell* case has served to make clear that the Commission's past interpretation of what constitutes a "political committee," and the Commission's allocation formula for non-connected committees, are both incorrect interpretations of FECA. In acting now to correct these misinterpretations, the Commission would not be "changing the rules" in the middle of an election, but rather ensuring that the nation's campaign finance laws, as enacted by Congress, are properly interpreted, administered and enforced. The Commission cannot justify a continuing failure to properly interpret the law, as made clear to the Commission by the Supreme Court, on the grounds that an election is taking place and we need to wait until next year to properly interpret the law.

Furthermore, the problems we urge the Commission to address in this rulemaking are problems that arise under the FECA, the longstanding prior law, and not under BCRA, the law enacted in 2002. Both the efficacy of the Commission's existing Part 106 allocation rules, and the question of when a section 527 group should register as a political committee, involve issues that pre-date BCRA, and that are decided by reference to FECA.

Thus, the fact that BCRA does not address these issues is neither surprising nor relevant: these are both questions that involve the incorrect prior interpretations of FECA that were made by the Commission.

Both of these questions need expedited answers because they both address ongoing schemes of circumvention that threaten to continue for the rest of this election cycle, and thereby to serve as avenues for the improper spending of tens of millions of dollars of soft money in this year's election. These two groups alone – ACT and the Media Fund – have announced ambitious plans to raise and spend as much as $190 million in soft money in the 2004 campaign. Other groups, in both parties, may soon follow suit.

And both of these questions are sufficiently defined and focused so as to permit the Commission to resolve them in the context of an expedited rulemaking, and have new rules take effect immediately.

By contrast, the other questions raised in the NPRM, although important, do not present issues of immediate consequence to ongoing schemes to evade the law that are already underway in this election cycle.

This of course does not mean that the other questions should not be resolved by the Commission at a later stage,[2] with the exception of the issues raised in the NPRM regarding section 501(c) groups. With regard to those questions, we believe the Commission has taken incorrect positions, and in any event, those issues would have to be addressed in the first instance by Congress, not by the Commission.

The prioritization that we suggest means that the Commission should bifurcate this rulemaking: to first address and resolve the two questions outlined above on the expedited schedule set forth in the NPRM, with the goal of making new rules effective immediately upon promulgation, and to then address the other questions raised in the NPRM on a non-expedited schedule that will permit more time and consideration of those rules.

As we pointed out in our March 16 letter, this proposed bifurcation has multiple advantages for the Commission and the regulated community. It best reflects the priorities that the Commission should set in meaningfully confronting the problems and evasions that are apparent in *this* election cycle. It provides more time for a rulemaking on issues that require greater public understanding and opportunity for discussion than this expedited schedule can provide. And it follows a pattern adopted by Congress in enacting BCRA, to conduct complex rulemaking proceedings on different tracks that reflect relative priorities.

In short, bifurcation maximizes the chances that this rulemaking will not succumb to paralysis, deadlock and inaction generated by the complexity and controversy inherent in the NPRM as adopted.

As noted above, it is not for the Commission to even address what is surely the most contentious issue raised in the NPRM – under what circumstances should a section 501(c) organization be required to register as a political committee, and when should the public communications of such groups be considered "expenditures." As the Commission is well aware, these questions generated tremendous concern in the non-profit community in the context of AOR 2003-37, when they were not even presented by the facts of that request. In this NPRM, however, the Commission has placed these issues directly on the table.

Given the experience in AOR 2003-37, it was predictable that there would be a strong response from the non-profit community in opposition to any action by the Commission. Indeed, this response is already apparent in the form of highly organized campaigns to generate a flood of comments to the Commission protesting the proposed rules that might apply to section 501(c) nonprofit groups. It appears furthermore, that some section 501(c) groups involved in this effort have the goal, not just to prevent Commission action regarding section 501(c) groups, but also to prevent *any* new rules being adopted for section 527 groups as well. We attach for the record a

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[2] The other questions presented in the NPRM, for instance, include a new definition of "partisan voter drives," 11 C.F.R. § 100.34 (proposed), 11 C.F.R. § 100.115 (proposed), as well as rules governing solicitations with express advocacy, 11 C.F.R. § 100.57 (proposed).

letter dated April 2, 2004 from Senators John McCain and Russell Feingold to their colleagues on this matter.

It is important that the Commission not permit controversy about the proper regulation of section 501(c) groups to become a distraction from, or an excuse to block action on, the very different question about the proper regulation of section 527 groups. It is that latter question which is of immediate importance to ongoing schemes to circumvent the law in the 2004 election, and which must be addressed by the Commission now.

But by proposing rules which much more broadly apply to all section 501(c) groups, the Commission risks losing its focus on the real and serious problems before it. The controversy generated by these unreasonably broad proposed rules – and the active lobbying campaigns they have spawned to block any action by the Commission – may well have the effect of serving as "cover" for the section 527 groups to continue their illegal activities in this election.

As we have stated repeatedly in documents filed with the Commission by our organizations over the last two months,[3] section 501(c) groups – like corporations generally and labor unions – have the constitutional benefit of a "bright line" test to divide their public discussions of issues (speech not subject to regulation under the campaign finance laws), from their public discussion of candidates and elections (speech which is appropriately subject to such regulation). This is true both for purposes of classifying public communications by such groups as "expenditures," and for the purpose of determining when such groups become "political committees."

Thus, the Supreme Court in *Buckley v. Valeo,* 424 U.S. 1 (1976), held that only public communications that contain express advocacy are within the definition of "expenditure" for such groups. This "bright line" test was supplemented in BCRA, when Congress classified certain broadcast ads as "electioneering communications" subject to regulations similar to those imposed on expenditures. But public communications by section 501(c) non-profit organizations and other corporations that do not fall within either of these two "bright line" classifications are not currently regulated by the federal campaign finance laws.

The Commission cannot change or supplement these categories, in this or any other rulemaking. It would be up to Congress to replace the express advocacy test for "expenditure" with some new or supplemental test. Congress may choose to do so in light of the fact that the Supreme Court has held that the express advocacy test is "functionally meaningless." *McConnell, supra* at 579. But any new test created by Congress to define "expenditure" would be required to adhere to some form of "bright line" standard in order to avoid constitutional problems of vagueness, in the same manner as BCRA's definition of "electioneering communication," which the Court upheld as against a vagueness challenge. *Id.* at 580.

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3 *See* Comments of Democracy 21, *et al.* in AOR 2003-37 (filed December 17, 2003) at 4; Comments of Democracy 21, *et al.* on Draft AO 2003-37 (filed February 4, 2003) at 9-10; Comments of Democracy 21 *et al.* in AOR 2004-5 (filed February 12, 2004) at 2-12; Letter of Democracy 21 *et al.* to Chairman Bradley Smith *et al.* (filed March 16, 2004) at 3-4.

What this means, in short, is that the Commission cannot, and should not, by rulemaking, subject public communications by section 501(c) organizations to the campaign finance laws beyond the current rules that apply to "express advocacy" and "electioneering communications."[4] Furthermore, neither the Commission nor Congress can apply a non-"bright line" test such as "promote, support, attack or oppose" to the uncoordinated communications of non-profit groups or other corporations. Unless and until Congress acts, section 501(c) groups are subject only to the "express advocacy" and "electioneering communications" tests for classifying when their public communications fall under the regulation of the federal campaign finance laws.

By contrast, a section 527 organization, by definition, has a principal purpose to influence elections and therefore does not receive, and never has received, the benefit of being subject only to "bright line" standards in defining the public communications that may be regulated by the campaign finance laws. Such groups are instead subject to the statutory definition of "expenditure" as communications "for the purpose of influencing" a federal election. 2 U.S.C. § 431(9). This statutory standard may be applied to such groups by using a "promote, support" test, a standard that the Court found adequately demarcated the speech of state parties that may be subject to regulation. *Id.* at 565 n.64. Section 527 groups, like state or national party committees, or like candidate committees, are in the business of influencing elections, and thus can be subject to this form of the statutory test.

Some have pointed to the distinction made by the Court in *McConnell* (in dismissing plaintiffs' equal protection claims) between parties and "interest groups," where the Court noted that such "interest groups" remain "free to raise soft money to fund voter registration, GOTV activities, mailings, and broadcast advertising (other than electioneering communications." 157 L.Ed.2d at 576. The argument is made that section 527 groups were thus categorized by the Court, along with section 501(c) groups, as such "interest groups," all in distinction to political parties.

