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RESPONSE OF JOHN EDWARDS FOR PRESIDENT TO DRAFT FINAL AUDIT REPORT

This Response is submitted on behalf of John Edwards for President ("JEFP" or "Committee") regarding the Draft Final Audit Report of the Audit Division on John Edwards for President ("DFAR" or "Draft"). The Draft recommends that the Commission determine that JEFP make a repayment of \$2,278,315. This response discusses the following issues involved in the Audit Division's recommendations: 1) \$528,454 in payroll expenses; 2) \$2,136,507 in excess entitlement; and 3) valuation of capital assets.

1. Payroll Issue

The Audit Division maintains that \$528,454 of JEFP's final payroll is a non-qualified campaign expense. The primary issue raised here is whether it is reasonable to treat this amount paid to staff as a qualified campaign expense related to their activities before the candidate's date of ineligibility ("DOI"). The Committee strongly asserts that not only is it reasonable but it is clear that the entire final payroll, including the \$528,454 amount challenged by the Audit Division, should be treated as a pre-DOI qualified campaign expense. As the Committee has stated, this amount was paid to staff for several reasons:

- 1) To compensate them for overtime and extra hours they were required to work during January, 2008;
- 2) To compensate them for remaining with the campaign after DOI to perform functions relating to close out of campaign offices, something that was an absolute necessity for JEFP; and
- 3) To compensate them for extra expenses they may have incurred, including assisting in the close out of the campaign (vacating office space, returning leased equipment, rental car returns, etc.).

The final payroll amount was to compensate staff for their work prior to DOI and to deal with obligations (leased office space, rental cars, leased equipment, etc.) that were undertaken by the campaign prior to DOI. As such, the final payroll amount that the Audit Division is challenging is a qualified campaign expense.¹ This expenditure occurred within several days of

¹ The Audit Division recognizes that JEFP's position is "...that the February 7, 2008 payroll is a qualified campaign expense, which was due at DOI and therefore should be included in the MDCO as such." (DFAR, page 11.)

the end of the campaign, was driven by conditions and obligations in existence prior to DOI and should be treated on the same basis as other pre-DOI campaign expenditures.

The Audit Division's approach in the DFAR essentially expects a committee to cease all expenditures at the moment a campaign ends, and presumes that staff salaries must remain static, despite increased workload taken on by employees or despite the fact that JEPF needed to retain staff at least for a few days to perform functions critical to closing out the campaign.² It is unwarranted for the Audit Division to presume that JEPF was barred from paying staffers who remained with the campaign to close offices and return rental equipment and vehicles. The Audit Division apparently presumes DOI is a pre-planned event, the date of which is known in advance, and a date by which all obligations would have been satisfied. However, actual events on the ground do not work that way. In the case of JEPF, the candidate's withdrawal announcement was sudden and unexpected. It occurred when a majority of staff was scattered throughout the early caucus and primary states. The abrupt change required staff to assist in closing down sites in over 70 far-flung locations, then return to their home offices to close down those sites. If staff had not performed these functions, JEPF would have incurred huge costs with landlords, utility companies, equipment and car rental companies. It is unfathomable that the Audit Division refuses to treat any of the cost for staff salary to perform these functions as a qualified campaign expense.

The Audit Division's rigidity is not mandated by the regulations, nor is it realistic. The Audit Division relies on a regulation dealing with bonuses to reach its conclusion.³ This regulation does not bar bonuses but specifically allows them. However, bonuses are not at issue here; the issue is compensation paid commensurate with work actually performed. Accordingly, a far more rational approach than that offered in the DFAR is to recognize that many expenditures occurring within several days of the end of a campaign are driven by conditions and obligations set in place prior to the date of eligibility and should be treated on the same basis as those expenditures. The Commission has a duty to administer the public financing program and apply its regulations in a manner that results in a rational, consistent approach to the practical realities facing a campaign.⁴

Moreover, as stated above, a portion of the final payroll was paid to staff to cover any expenses incurred in closing out the campaign operation. These expenses would have been incurred by staff for travel, lodging, meals and any expenses involved in moving out of the

² Potentially, the Committee could have been required to pay some of these staffers overtime for extra hours worked in January 2008.

³ 11 C.F.R. §9034.4(a)(5).