There is no basis or support, however, for this reading of *McConnell*. In assessing the equal protection claim, the Court specifically referenced "special interest groups such as the National Rifle Association (NRA), American Civil Liberties Union (ACLU), and Sierra Club." Id.. The Court was clearly distinguishing section 501(c) non-profit interest groups, rather than section 527 political organizations, from political parties. Indeed, the Court separately made precisely this distinction between sections 527 and 501(c) groups, in noting that "section 527 'political organizations' are, unlike § 501(c) groups, organized for the express purpose of engaging in partisan political activity." Id. at 567 n.67 (emphasis added).

In short, section 501(c) groups are on one side of the line, and section 527 groups – along with party committees, candidate committees, and non-connected political committees – are on the other, when it comes to whether the express advocacy test should be used in determining if federal campaign laws apply to their public communications .

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[4] Partisan voter mobilization activities directed to the general public, and coordinated communications about candidates, are also, of course, subject to the federal campaign finance laws.

Given this fundamental distinction between section 501(c) groups and section 527 groups, the Commission can and should move decisively and expeditiously to forestall the ongoing schemes to circumvent the law that have been undertaken by the latter. Most importantly, the controversy that has resulted from the improvident proposals in the NPRM to radically expand the campaign finance laws to broadly cover the speech of section 501(c) groups, without basis in the law to do so, further counsels for the Commission to drop the section 501(c) issues from this rulemaking.

In our analysis below, we elaborate on these points. We do not attempt to address all of the issues presented by the NPRM, or to answer all of the questions posed by the Commission. Many of these questions need not be, and should not be, addressed by the Commission now, in the context of an expedited rulemaking.

Instead, we first present the overall analysis of constitutional law that informs the Commission's ability to regulate the electioneering activities of section 527 groups, and distinguishes the activities of such groups, and the constitutionally permitted scope of the regulation of such groups, from those of section 501(c) groups. We then discuss the proposed rules in the NPRM relating to the two urgent questions that are appropriately the subject of this expedited rulemaking: first, the proposals to change the existing allocation rules in order to comply with the FECA and close a major loophole that is being used to funnel soft money into the 2004 campaign, and then the "political committee" standards that should apply to the activities of section 527 groups.

2. Constitutional Analysis

For purposes of applying the campaign finance laws, the Supreme Court has sharply and explicitly distinguished the activities of political committees and other groups principally engaged in electioneering activity, such as section 527 organizations, from all other kinds of groups – *e.g.*, for-profit corporations, non-profit corporations, unincorporated associations and labor unions.

Thus, as a matter of campaign finance law and Supreme Court precedents, the rules that apply to groups whose major purpose is to influence elections, such as section 527 organizations, are different from the rules that apply, or can apply, to these other kinds of groups. The Court's recent ruling in *McConnell v. FEC* affirmed this important distinction, first formulated by the Court more than 25 years ago in *Buckley v. Valeo*.

A. The *Buckley* distinction. The background for treating political organizations and other entities, including section 501(c) groups, differently under federal campaign finance laws was set forth in *Buckley*. There, the Court in two contexts faced the question of whether campaign finance laws were unconstitutionally "vague" because they allegedly failed to clearly separate campaign communications from issue discussion. In both instances, the Court established the "express advocacy" standard, but did so *only* for groups that did not have as their "major purpose" influencing the election of candidates.

The first context concerned a provision that limited the amount of money that persons other than candidates and political committees could spend on "expenditures relative to a clearly identified candidate" *Id.* at 41. "The use of so indefinite a phrase as 'relative to' a candidate fails to clearly mark the boundary between permissible and impermissible speech," the Court said. *Id.* at 42. The Court further noted that "the distinction between discussion of issues and candidates and advocacy of election or defeat of candidates may often dissolve in practical application." *Id.*

For this reason, the Court limited the scope of this statutory provision "to communications that include explicit words of advocacy of election or defeat of a candidate." *Id.* at 43. The law would apply "only to expenditures for communications that in express terms advocate the election or defeat of a clearly identified candidate for federal office." The Court further explained this test to encompass only "express words of advocacy" such as "vote for, elect, support, cast your ballot for" and similar terms. *Id.* at 44 n.52.[5]

The Court in *Buckley* returned to this problem in another provision of the law that required disclosure of "contributions" or "expenditures" over $100 made by any person, other than a candidate or "political committee." *Id.* at 77. Candidates and political committees were under a separate disclosure requirement for their spending. The terms "contribution" and "expenditure" were defined in the statute as the use of money "for the purpose of influencing" the election of candidates for federal office. *Id.*

These definitions in the disclosure law raised concerns for the Court about possible vagueness, because they might not provide "adequate notice to a person of ordinary intelligence that his contemplated conduct is illegal..." *Id.* The Court said that the statutory definition of "contribution" in the law was sufficiently clear for this purpose, but that the definition of "expenditure" caused "line drawing problems of the sort we faced" with the spending limit discussed earlier. *Id.* at 78:

> [The term "expenditure"] shares the same potential for encompassing both issue discussion and advocacy of a political result. The general requirement that "political committees" and candidates disclose their expenditures could raise similar vagueness problems, for "political committee" is defined only in terms of amounts of annual "contributions" and "expenditures," and could be interpreted to reach groups engaged purely in issue discussion.
>
> *Id.* at 79 (emphasis added)

The Court resolved the problem by dividing it in two. First, it narrowed the definition of "political committee":

> To fulfill the purposes of the Act, [political committees] need only encompass organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate. Expenditures of candidates

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[5] Having construed the limit on expenditures narrowly in order to avoid constitutional problems of vagueness, the Court then struck it down as an infringement on the First Amendment. *Id.* at 44-5.

> and of 'political committees' so construed can be assumed to fall within the core area sought to be addressed by Congress. They are, by definition, campaign related.
>
> *Id.* (emphasis added).

Then the Court addressed the question of whether – for organizations under the control of a candidate or "the major purpose of which is the nomination or election of a candidate"– the statutory requirement that they disclose their "expenditures" was sufficiently clear to meet constitutional concerns. The Court held that because such groups "are, by definition, campaign related," the definition of "expenditure" to include any spending "for the purpose of influencing" federal elections did not cause a problem of vagueness. *Id.*

Second, the Court addressed the same question for all other spenders:

> But when the maker of the expenditure is not within these categories – when it is an individual other than a candidate or a group other than a "political committee" – the relation of the information sought to the purposes of the Act may be too remote. To insure that the reach of [the disclosure provision] is not impermissibly broad, we construe "expenditure" for purposes of that section in the same way we construed the terms of [the spending limit] – to reach only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate.
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> *Id.* at 80 (emphasis added)

Thus, the Court in *Buckley* made a crucial distinction: when the spender is an organization with a "major purpose" to influence candidate elections, the statutory definition of "expenditure" as spending "for the purpose of influencing" a federal election is sufficiently clear to be constitutional, because such organizations "are, by definition, campaign related" and their spending "can be assumed" to fall within the area properly regulated by Congress. Therefore, the "express advocacy" standard does not apply as a limit on the definition of an "expenditure."

On the other hand, when the spender is any other kind of organization – any organization which does not have a "major purpose" to influence elections – then a narrowed construction of "expenditure" is required in order to avoid constitutional problems of vagueness. The Court in *Buckley* used the "express advocacy" test for this purpose to narrow and clarify what "expenditure" means. For these groups, including section 501(c) groups, communications without "express advocacy" were not treated as "expenditures."

B. The ban on corporate "expenditures." In *FEC v. Massachusetts Citizens for Life,* 479 U.S. 238 (1986), the Court imported this same analysis to construe another provision of the campaign finance laws – the prohibition on spending by any corporation or labor union for any "expenditure." 2 U.S.C. § 441b. Again, the Court said that the statutory term "expenditure" was potentially vague, and the Court therefore held "that an expenditure must constitute 'express advocacy' in order to be subject to the prohibition of § 441b." *Id.* at 249.

The Court's discussion in *MCFL* is consistent with the distinctions it drew in *Buckley*. The issue in *MCFL* was how the prohibition on "expenditures" would be applied to a non-profit corporation organized under section 501(c)(4) of the tax law. The Court specifically noted that "it is undisputed on this record that MCFL" is not an entity "the major purpose of which is the nomination or election of a candidate." *Id.* at 625, n. 6. It said that "its central organizational purpose is issue advocacy, although it occasionally engages in activities on behalf of political candidates." *Id.*

As such, the Court applied the same narrowing construction to the term "expenditure" that it used in *Buckley*, so that the statutory prohibition on "expenditures" by a corporation would cover only "express advocacy."[6]

The Court exempted MCFL from the prohibition on making "expenditures" because it found MCFL was a purely ideological corporation that engaged in no business activities and took no union or corporate funds. MCFL and other similar ideological nonprofit groups are "more akin to voluntary political associations than business firms, and therefore should not have to bear burdens on independent spending solely because of their incorporated status." *Id.* at 631.

But the Court again drew the same distinction as in *Buckley* between those organizations like MCFL that do not have a "major purpose" to influence federal elections – and those that do, and as such are "political committees." The Court noted that:

> ...should MCFL's independent spending become so extensive that the organization's major purpose may be regarded as campaign activity, the corporation would be classified as a political committee. As such, it would automatically be subject to the obligations and restrictions applicable to those groups whose primary objective is to influence political campaigns.
>
> *Id.* at 262 (emphasis added).

Thus, as a result of *Buckley* and *MCFL,* the Court established that, for entities which do not have a "major purpose" to influence candidate elections, the term "expenditure" in the campaign finance laws must be construed to extend only to their public communications which contain "express advocacy" in order to avoid problems of constitutionally impermissible vagueness. Their public communications which do not contain "express advocacy" are accordingly not subject to the campaign finance laws.

By contrast, for those organizations that do have a "major purpose" to influence candidate elections, there is no constitutional requirement that the statutory definition of "expenditure" – any spending "for the purpose of influencing" a federal election – be narrowed by a bright line construction such as "express advocacy."

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[6] The Court in MCFL found the speech in question – an exhortation to vote for "pro life" candidates that were then identified – to be express advocacy. "The fact that this message is marginally less direct than 'Vote for Smith' does not change its essential nature." 479 U.S. at 249.

Because political committees have a "primary objective to influence political campaigns," and "are therefore, by definition, campaign related," their public communications do not get the benefit of the "express advocacy" standard and are presumed to constitute campaign spending subject to the campaign finance laws.

This has been the Supreme Court's framework for application of the campaign finance laws since *Buckley*.

C. BCRA and *McConnell*. The enactment of the Bipartisan Campaign Reform Act (BCRA) in 2002 did not change this underlying principle. Nor did Congress alter the statutory definition of "expenditure." Rather, Congress defined a new category of speech – called "electioneering communications"[7] – and imposed regulations on spending for such speech that are similar to the regulations imposed on express advocacy "expenditures." And as with express advocacy "expenditures," the rules on "electioneering communications" apply to all spenders, including those that do not have a "major purpose" to influence elections.

The Supreme Court in *McConnell* upheld the definition of "electioneering communication" because it found it to be "neither vague nor overbroad." 157 L.Ed.2d at 578. And the Court found that its analysis in *Buckley* and *MCFL* "in no way drew a constitutional boundary that forever fixed the permissible scope of provisions regulating campaign-related speech" as limited to express advocacy. *Id.*

The Court went on to find that "the unmistakable lesson from the record in this litigation, as all three judged on the District Court agreed, is that *Buckley's* magic-words requirement is functionally meaningless." *Id.* at 579.

The Court in *McConnell* also reiterated the distinction it drew in *Buckley* between organizations with a "major purpose" to influence candidate elections, and other entities, for purposes of whether campaign finance regulations meet the constitutional requirement to be clear and non-vague. In reviewing a separate BCRA requirement that state parties use hard money to pay for a public communication that "promotes or supports" or "attacks or opposes" a federal candidate, 2 U.S.C. §§ 431(20)(A)(iii); 441i(b)(1), the Court rejected a challenge that the definition was unconstitutionally vague because, it said, the words "clearly set forth the confines within which potential party speakers must act in order to avoid triggering the statutory provision." *Id.* at 565, n. 64.

The Court said that this is "particularly the case here, since actions taken by political parties are presumed to be in connection with election campaigns." *Id.* The Court then cited and quoted its discussion in *Buckley* by "noting that a general requirement that political committees disclose their expenditures raised no vagueness problems because the term 'political committee' 'need only encompass organizations that are under the control of a candidate or the major

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[7] 2 U.S.C. § 434(f)(3). These are broadcast ads that refer to a clearly identified federal candidate, are targeted to the electorate of the candidate, and are aired within 30 days of a primary or 60 days of a general election.

purpose of which is the nomination or election of a candidate' and thus a political committee's expenditures 'are, by definition, campaign related.'" *Id.*

Thus, the Court in *McConnell* affirmed that the express advocacy test set forth in *Buckley* was not for groups whose major purpose is to influence elections, such as section 527 groups, and furthermore, made clear that the test is "functionally meaningless," and may therefore require Congress to establish new, meaningful "bright line" standards.

D. The application of tax law. These election law distinctions reflect similar categories created by tax law. Nonprofit corporations organized under section 501(c) of the tax code, including 501(c)(4) advocacy groups, section 501(c)(5) labor organizations, and section 501(c)(6) trade association, all may engage in political campaign activity, but not to the extent that it becomes their "primary" purpose.[8]

By contrast, section 527 of the tax code governs "political organizations," which are defined as an entity "organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." 26 U.S.C. § 527(e)(1) (emphasis added). "Exempt function," in turn, is defined as "influencing or attempting to influence the selection, nomination, election or appointment" of any individual to public office. *Id.* at (e)(2). As the Supreme Court noted in *McConnell,* "Section 527 'political organizations' are, unlike § 501(c) groups, organized for the express purpose of engaging in partisan political activity." 157 L.Ed.2d at 567 n.67. The Court further noted that section 527 organizations, "by definition engage in partisan political activity..." *Id.* at 569.

These categories of tax law correspond to the categories of election law discussed above. Section 501(c) groups cannot – by definition – "primarily engage" in campaign activity, therefore such activity cannot be their "major purpose." Any section 501(c) group operating in conformance with its tax status accordingly does not qualify as a "political committee." Such groups are therefore (for election law purposes) subject only to bright line standards for determining when their public communications must be funded with hard money. These standards are express advocacy communications and "electioneering communications."[9]

On the other hand, any entity organized under section 527 of the tax code is operated "primarily for the purpose" of influencing candidate elections. Such groups thus have a "major purpose" to engage in electioneering. This means that, under the reasoning of *Buckley,* such groups are "by definition, campaign related," and therefore subject to regulation of their

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8 See, e.g., Treas. Reg. § 1.501(c)(4)-(1)(a)(2)(i) (providing that a section 501(c)(4) organization must be "primarily engaged in promoting" general welfare, and id. at § 1.501(c)(4)-(1)(a)(2)(ii) (providing that the promotion of social welfare does not include "direct or indirect participation or intervention in political campaigns on behalf of or in opposition to any candidate for public office."). By contrast, Section 501(c)(3) charities may not "participate in, or intervene in" political campaigns at all. 26 U.S.C. § 501(c)(3).

9 This principle would not apply, of course, to any section 501(c) group that is not operating in conformance with its tax status.

"expenditures," defined as spending "for the purpose of influencing" federal elections, without the need for any limiting construction such as express advocacy. Whether such groups also constitute "political committees" is discussed below.

E. The applicable principles. From this discussion of case law, a set of clear principles has emerged to govern when communications are "expenditures" required to be funded with contributions subject to the limitations, prohibitions and reporting requirements of the campaign finance laws.

First, the Court has developed and adhered to an important distinction between those groups which have a "major purpose" to influence political campaigns, and those groups which do not. The activities of the former are "presumed to be in connection with campaigns" and their spending is "by definition, campaign related." They do not get the benefit of the "express advocacy" test as a limiting construction on "expenditures."

Second, because of this distinction, campaign finance regulations that apply to the activities of those groups which do not have a "major purpose" to influence political campaigns must meet a constitutional concern with vagueness. For such groups, including section 501(c) nonprofit groups, the "express advocacy" standard and the "electioneering communications" test established in BCRA determine whether their public communications are covered by federal campaign finance laws. The concern for vagueness does not apply to those entities which do have a major purpose to influence candidate elections, including "political committees" and section 527 organizations.