⁴ General election public financing provisions recognize that campaigns need the flexibility to make expenditures "post-DOI" -- or, in that case, "post expenditure report period" -- that are nevertheless treated as "pre-DOI" qualified campaign expenses because it is not possible to simply shut a campaign down on the same day a candidate drops out of the race. Those regulations allow campaigns to incur expenses through the end of the expenditure report period or 30 days after the election for staff salaries or other expenses. See 2 U.S.C. §§9002(12), 9004(c)(1) and 11 C.F.R. §§9002.12, 9002.11(a)(2). This is a rational, coherent approach to the practical realities facing a campaign at closing and should guide the Commission in its determination in this Audit.

various campaign offices or volunteer sites. As a management matter, it was easier to pay staffers a lump sum amount as salary than to require the departing staffers to submit expense reimbursements forms, a procedure that would have resulted in a lengthy and delayed payment process, both in terms of getting the requests submitted and in paying them. Instead, to encourage staffers who remained to help with closeout, JEPF intended a portion of the final payment as a lump sum amount to cover such costs in lieu of going through the reimbursement process which would have been cumbersome for both the staffers and the committee.⁵

Should the Commission determine that the disputed \$528,454 or any portion of it is not a qualified campaign expense that was due at DOI, such amount should at least be treated as winding down costs, which are qualified campaign expenses. While JEPF maintains that the amount in question should be treated as a qualified campaign expense related to pre-DOI activity, treating the expenditures at issue as winding down costs would be preferable to determining that they are non-qualified campaign expenses. Winding down costs typically encompass amounts spent on compliance with the Federal Election Campaign Act and the Presidential Primary Matching Payment Account Act. (11 C.F.R. §9034.11.) Since the expenditures questioned by the Audit Division were made to close out campaign operations, they could fall within the category of winding down costs. Indeed, the Audit Division seems to envision that the disputed \$528,454 could be treated as such as the DFAR states that incurring salary and expenses after DOI would be considered permissible winding down expenses. (DFAR, page 16.) Once again, while the final payroll meets all of the requirements of a pre-DOI qualified campaign expense, treating this expenditure as a winding down cost is preferable to treating the amount as a non-qualified campaign expense.

The DFAR includes a number of irrelevant comments that are both unnecessary and incorrect. In this vein, the DFAR recites the supposed number of "explanations" that JEPF has provided, inexplicably attaching a particular individual to each (indicating that the purported provider of a particular explanation was either the Assistant Treasurer or Counsel). As shown above, the final payroll was intended to deal with a variety of issues, including all of the explanations enumerated in the DFAR. All of these explanations are discussed in the Committee's Response of April 16, 2009, which was prepared with the input of both staff and counsel. This document stands as the response of the committee, not the response of a particular individual. For example, the DFAR states that JEPF Assistant Treasurer explained that "...the purpose of the February 7, 2008 was to reimburse employees who had not been paid their entire salary due to limited funds available beginning sometime in August 2007....The review indicated that JEPF's explanation was incorrect." (DFAR, page 11.) The statement that JEPF's explanation is "incorrect" is overly broad and misleading. In fact, the Audit Division includes over \$249,000 of that payroll as qualified campaign expenses representing either makeup salary for employees whose pay was reduced or who received partial pay in the August through January 30 time frame. (DFAR, pages 11 and 15.) JEPF's explanation should not be termed "incorrect" in the DFAR.

⁵ Advances by staffers could be considered contributions if not paid by a committee within 30 to 60 days. (11 C.F.R. §116.f.) Paying JEPF staffers a lump sum as salary eliminated this possibility since they would not have been outstanding for that period of time.

Moreover, the Audit Division mischaracterizes JEPF's events surrounding the payroll issue. The Committee's April 16, 2009 Response directly resulted from the Audit Division's own March 12, 2009 email, in which over five weeks after the Exit Conference the Audit Division informed JEPF *for the first time* of a potential finding of \$558,878.⁶ This is of course why the Audit Division in that email offered JEPF a second 10-day response opportunity, in a belated attempt to comply with Commission regulations.⁷ At the time this email was received, JEPF actually had packed up all of its payroll records in anticipation of moving its offices to another location, and therefore, could not respond within the 10-day time frame outlined in the email. Responses were filed in April 2009.