And third, to accommodate this distinction, the definition of "expenditure" has always had two different meanings, depending on the type of entity it is applied to:

For groups with a "major purpose" to influence campaigns, including section 527 organizations, the statutory definition of "expenditures" – spending "for the purpose of influencing" a federal election – applies.

For all other groups, a narrowing construction under *Buckley* and *MCFL* applies – the statutory term "expenditures" covers public communications that contain express advocacy. As noted above, with the enactment of BCRA, such groups are also subject to similar regulation for their "electioneering communications."

3. Issues Relating to Allocation

A. Introduction. The patent and ongoing abuse of the Commission's existing Part 106 allocation rules is a fundamental problem that *must* be addressed and resolved in this rulemaking. The Commission must act now to halt the use of these rules to allow the virtually exclusive use of soft money to fund widespread voter mobilization activities with the self-declared purpose and the self-evident effect of influencing this year's presidential elections. At least in one case, the circumvention is so bold, so extensive and so apparent that it will make a mockery of the law if the Commission does not act to stop it.

This is not an issue, in the first instance, of whether to establish a political committee. The existing rules make clear that partisan generic voter mobilization activities must be allocated between a federal and non-federal account. 11 C.F.R. § 106.6(c)(2)(iii). Thus, for instance, ACT has established itself as a federal political committee, but also has a nonfederal account. The central problem, instead, is that the existing regulations invite massive circumvention by allowing non-connected committees to manipulate their allocation ratios so that they may pay for most -- or all -- of their expenses with nonfederal funds, even if they are overwhelmingly focused on electing or defeating federal candidates.

The NPRM seeks comment on whether the Commission should make any changes to the allocation rules for separate segregated funds (SSFs) and non-connected committees (collectively, "PACs"). The notice also asks about the effect of BCRA and the Supreme Court's decision in *McConnell* on the Commission's allocation rules.

For the reasons set forth below, the Commission should revise its allocation rules in two ways:

First, the Commission should revise the "funds expended" allocation method in 11 CFR § 106.6(c) to include a minimum federal percentage for the allocation of administrative expenses, partisan voter drives and public communications that promote or support a political party.

Second, the Commission should revise the time-space allocation method in section 106.1 to include a minimum federal percentage for communications that refer to clearly identified federal candidates.

B. Current rules. The FECA prohibits individuals from making contributions in excess of $5000 per year to a PAC to be used to influence federal elections. 2 U.S.C. § 441a(a)(1)(C).[10] The FECA also prohibits corporations and labor organizations from making contributions to PACs in connection with a federal election. 2 U.S.C. § 441b.[11]

In 1990, the Commission promulgated allocation rules to implement these statutory limitations and prohibitions. *Methods of Allocation Between Federal and Non-Federal Accounts;* Payments*; Reporting*, 55 Fed. Reg. 26058 (June 26, 1990). These rules were promulgated in response to a court decision in which the court concluded that the FEC's previous allocation rules "fail[ed] to regulate improper or inaccurate allocation between federal and nonfederal funds." *Common Cause v. FEC*, 692 F. Supp. 1391, 1395 (D.C. 1987).

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10 Questions have been raised about the constitutionality of this contribution limit insofar as it applies to non-connected committees that make only independent expenditures. We believe this limit is constitutional. *E.g., McConnell,* 157 L.Ed.2d at 554 n. 48. Furthermore, nothing in FECA or BCRA exempts such committees from the contribution limit, and a longstanding regulation of the Commission specifically applies the contribution limit in this context. 11 C.F.R. § 110.2(k). This regulation has not been noticed in this rulemaking and the regulation, and issues relating to it, therefore, are not before the Commission in this proceeding.

11 Notwithstanding this broad prohibition, section 441b(b)(2)(C) allows the connected organization of an SSF to pay for its administration and solicitation costs.

Section 102.5 of the regulations sets forth rules governing the use of funds by organizations that are active in both federal and nonfederal elections. Section 102.5(a)(1) requires these organizations to maintain either a single federal account, or separate federal and nonfederal accounts, and deposit only federal funds in their federal account. It also requires them to make all disbursements in connection with a federal election from their federal accounts, and prohibits them from transferring nonfederal funds into their federal accounts except in accordance with the allocation rules in 11 CFR 106.6(e).

Section 106.6 contains rules for allocating costs incurred by separate segregated funds and non-connected committees for certain types of mixed federal and nonfederal activities. Under section 106.6(c)(1), the allocation ratio for generic voter drive activity is based on the ratio of the committee's expenditures on behalf of specific federal candidates to its total disbursements for specific federal and non-federal candidates (not including overhead or other generic costs) during the two-year federal election cycle.

Section 106.1 requires committees to allocate the costs of activities attributable to multiple specifically identified candidates "according to the benefit reasonably expected to be derived." For broadcast communications, this section instructs committees to allocate costs based on "the proportion of space or time devoted to each candidate as compared to the total space or time devoted to all candidates." 11 C.F.R. § 106.1(a).

C. *McConnell v. FEC.* The theory of the allocation rules – which, prior to BCRA, applied both to party committees, and non-party political committees – was to provide that political parties and PACs use some federal funds when paying for activities that impact both federal and nonfederal candidates and elections. However, as the Supreme Court recognized in *McConnell*, the rules issued by the Commission fundamentally undermined the FECA. The *McConnell* Court found that the FECA "was subverted by the creation of the FEC's allocation regime," 157 L.Ed. 2d at 548, which allowed the political parties "to use vast amounts of soft money in their efforts to elect federal candidates." *Id.* The Court flatly stated that the Commission's allocation rules "invited widespread circumvention" of the law. *Id.* at 550. The rules made possible the virtually unrestricted flow of soft money through the political parties into federal elections, so much so that the Supreme Court described these rules as "FEC regulations [that] permitted more than Congress, in enacting FECA, had ever intended." *McConnell,* 157 L.Ed. 2d at 548, n. 44.

Although the *McConnell* Court was discussing the allocation rules for political parties, its conclusions are equally applicable to the allocation rules for separate segregated funds and non-connected committees. In particular, the section 106.6 allocation rules are allowing non-connected political committees to use massive amounts of nonfederal funds to pay for activity designed to influence federal elections. The Commission has an obligation to revise these rules now, to put an end to this improper use of soft money in federal elections.

The clear message in *McConnell* is that it never should have been necessary for Congress to enact legislation to stop the party committees' use of soft money to influence federal elections. A proper approach by the Commission would have prevented this abuse from occurring in the first place.

The Commission must recognize that this message from the Supreme Court applies equally to the allocation rules for non-connected committees, and revise these rules now in order to ensure that such committees are not able to massively circumvent the FECA and use nonfederal funds to influence federal elections.

D. The effect of the current rules. The current rules essentially allow PACs to establish their own allocation ratios for their administrative expenses and generic voter drive activities. This enables them to manipulate the ratio so that the federal portion is zero or close to zero, even if their activities are, in fact, entirely directed at influencing the outcome of a federal election.

The ratio of federal funds required for generic activity and administrative costs is entirely based on the committee's candidate-specific disbursements. As noted above, the current formula compares the committee's expenditures on behalf of specific federal candidates to its total disbursements for specific federal and non-federal candidates (not including overhead or other generic costs) during the two-year federal election cycle. 11 C.F.R. § 106.6.

Thus, if a committee avoids making any federal candidate-specific disbursements, and then makes even a single small disbursement from nonfederal funds on behalf of a specific nonfederal candidate, the rule allows the committee to pay for all of its administrative expenses and generic partisan voter drive activity entirely with nonfederal funds, since it will have made *no* expenditures "on behalf of specific federal candidates."[12]

This is not merely an abstract or theoretical possibility. At least one non-connected committee that is heavily involved in the 2004 presidential election, America Coming Together, or ACT, is currently using an allocation ratio of 2% federal and 98% nonfederal. In so doing, it is proving that the Supreme Court's position about the subversion and circumvention made possible by the Commission's party allocation rules also applies to the Commission's PAC allocation rules.

As we have explained in detail in two other submissions to the Commission,[13] ACT was set up as a federal PAC with an associated nonfederal 527 committee to conduct voter mobilization activity designed to defeat President Bush in the 2004 presidential election. According to its public statements, the group plans to conduct "a massive get-out-the-vote operation that [it] think[s] will defeat George W. Bush in 2004."[14] In addition, the group is

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12 The rule does not address the very real possibility that a PAC might make no candidate-specific disbursements whatsoever, a situation that would generate a ratio of 0/0, which is mathematically incoherent. Although PACs may currently view this as authorization to use 100% nonfederal funds, the spirit of the regulation would be better served by the use of a 50/50 allocation ratio in this circumstance. In any case, this flaw is yet another reason to revise the rule to include a minimum federal percentage.

13 See Democracy 21 et al. v. ACT et al. (FEC) (filed January 15, 2004); Comments of Democracy 21 et al in AOR 2004-5 (filed February 12, 2004) at 2-12.

14 T. Edsall, "Liberals Form Fund to Defeat President; Aim is to Spend $75 Million for 2004," The Washington Post (Aug. 8, 2003).

raising funds to finance this activity by asking donors "to help send President Bush home to Texas.[15] Its fundraising solicitations explain that it will be targeting its GOTV operation specifically to the *presidential* battleground states.[16]

Despite the fact that its overwhelming purpose is to defeat a federal candidate, ACT is claiming that its funds expended allocation ratio is 2% federal and 98% nonfederal.[17] It can achieve this result, under the Commission's existing rules, by spending its funds primarily for generic partisan voter drive activity, and avoiding any federal candidate-specific disbursements. Under the Commission's allocation formula, this makes the numerator in the formula zero or nearly zero, whatever the size of the denominator, thus resulting in a federal allocation ratio of at or close to zero.

In the real world, this yields absurd results which violate common sense and subvert the law. ACT is a group which is overwhelmingly, if not entirely, devoted to defeating President Bush. It has announced that its purpose is to defeat President Bush, is raising money on the basis of saying those funds will be used to influence the presidential election, and it is targeting its spending specifically to the *presidential* battleground states. That it can claim that only two percent of its allocated spending has to be funded with federally legal funds, and that ninety-eight percent of its spending is, in effect, for state and local purposes, plainly illustrates that the Commission's existing allocation rules are wrong as a matter of law, and lack any credibility. As with the Commission's previously discredited party allocation rules, the existing PAC rules allow committees "to use vast amounts of soft money in their efforts to elect federal candidates." *McConnell,* 124 S. Ct. at 660.

E. Recommended changes to 106.6

i. The minimum federal percentage.

In order to prevent this abuse of the allocation rules, the Commission should revise the "funds expended" allocation formula in section 106.6 to include a minimum federal percentage.[18]

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15 A copy of the ACT solicitation letter, which is suffused throughout with evidence of its principal purpose to raise funds to influence the presidential election, is attached to the comments filed by Democracy 21 et al. in regard to 2004-05 (February 12, 2004).

16 *Id.*

17 A copy of the Schedule H-1 filed with the Commission by ACT, setting forth its allocation ratio, is attached to the letter of Democracy 21 et al. to the Commission, dated February 25, 2004.

18 We note that the whole allocation system was not initially a statutory matter, but a regulatory construct created by the Commission, e.g. Adv.Op. 1978-10, and one that, as the Supreme Court repeatedly indicated in McConnell, has caused fundamental problems that served to "subvert," "circumvent" and "erode" the law. 157 L.Ed.2d at 548, n.44, 563. It may be time for the Commission to undertake a future rulemaking to re-examine the whole concept of allocation. In the same vein, it is important to recognize that the underlying rationale of allocation is the assumption that a committee's activities are intended to have a mixed purpose of influencing state and local as well as federal elections.

The NPRM seeks comments on a number of ways to implement a minimum federal percentage. One alternative, described in the narrative, would use a two-tiered minimum based on the number of states in which the committee conducts activities. Committees active in fewer than ten states would use a minimum of 25% federal funds. Those active in ten states or more would use a minimum of 50% federal funds. 69 Fed.Reg. at 11754.

The Commission should adopt this two-tiered approach, with one critically important modification. The number of states at which a committee's minimum federal percentage increases to 50% should be set at a level that ensures that committees pursuing anything more than a local campaign strategy will be subject to the higher minimum. At the same time, it should recognize that organizations operating in metropolitan areas that straddle state boundaries (*e.g.*, New York City, Washington, D.C.) will likely be required by the nature of media markets to conduct activity in multiple states even if they are seeking to influence the outcome of state or local elections. The threshold should be set to strike an appropriate balance between these concerns.

It is widely believed that the outcome of this year's presidential election will be decided in just seventeen key battleground states. With so few states "in play," the ten state threshold proposed in the NPRM is far too high. Setting the threshold at three states, or at most, five states, will ensure that committees pursuing federal electoral goals will be required to use the 50% allocation ratio, while also allowing organizations whose activities cross over into two or three jurisdictions to be subject to the 25% minimum.

The NPRM contains several variations of the minimum percentage that would use the state party Levin fund allocation ratios. These ratios were derived from the ballot composition ratios for state party committees in repealed section 106.5(d), which gauged the relative priorities of a state party committee by using the types of offices on the ballot in the committee's state in a particular year. Using these ratios might be appropriate for a committee operating in a single state, but uniform minimum federal percentages would be much easier to understand and administer for PACs operating in multiple states. Therefore, the Commission should decline to adopt a minimum percentage based on the Levin fund ratios.

ii. Affiliation for purposes of the minimum federal percentage

Requiring committees to use a minimum federal percentage based on the number of states in which the committee is active may well prompt some organizations to set up multiple, ostensibly independent, committees to operate in different states, in order to claim entitlement to the lower tier 25% minimum ratio. As a result, the Commission will be called upon to determine whether a number of nominally separate committees are in fact one organization, conducting activity in multiple states, for purposes of the minimum allocation ratio.

This calls attention to the limitations of the current affiliation rules, which the Commission has historically been reluctant to apply aggressively to non-connected committees. In their current form, these rules leave the Commission ill-equipped to effectively prevent a

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Thus, where a political committee has an overriding purpose to influence federal elections, allocation is inappropriate and should not be permitted.

proliferation of committees designed to evade the 50% minimum percentage. The Commission should, in this rulemaking, adopt and implement stringent affiliation rules that can be used to more effectively enforce the minimum allocation requirement.

iii. Federal candidate-specific expenditures

The Commission should adopt the proposed changes to section 106.6(c)(1)(i), which clarify that independent expenditures, electioneering communications, and other communications that promote, support, attack or oppose a clearly identified federal candidate must be included in the funds expended ratio.

F. Recommended changes to 106.1

The time-space allocation method in section 106.1(a)(1) raises many of the same concerns as the funds expended method in 106.6(c). In Adv.Op. 2003-37, the Commission addressed the proper allocation of a communication with the following text:

> George Bush and the Republican Team have made the United States safer. On November 2, vote for George W. Bush for President; X for U.S. Senate; and Y for Governor.

The Commission concluded that "11 CFR 106.1(a) would require allocation among the three candidates, and a reasonable allocation would require that two-thirds of the cost be paid with funds from the Federal account." Adv.Op. 2003-37.

From this statement, it appears the Commission applies the time-space allocation method by simply dividing the cost of a communication by the number of clearly identified candidates referred to in the communication. This approach invites major abuse of the time-space method. If the text quoted above had included the names of two additional nonfederal candidates, but was also continuously superimposed on a large picture of George Bush, the Commission's "head count" approach would nevertheless have allowed the requester to allocate the communication 2/5 federal and 3/5 nonfederal. The picture might be disregarded, even though it consumes most of the space in the communication.

For this reason, the Commission should add a minimum federal percentage to the time-space allocation method in section 106.1(a). This rule should require PACs to pay for any communication that refers to a clearly identified federal candidate with at least 50% federal funds. For communications whose content would yield a higher federal ratio, the rule should require the committee to use the higher ratio. Adopting this rule would prevent PACs from abusing the "reasonable allocation" approach described in Adv.Op. 2003-37 by adding a list of nonfederal candidates to a communication that otherwise focuses on federal candidates.

4. "Political Committee" Status of Section 527 Groups

A. "Major Purpose" Test. The NPRM proposes a new regulation to define the statutory FECA term of "political committee." *See* 11 C.F.R. § 100.5 (proposed). The proposed regulation, correctly, defines "political committee" by a two-part test: whether the committee,

club, association or other group of persons receives contributions or makes expenditures aggregating in excess of $1,000 during a calendar year, *id.* at 100.5(a)(1)(i) (proposed), and second, whether it is a group "for which the nomination or election of one or more Federal candidates is a major purpose." *Id.* at (a)(1)(ii) (proposed).