Accordingly, for the reasons stated above, the entire final payroll, including the \$528,454 amount challenged by the Audit Division, should be treated as a pre-DOI qualified campaign expense.

2. Excess Entitlement Issues

a. Repayment for Excess Entitlement

The DFAR recommends that the Commission determine that JEPF received \$2,136,507 in excess of its entitlement. Should the Commission adopt this recommendation, the Committee would be required to make a repayment in that amount. As discussed below, the conclusion reached in the DFAR is not supported by applicable statutory provisions and would lead to an inequitable result for JEPF.

JEPF made a total of four timely submissions to the FEC for matching funds (11/1/07, 12/3/07, 1/2/08 and 2/1/08).⁸ JEPF should have received its first public fund payment in early January, 2008 in the amount of \$8.8 million, but this did not occur due to a shortfall in the

⁶ \$556,871, per DFAR relating to the final payroll.

⁷ The DFAR also includes several extraneous comments from the Audit Division concerning the payroll issue that are either irrelevant or factually incorrect. The Auditors unduly mischaracterize JEPF's request that regulatory procedures be followed: "Counsel for JEPF (Counsel) objected to the notification by email and *demand*ed a second exit conference" (Preliminary Audit Report, page 10 and Draft Final Audit Report, page 11 (emphasis added)). The Audit Division appears to suggest that following the required procedures presents some sort of a hardship. "Although not required, a second exit conference was held" (Preliminary Audit Report, page 10 and Draft Final Audit Report, page 12). Further, the Audit Division continues to cite the Committee's "average daily cash" balance on the misguided assumption that this resource was available for paying staff salaries in January. In fact, this was not the case as those funds were budgeted for future campaign obligations, as well as outstanding accounts payable, neither of which is taken into account by the Audit Division when making blanket assertions based on daily cash balances. Comments such as these are misleading, and should not be repeated throughout the Audit Division Final Audit Report.

⁸ Because FEC procedures prevented the Committee from submitting its January 2008 contributions for matching until February 2, 2008, the last of JEPF's four submissions occurred three days after the campaign ended.

Presidential Election Campaign Fund ("Fund"). Payments to JEPF were delayed until after DOI (January 30, 2008).

Under statutory provisions, public fund payments made prior to a candidate's DOI are based on submission of qualifying contributions that are matched dollar for dollar, up to \$250. (26 U.S.C. §9034.) However, where the candidate does not receive payment until after DOI, the FEC regulations adopt a very different standard, premising a candidate's entitlement to public funds on the status of his or her net outstanding campaign obligations at the time of payment of those funds. (11 C.F.R. §9034.1(b).) Hence, the Audit Division argues that JEPF should be required to repay any amounts which are not necessary to defray qualified campaign expenses. This in essence denies JEPF its full matching fund entitlement.

The Auditors' repayment argument is essentially based on the timing of matching fund payments to JEPF. This timing was driven by a combination of two unprecedented and extraordinary events that occurred in 2008. First, there was a shortfall in the Presidential Election Campaign Fund, and candidates could not receive payment of public funds to which they were entitled. Second, the FEC was essentially out of business for the first 7 months of 2008 because appointments to the Commission were stalled in the Senate confirmation process. Due to this lack of a quorum, the Commission had no legal authority to take any official action, which meant that submissions for matching funds could not be certified between January 1, 2008 and July 17, 2008.

The combination of these unforeseen events had a severe impact on the finances of the campaign. As a result of the shortfall in the Fund, payment of public funds was so delayed the Committee did not receive its first matching fund payment until February 14, 2008 – after DOI – and that payment represented a small fraction (approximately 10%) of the amount to which JEPF was entitled.⁹ Moreover, contributions received by JEPF in December 2007 and January 2008 were not certified for matching until several months later, on July 17, 2008, when the Commission quorum was restored.

Normally, campaign committees are able to deal with a shortfall in the Fund by obtaining bank loans based on FEC certification of matching fund submissions. However, because the Commission could not conduct any business, the bank curtailed the amount that the Committee could borrow on the basis of submissions certified by the Commission before the Commission ceased operations. Indeed, due to the conditions present in early 2008, JEPF's bank refused to lend the committee any more than 70% of its entitlement, 20% less than the 90% financing that would have been available had the Commission been in existence. The net result in funding meant that the Committee had \$1.5 million less for operating expenses in January 2008.