In defining the second prong "major purpose" standard, the proposed regulation sets forth three alternative tests applicable to any organization. 11 C.F.R. § 100.5(a)(2)(i)-(iii) (proposed). These alternatives would variously count whether an organization has spent $10,000 (subsection (i)), $50,000 (subsection (iii)), or 50 percent of its total annual disbursements (subsection (ii)) on a combination of contributions, expenditures, electioneering communications and federal election activities as defined in 11 C.F.R. § 100.24(b), which includes public communications that "promote, support, attack or oppose" federal candidates.

For the reasons discussed above, we do not believe the Commission has the authority to promulgate so expansive a definition of "political committee" for section 501(c) organizations, nor to apply a "promote, oppose" type test to the spending of all groups, including section 501(c) organizations, in determining whether they trigger "political committee" status. And for the reasons also set forth above, we urge the Commission to drop consideration of such proposed rules insofar as they apply to section 501(c) groups.

The Commission, however, should act now on the fourth alternative test of the "major purpose" standard, which applies specifically and solely to section 527 groups. Here, the Commission sets forth two sub-alternatives.

> Alternative 2-A provides that the "major purpose" test is met if a group
>
> ....is organized under Section 527 of the Internal Revenue Code, 26 U.S.C. 527, except that this paragraph (a)(2)(iv) shall not apply to:
>
> (A) The campaign organization of an individual seeking nomination, election, appointment or selection to a non-Federal office;
>
> (B) A committee, club, association or group of persons that is organized solely for the purpose of promoting the nomination or election of a candidate or candidates to a non-Federal office;
>
> (C) A committee, club, association or group of persons whose election or nomination activities relate solely to elections where no candidate for Federal office appears on the ballot;
>
> (D) A committee, club, association or group of persons that operates solely within one State and, pursuant to State law must file financial disclosure reports with one or more branches, departments or agencies of that State's government, showing all its activities in that State; or

> (E) A committee, club, association or group of persons that is organized solely for the purpose of influencing the nomination or appointment of individuals to a non-elected office, or the nomination, election or selection of individuals to leadership positions within a political party.
>
> 11 C.F.R. § 100.5(a)(2)(iv) (proposed)
> (Alternative A)

Alternative 2-B, by contrast, proposes that the "major purpose" test is satisfied simply by the group being organized under section 527. *Id.* (Alternative B).

We strongly favor the approach taken in this fourth alternative test, and in Alternative 2-A, to define "major purpose" by reference to an organization's status under section 527 of the tax code. As we discussed above, this status indicates that a group has registered with the IRS as a "political organization" that is "organized and operated primarily for the purpose" of accepting contributions or making expenditures. 26 U.S.C. § 527(e)(1).

On its face, this tax code definition of "political organization" embodies the same concept as the "major purpose" test for "political committee" status. Thus, it is entirely appropriate for the Commission to look to, and rely upon, a group's registration as a section 527 organization in determining whether the "major purpose" test has been met.

Not all section 527 organizations should be treated as political committees. Section 527 organizations that are concerned exclusively with non-elective offices (such as, *e.g.*, the nomination and appointment of federal judges) or exclusively with non-federal elections (such as, *e.g.*, a state candidate's campaign committee) should not be treated as federal political committees. For this reason, we prefer, with one exception, the approach taken in the Commission's Alternative 2-A that sets forth five *per se* categories of section 527 groups which do *not* satisfy the prong two "major purpose" test.

Proposed categories (A), (B) and (C) all encompass section 527 organizations whose activities relate solely to non-federal elections, and thus would not have a "major purpose" to influence federal elections.[19] Category (E) encompasses section 527 organizations whose activities solely relate to influencing non-electoral offices, such as the appointment of judges. Again, these groups by definition would not meet the FECA "major purpose" test. We agree that these four categorical exemptions to section 527 groups should be included in the Alternative 2-A proposal.

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19 We do not construe subparagraph (B) as pertaining to, and thus excluding from the definition of "major purpose," section 527 groups that engage in partisan voter mobilization activities aimed at the general public as defined in prongs (i) and (ii) of "federal election activities." 2 U.S.C. § 431(20)(A)(i), (ii). Such activities by definition affect federal elections and therefore any group engaged in such activities is not organized "solely" for the purpose of influencing non-Federal elections, and should not be exempted from meeting the "major purpose" test.

But we oppose proposed subparagraph (D), which exempts any section 527 group that "operates solely within one State" and files disclosure reports with that State. The fact that a section 527 group operates only within one state does not mean that it lacks a "major purpose" to influence federal elections. Indeed, it could be a political committee organized to support the election of a given Senator, and does so by activities confined to a single state. Thus, the fact that a group operates within a state is no basis in itself for exempting a section 527 organization from meeting the prong two "major purpose" test.

With this modification, we support Alternative 2-A.[20] We note as well that under FECA, as construed by the Court in *Buckley,* even a organization which meets the "major purpose" test must also satisfy the statutory standard that it receive contributions or make expenditures of $1,000 in a calendar year. 2 U.S.C. § 431(4).

For a section 527 organization, which by definition has a primary purpose to influence elections, this standard is met by any spending "for the purpose of influencing" a federal election, and is not restricted to express advocacy. Public communications by a section 527 organization that "promote, support, attack or oppose" a federal candidate constitute "expenditures" for purposes of this test, whether or not those communications contain express advocacy.

This proposed rule would clearly reach the activities of the Media Fund, a section 527 organization that is spending millions of dollars on ads promoting or attacking presidential candidates.

As a section 527 group that does not fall within any of the four proposed categorical exemptions discussed above (i.e., its activities are not solely related to non-federal elections nor non-elective office), the Media Fund would meet the "major purpose" test.

Further, as a section 527 group, the Media Fund makes "expenditures" when it spends money "for the purpose of influencing" a federal election, whether or not the communication contains express advocacy, or is an "electioneering communication." The ads run by the Media Fund clearly promote or attack federal candidates and thus constitute "expenditures." Given that it has therefore made far in excess of $1,000 in expenditures and that, as a section 527 organization it has a "major purpose" to influence federal elections, the Media Fund is a "political committee." Although we believe this result is true under existing law and regulations,

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20 The Commission also seeks comment on whether, to trigger "political committee" status, the major purpose of a group should be to influence elections, to influence federal elections, or to influence the election of particular federal candidates. 69 Fed.Reg. at 11744-45. It is our view that the "major purpose" test should not be restricted solely to influencing the election of particular federal candidates, as the district court erroneously held in *FEC v. GOPAC*, 917 F.Supp. 851 (D.D.C. 1996), a case that the Commission incorrectly failed to appeal. This too narrowly construes the test, and eliminates from consideration clearly federal activities, such as ads that urge support for "Republican candidates to the House" or "the Democratic congressional ticket," or even to "Elect women to Congress." Even though these activities do not support "particular" federal candidates by name, they are clearly intended to influence federal elections. Thus, such spending should count towards the major purpose test.

the Commission should, on an expedited basis, adopt the proposed regulation as discussed above in order to provide whatever additional clarity is necessary to properly implement the law as soon as possible.[21]

We appreciate the opportunity to submit these comments.

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21 Some, including Vice Chair Weintraub, have expressed concern that if the Commission adopts a rule that would require existing section 527 groups to register as "political committees" based on their status as section 527 groups, the result might be that section 527 groups would simply terminate and reorganize under section 501(c)(4) of the tax code. See "Statement for the Record of Vice Chairman Weintraub on 'Notice of Proposed Rulemaking on Political Committee Status'" (March 4, 2004) at 2 ("If, for example, we merely regulate 527 organizations and not 501(c)4s, the 527s will simply dissolve and reincorporate as (c)4s, and we will have accomplished nothing.").

We believe this speculation should not deter action by the Commission on section 527 groups, for several reasons. First, this argument does not and cannot justify the Commission allowing massive violations of the federal campaign finance laws to occur. The fact is that the problems apparent in this election cycle concern circumventions of the law by section 527 groups, not by section 501(c)(4) groups. It is reasonable for the Commission to proceed "one step at a time, addressing itself to the phase of the problem which seems most acute..." McConnell, 157 L.Ed. 2d at 588 quoting Buckley, 424 U.S. at 105. If later problems arise with section 501(c)(4) groups, Congress can address those problems.