The Audit Division's literal application of the language of the FEC regulations premising entitlement on the timing of payment of public funds is misplaced, especially under the conditions that existed in 2008. The Commission's regulations were written with the expectation that the Commission would be a functioning agency that could approve certifications in a timely

⁹ This payment was based on JEPF's 11/1/07 Submission, certified for \$7,515,063.96.

fashion. This was far from the case in the first half of 2008. Indeed, in the DFAR, the Audit Division admits, "There is no question that the combination of the shortfall in the Matching Payment Account and the Commission's lack of a quorum delayed payments." (DFAR, page 14.) The Auditors' literal interpretation of the regulations is inconsistent with the dollar-for-dollar entitlement established under the statute, especially in this situation. Matching all contributions received by a candidate prior to the date of ineligibility is not only mandated by the statutory provisions but it is the only equitable approach under the circumstances extant in early 2008 when two totally unforeseen events occurred simultaneously. These circumstances were completely outside the control of the Committee and severely curtailed the ability of the campaign to continue, since JEPF could not borrow anything near its full entitlement.

The Audit Division relies on statutory provisions at 26 U.S.C. §9033(c)(2) as a basis for concluding that after DOI a candidate may receive matching funds only to the extent that campaign obligations exceed private contributions. (Preliminary Audit Report of the Audit Division, page 12.) However, this statutory provision does not support such a conclusion.¹⁰ The statutory provision does not to affect the matchability of contributions received before a candidate's DOI but rather extends the right of candidates to receive funds after ineligibility. Yet, the PAR uses this provision as support to deny matching funds to a candidate, interpreting the statutory language in a way that completely undermines the plain language of the statute. Under the analysis in the PAR, valid contributions received while the candidate was active and eligible will not be matched.

Accordingly, and for the reasons stated above, the Commission should reject the Audit Division's recommendations and conclude that JEPF did not receive any matching funds in excess of its entitlement, and hence, no repayment is due,

b. Qualified Campaign Expense Issue Regarding Costs Incurred In Providing Information to Another Agency

In its Response to the Exit Conference Preliminary Audit Findings (February 20, 2009), JEPF noted that other governmental agency activities might impact the Committee. Since JEPF filed its Response to the Preliminary Audit Report in December 2010, JEPF has become involved in providing extensive information to the Department of Justice. Although the Committee is not under investigation, it has been necessary for JEPF to incur unanticipated expenses, including additional staff and legal costs. These costs do not fall within the ambit of typical "winding down" costs because they are not incurred for a Commission audit or compliance with public financing laws. Rather, these costs are actually qualified campaign expenses that are beyond winding down costs. Because the Committee's efforts have been more

¹⁰ Indeed, the Audit Division's statement regarding that provision distorts the actual statutory language. The Audit Division states that "Under 26 USC §9033(c)(2), a candidate who has passed the date of ineligibility is not entitled to any further matching fund payments except to defray qualified campaign expenses incurred before the candidate became ineligible." (Emphasis added.) In fact, the statute does not state that a candidate is "not entitled to any further" payments, but rather states that an ineligible candidate "...shall be eligible to continue to receive payments...." (26 USC §9033(c)(2).)

extensive than anticipated, and have required a large financial commitment, JEPF might exceed the limit on winding down costs. (11 C.F.R. §9034.11.) Therefore, JEPF is seeking a determination from the Commission that the Committee may re-allocate those costs as qualified campaign expenses. In the alternative, the Committee requests that the Commission determine that, due to unforeseen circumstances, these expenses be excluded from winding down costs for the purposes of the 10% limit on such costs.

3. Valuation of Assets

The NOCO as it appears in the DFAR values JEPF's capital assets at \$29,134. This valuation is not an accurate reflection of the current value of the Committee's assets. The DFAR reflects valuation of assets from 2008 - 2 1/2 years ago. Since that date, the value of these assets has declined dramatically. For example, electronic items substantially decrease in value with age. In addition, several of these items have no longer functional and should not figure in to the NOCO values. The attached spreadsheet reflects current value of Committee assets. Additional documentation will be provided to the Audit Division regarding this issue.

Submitted:
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