Second, the premise itself is highly speculative. Many of the activities currently being conducted by section 527 groups – such as partisan voter mobilization activities – cannot be conducted by incorporated section 501(c)(4) organizations. Cf. 11 C.F.R. § 114.4(d)(3) (prohibiting corporate spending on partisan voter drive activities). Nor can section 501(c)(4) corporations use treasury funds to run "electioneering communications." 2 U.S.C. § 441b(c)(1).

Further, there are fundamentally different tax law consequences to the two different forms of organization. Section 501(c)(4) groups are constricted by tax law in the amount of political activity they can do – the limiting principle is that electioneering cannot become the "primary" activity of a section 501(c)(4) organization, a constraint which does not apply to a section 527 group. Violating this constraint risks enforcement and penalties by the IRS. In addition, gifts to section 501(c)(4) groups are subject to gift tax, while gifts to section 527 groups are exempt from the gift tax. These differences may make it far more difficult for section 501(c)(4) organizations to raise the large gifts that the section 527 groups receive to sustain their political activity, and to spend their funds on extensive electioneering activities.

Respectfully,

/s/Fred Wertheimer	*/s/ Trevor Potter*	*/s/ Lawrence Noble* */s/ Paul Sanford*
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April 2, 2004

Dear Colleague,

We write to respond to a recent campaign of misinformation surrounding the Federal Election Commission's (FEC) pending rulemaking on the issue of political committees. We believe that it is ill-advised for the FEC to undertake a rulemaking that would affect entities other than those organized under section 527 of the tax code. Specifically, many have been led to believe that the FEC will issue a ruling that would cover 501(c) non-profit organizations, thereby raising the possibility of severe restrictions being placed on the legitimate, nonpartisan activities of these groups.

We are greatly concerned that the 501(c) issue is simply being used as cover in an effort to derail the FEC's review of 527 political activity. Many of those who are raising an alarm about the effect of the FEC's rulemaking on 501(c) nonprofit organizations would like you to believe that the only way to prevent the restrictions they fear is for the FEC to take no action at all. This would be a serious mistake. We continue to believe that the FEC should address the activities of 527 groups this election year on an expedited basis. As you know, some 527s are in a different legal position than traditional interest and issue groups because, under the tax laws, their major purpose is election-related activity, and they have already declared publicly that their principal goal is to affect the outcome of this year's Presidential election. Because these organizations are poised to spend millions of dollars in soft money in the upcoming election, it is imperative that the FEC address the serious questions about their political committee status.

Undoubtedly, you have heard or will soon be hearing from non-profits, charities, and even labor unions which have been misled into thinking that the FEC rulemaking is aimed at shutting them down. This is nonsense. The consequences of classifying all these groups as political committees are so far-reaching and absurd that we cannot imagine a scenario in which such a plan would meet the approval of the FEC. The FEC should be encouraged to move expeditiously in dealing with 527s, and only 527s, in the current rulemaking.

Recently, we testified before the Senate Rules Committee about these issues. Prior to submitting letters or comments to the FEC on the rulemaking, we hope you will consider the views contained in the attached copies of our testimony from the March 10th hearing.

Sincerely,

John McCain
United States Senate

Russell D. Feingold
United States Senate

Statement of Senator John McCain

Senate Committee on Rules

Wednesday, March 10, 2004

In its recent opinion in *McConnell v. FEC*, the Supreme Court wisely noted that money, like water, is going to seek a way to leak back into the system. We already see that. Now that the parties have been taken out of the soft money business, there are efforts by political operators to redirect some of that money to groups that operate as political organizations under Section 527 of the IRS Code, or so-called "Section 527" groups.

The game is the same: these groups are raising huge corporate and union contributions, and multi-million dollar donations from wealthy individuals, and want to spend that money on so-called "issue" ads that promote or attack federal candidates, and voter mobilization efforts intended to influence federal elections.

The tax laws say that a 527 group is a "political organization" that is organized and operated primarily for the purpose of influencing the election of candidates.

In other words, any 527 group is by definition in the business of political campaigns, and it has voluntarily sought the tax advantages conferred on political groups. But these groups should not then be permitted to shirk their other obligations, including those under the campaign finance laws.

Use of soft money by 527 groups whose major purpose is to effect federal elections is not legal. This is not a matter of the Reform Act of 2002; it is a fundamental rule of federal election law since 1974. That law, as construed by the Supreme Court in *Buckley v. Valeo*, requires any group that has a "major purpose" to influence federal elections, and spends $1,000 or more to do so, to register with the Federal Election Commission as a "political committee," and be subject to the contribution limits, source prohibitions and reporting requirements that apply to all political committees.

That 527s have been allowed for years by the FEC to operate outside of the law is not surprising. In *McConnell*, the Supreme Court stated, in no uncertain terms, how we ended up in the soft money crisis to begin with. The Justices placed the blame squarely at the doors of the FEC, concluding that the agency had eroded the prohibitions on union and corporate spending through years of bad rulings and rulemakings, including its formulas for allocation of party expenses between federal and non-federal accounts.

The Supreme Court stated in *McConnell* that the FEC had "subverted" the law, issued regulations that "permitted more than Congress . . . had ever intended", and, with its allocation regime, "invited widespread circumvention of FECA's limits on contributions."

What we need today is for the FEC to enforce the law the way it should be enforced. This is what the FEC rulemaking is about. The FEC has been wrong with respect to its treatment of

527s for years, and the agency needs to get its house in order fast, and make clear that a section 527 group – a group that has voluntarily identified itself for tax law benefits as a "political organization" – must comply with the federal election laws when its major purpose is to influence federal elections.

Section 527 groups need to play by the rules that all other political committees are bound by, the rules that Congress has enacted to protect the integrity of our political process – they need to raise and spend money that complies with federal contribution limits and source prohibitions for ads they run that promote or attack federal candidates or otherwise have the purpose to influence federal elections, and they need to spend federal funds for voter mobilization activities that are conducted on a partisan basis and are intended to influence federal elections. Just like every other political committee.

Let me also say that the FEC in this rulemaking must change its absurd allocation rules. Under these rules, a committee that wants to manipulate the law can arrange its activities to spend 100 percent soft money for voter drive efforts that obviously are for the purpose of influencing federal elections. Indeed, one of the 527 groups operating today-- America Coming Together, or ACT – has made overwhelmingly clear that its principle purpose is to defeat President Bush. Yet ACT recently filed a report with the FEC in which it claims that under the Commission's existing allocation rules, it can fund its voter drive activities with 98 percent soft money. This is ridiculous, and it makes a mockery of the law. The Commission needs to put some teeth in its allocation rules, now.

But many other organizations, although politically active, do not have partisan politics as their primary purpose. Section 501(c) groups, for instance, are prohibited by the tax laws from having a primary purpose to influence elections. These groups thus operate under different rules, and appropriately so.

Section 501(c) groups can – and should – engage in nonpartisan voter mobilization activities without restriction. And under existing tax laws, Section 501(c) groups – unlike section 527 groups –cannot have a major purpose to influence federal elections, and therefore are not required to register as federal political committees, as long as they comply with their tax law requirements. Much of the public controversy surrounding the FEC's rulemaking stems from a failure to understand these simple distinctions.

It's tempting to see everything that is done in campaign finance reform through a partisan lens. And sometimes, it's true that things are done with partisan ends in mind. But we all need to remember that what may seem, in the middle of an election, to be in the short-term political interest of one party is not necessarily a good thing in the long run – even for that party.

I note that FEC Vice-Chair Ellen Weintraub opposed a rulemaking on 527 activity at this time, saying "at this stage in the election cycle, it is unprecedented for the FEC to contemplate changes to the very definitions of terms as fundamental as "expenditure" and "political committee" . . . sowing uncertainty during an election year." Weintraub stated "I will not be rushed to make hasty decisions, with far-reaching implications, at the behest of those who see in our hurried action their short-term political gain."

In fact, what the FEC needs to do now is simply enforce existing federal election law as written by Congress in 1974 and interpreted by the Supreme Court in 1976. It defies the whole purpose of the FEC to say that it should not enforce this law in the middle of an election year because such enforcement might effect that election. The fact that the FEC has neglected to enforce the law correctly for the last several years because it erroneously interpreted the rules for 527s is not a reason for the Commission's continued failure to enforce it now that the Supreme Court has made it clear in *McConnell* that they should do so.

One of the problems the FEC faces today is that Commissioners refuse to acknowledge even the Supreme Court's authority in this area. FEC Chairman Brad Smith's response to the *McConnell* decision was to say; "Now and then the Supreme Court issues a decision that cries out to the public, 'We don't know what we're doing!' *McConnell* is such a decision." What an extraordinary statement from a public official whose statutory responsibility is to enforce the laws of the land as written by Congress, signed by the President, and upheld by the Supreme Court!

Mr. Chairman, it is statements like this that point out the need for fundamental reform of the FEC. I hope this Committee will hold hearings on the legislation that Senator Feingold and I have introduced to do this. The FEC's current difficulty in dealing with an issue as straightforward as these 527 organizations spending soft money in the 2004 federal elections, and the 3-3 ties at the Commission when it recently considered an advisory opinion on this issue, are only the most recent examples of the need for FEC reform.

While FEC Vice-Chairman Weintraub spoke about her concern that the 527 issue was being raised for "short-term political gain", I trust no one will suggest that my position in this hearing is so motivated. The Chairman certainly knows of the many occasions where I have been accused of neglecting partisan interests. My dedication to the cause of campaign finance reform goes back many years and will extend far beyond the current election cycle. The same may of course be said of my colleague, Russ Feingold, who joins me here today.

We believe the FEC needs to do what is right, which is to ensure that both the Federal Election Campaign Act of 1974 and the Bipartisan Campaign Reform Act of 2002, are fully enforced. I welcome recent efforts by the Republican National Committee to encourage enforcement of the law regarding 527 federal political activities. Support for enforcement is welcome no matter the reasons for it. Just as some former opponents of campaign reform now favor enforcement actions by the FEC, some of those who in the past urged enforcement of the law have suddenly changed their tune. Let me read you a portion of a letter sent to the Department of Justice asking for a criminal investigation of a 527 group which was proposing to run issue advertising and conduct voter registration for the purpose of affecting federal elections and which had failed to register with the FEC as a federal political committee.

> [It has} begun to raise $25 million so that this group can finance issue advocacy advertisements and get-out-the-vote activities. This organization plans to finance these activities from donations raised outside of the Federal Election Campaign Act's ("FECA" or the "Act") source limitations and amount restrictions, and without regard to the FECA's registration and reporting requirements. The result is an organization that is

claiming tax-exempt status as a "political organization" under Section 527 of the Internal Revenue Code, but which is willfully refusing registration and reporting expenditures and contributions received.

This letter came from Democratic election law attorney Bob Bauer and his law firm Perkins Coie in 1998, objecting to a 527 created by Congressman Tom Delay. I agree with Mr. Bauer's analysis of federal election law relating to 527s and federal political committees as stated in this letter. Unfortunately, Mr. Bauer and his law firm are now representing 527s who want to engage in the sort of activity which they argued only a few years ago was "illegal" and required criminal investigation. [Letter in record]

What this letter proves is that it is foolish for anyone-including Members of Congress or Commissioners of the FEC-- to make decisions on enforcing the election laws based on perceptions of short-term, inherently changeable, partisan considerations. Instead, precisely because partisan calculations change over time, and then change again, the only appropriate basis for interpreting the law in this area is the statutes themselves, and the principle of keeping corporate and labor funds out of federal elections.

With the Bipartisan Campaign Reform Act, we showed our constituents, in a bipartisan way, that we care about making sure that they have the political power in this country, rather than the Enrons and the WorldComs and unions and the wealthiest of the wealthy. We need to continue that work, not undermine it, at this critical time. And we need not wait until the election is over. The FEC should act as quickly as it can to settle this matter, and bring the confusion over these groups to a close.

I hope the Commissioners will not let short-sighted political or personal ideological concerns deter them from the right course - for themselves, for their parties, and for the public they represent.

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Statement of U.S. Senator Russ Feingold

Before the Senate Rules Committee Hearing on Examining the Scope and Operation of Organizations Registered under Section 527 of the Internal Revenue Code

March 10, 2004

Mr. Chairman, thank you for inviting me to testify today. If my memory serves me correctly, the last time Sen. McCain and I were before this Committee was in 1996, to testify on the McCain-Feingold bill. The bill never made it out of committee, but we persevered and managed to convince the full Senate to pass it in 2001. The President signed the bill into law in 2002. And the Supreme Court upheld its constitutionality in 2003.

So here we are in 2004, with a very different campaign finance landscape before us as this Presidential election gets underway. What we did in the McCain-Feingold bill has improved the system. We are already seeing its positive effects. Members of Congress are no longer calling up CEOs or union leaders and asking them for huge contributions to the political parties. For the first time in nearly two decades, the parties are relying exclusively on hard money for their activities. Yet the parties are vital and vocal in this election and no one is telling me that their voices have been silenced. The doomsday scenarios we heard on the Senate floor back in 2001 and 2002 have not come to pass. The parties have adjusted. And both the President and Sen. Kerry seem to be getting their messages out.

Of course, there is more to be done on campaign finance reform, and I would very much like to see this committee be involved in a constructive way. To start, Sen. McCain and I have introduced legislation to reform the Federal Election Commission. In upholding the McCain-Feingold bill last year, the Supreme Court didn't pull any punches when it came to the FEC. It said that the FEC had "subverted" the law by allowing soft money to be used to aid federal candidates. With this validation of the position taken by reformers for many years, the Court underlined a cautionary note that we have sounded many times

before: No law in this area is self-executing. To be successful, campaign finance reform must be implemented and enforced by an agency that is dedicated to carrying out the will of Congress, not frustrating it.

We have concluded that the FEC as currently constituted cannot provide the strong and consistent enforcement of the federal election laws that this country needs. It would be very useful if the Committee could consider our bill, S. 1388, in a hearing this year and undertake a careful review of the performance of the FEC.

That brings me to the topic of today's hearing -- the operation of 527 organizations. Section 527 of the Internal Revenue Code is the section under which political parties, PACs, and even candidate committees gain tax-exempt status. Until the 2000 campaign, most people thought that 527s would also be registering and reporting with the FEC. After all, in order to claim a tax exemption under section 527, an organization must have as its primary purpose the influencing of elections. But the FEC took the position that if a 527 was not spending money on express advocacy, namely communications that urge a vote for or against a candidate, it could operate under the radar screen. That decision, in my view, was contrary to the Supreme Court's guidance in the *Buckley* decision where the express advocacy test was created to limit the applicability of the election laws to groups that were *not* in the business of influencing elections.

Congress stepped in and required these groups to register and make certain disclosures to the IRS. But because they were not considered political committees under the federal election laws, 527s were able to raise unlimited contributions.

The Supreme Court's ruling in the *McConnell* case makes it clear that the use of an express advocacy test is not constitutionally required for organizations engaged in electoral advocacy. And now the question has returned to the FEC over how to handle 527 organizations that have clearly proclaimed that their purpose is to influence federal elections, such as those groups formed to do voter mobilization or advertising to try to defeat President Bush. I assume that similar groups will sprout up dedicated to the President's reelection.

My view is that groups that claim a tax exemption because their primary purpose is to influence elections should be required to register as political committees with the FEC unless their activities are entirely directed at state and local elections. The FEC must not bless a new circumvention of the election laws, so soon after we closed the last loophole it created. Once again, we will be watching to see how the FEC performs.

You will notice that so far I've hardly mentioned the McCain-Feingold bill with respect to 527s. That is because McCain-Feingold didn't directly deal with this issue. Our bill

was concerned with the raising and spending of soft money by the political parties, and with phony issue ads run by any organization in proximity to an election. The question of whether and how 527s should be regulated in their fundraising and in their spending on other activities is a question that has to be answered under the Federal Election Campaign Act passed by Congress in 1974, and reviewed by the Supreme Court in the *Buckley* case.

Mr. Chairman, I am pleased that the Rules Committee is considering these questions. They are not simple. And care must be taken not to chill the legitimate activities of 501(c) advocacy organizations that do not have the primary purpose of influencing elections. But the functioning of our federal election laws is crucial to the confidence that the people have in their government, and therefore, to the health of our democracy. So it is my hope that FEC will act in a way that protects the integrity of those laws from efforts to puncture them with loopholes in the very first election after the enactment of the McCain-Feingold bill.

Thank you again for giving me the honor of appearing before this Committee.

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