

UTRECHT & PHILLIPS, PLLC

ATTORNEYS AT LAW

1900 M Street, NW

Suite 500

Washington, DC 20036

Main (202) 778-4000

Facsimile (202) 842-5825

RESPONSE OF JOHN EDWARDS FOR PRESIDENT TO THE PRELIMINARY AUDIT REPORT

A Preliminary Audit Report ('PAR') regarding the John Edwards for President ("JEFP" or "Committee") has been provided to the Committee. JEFP submits the following response to the four Findings in that PAR.

Finding 1

NOCO: There are no major discrepancies with regard to the NOCO.¹

Cash in Bank: JEFP objects to the statement by Audit Staff in the PAR that the Committee understated its cash figure. JEFP continues to maintain that general election contributions should never have been included in the cash in bank balance for the primary campaign. As stated in the PAR, JEFP and Audit Staff is currently in agreement as to cash balances.

Accounts Payable for Qualified Campaign Expenses – Payroll: Analysis of February 7, 2008 Payroll

- **Entire amount of February 7, 2008 payroll was qualified campaign expense**

Attempts by Audit Staff to characterize any portion of JEFP's final payroll as bonuses to employees are not justified.² JEFP salary payments to employees in its final payroll were qualified campaign expenses either as salary payments made to staff for work prior to the date of

¹ Audit staff asserts in the PAR that JEFP significantly understated its assets on its NOCO statement. In fact, JEFP valuation of its assets was only approximately \$6,000.00 less than Audit's evaluation, hardly a large discrepancy given that total assets were nearly \$8 million. In addition, JEFP continues to take the position that general election funds and interest earned on them should not be stated on the NOCO statement for the primary campaign.

² Regulatory provisions at 11 C.F.R. §9034.4(a)(5) state that, in order to be considered a qualified campaign expense, any bonus paid must be provided for pursuant to a written contract. 11 C.F.R. §9034.4(a)(5). JEFP did not enter written contracts with employees that specified their salaries. Rather, salaries were agreed to verbally by department heads and prospective employees.

ineligibility or as winding down costs paid to staff to close down campaign activities for the Committee.³

o Makeup Pay

Audit Staff agrees that \$204,322 of the January 31 payroll (paid on February 7) is a qualified campaign expense because this amount was necessary to make up for employees receiving only half pay for the January 30 payroll. However, Audit Staff concludes that employees were paid in full from August 15, 2007 through January 15, 2008. The conclusion that employees were paid in full is incorrect. In fact, the salary of several employees was reduced as of August 16, 2007 and this pay cut remained in effect through January 30, 2008. The missed pay for those employees who remained on staff as of February, 2008 totaled \$44,916 and this amount was included in their February, 2008 payroll checks. (See spreadsheet at Attachment 1.) Thus, total amount of makeup pay for the pay periods covering August 16, 2007 thru January 30, 2008 was \$249,238.⁴

o Winding Down Costs

The remaining portion, \$511,955, of the February 7 payroll was for winding down costs, which are qualified campaign expenses under 11 C.F.R §9034.11.⁵ The two main components of these winding down costs were staff salaries and lump sum payments made to staff to reimburse for travel, lodging and meal expenses incurred during the month of January, and through February 7, 2008.

Staff Salaries

The first component of the Committee's winding down costs was staff salaries. At the date of ineligibility, JEFP had in place approximately 70 offices and volunteer sites in several cities. It was crucial that JEFP retain sufficient staff to drive cars to their required rental return destinations, to close offices or volunteer sites, and to return rental equipment. In order to clean

³ The PAR contains a number of comments which are trivial in nature concerning JEFP responses to Audit Staff requests regarding the February 8, 2008 payroll. The alleged 5 week delay in responding to a request seems minor in comparison to the time span of this audit, which began over two years ago and it has taken nearly one and one half years since JEFP's last response (April 21, 2009) for the PAR to be issued.

⁴ Audit Staff asserts in the PAR that because JEFP had \$4.2 million average daily cash balance in January, JEFP had the resources necessary to pay any full or increased salaries in that month. However, the Audit Staff assertion is fallacious in that it does not take into account that this cash balance was budgeted for other projected campaign expenses, such as media, field operations and other activities. Nor is there any indication that audit Staff took into consideration accounts payable or other pending obligations, such as bank loans. Regardless of its average daily cash balance, JEFP cut staff pay in 2007 and on the January payrolls because projected available cash was budgeted to other expenses.

⁵ Note that Audit Staff uses an inflated figure of \$556,871 as the portion of the payroll that is a non qualified campaign expense. In reality that figure could not be greater than \$511,955, due to the \$44,916 that was owed to employees whose salary had been cut since August 16, 2007.

out and close field offices, and other sites, to return rented equipment; and to return rental cars, JEFP deployed its remaining staff to these locations, paying them for 8 days salary to do so (January 31 through February 7, 2008.)⁶

There were several steps involved in closing out an office, a process, which, depending on the size of the office, could take several days. It was necessary to sort through documents and, where appropriate, prepare them for storage or shipping to headquarters, to return all rented office equipment and to distribute office furniture by arranging to donate it or haul it to a trash site. In some cases, staffers used their own cars to travel to and close campaign offices and in other cases, they used JEFP rental cars.

It was also necessary to return many rental cars that were left behind by staffers as they moved from one campaign site to another. In several cases, staffers traveled to a State in JEFP rental cars, then left those rental cars in that State, and were bussed to another primary or caucus state (New Hampshire, Nevada, South Carolina, Georgia, Minnesota, Oklahoma, California, etc.). When the campaign ended on January 30, many staffers were required to travel to the locations where they had left JEFP rental cars in order to return those vehicles to an appropriate rental car company office that in some cases was hundreds of miles away. Some staffers were required to use JEFP rental cars to report to an office location to close it down, and thereafter return the rental car to yet another location.

Those employees on JEFP's February 7, 2008 payroll were all required to perform the above tasks. Contrary to Audit Staff's assertion, high level staff also took part in closing down campaign operations. The Chief Financial Officer took charge in organizing and archiving financial records, and contacting vendors to shut down accounts. The Finance Director was responsible for properly archiving all finance documents, thanking donors and coordinating with the candidate to set up conference calls to donors. The Chief of Staff was in charge of all state offices and making sure proper close down occurred, including tracking equipment, as well as organizing material in the headquarters for review by the candidate. All of these individuals also took part in organizing records for audit.⁷

⁶ Audit Staff apparently takes the position that employee salaries must remain frozen at a certain level and can never be increased. Hence, Audit Staff is willing to treat \$204,322 of the January 31 payroll (paid on February 7) as necessary to make up for employees receiving only half pay for the January 30 payroll. There is no regulation or other provision that gives Audit Staff the authority to bar JEFP from paying employees more than the half pay that was missed by increasing their pay for that January 30 payroll period. JEFP had the full right and ability to give a retroactive pay increase for the payroll in which it did not make full pay, as well as for any previous payroll in December, 2007 or January, 2008.

⁷ Audit Staff makes an arbitrary statement in the PAR that the closeout took place after DOI and that only 14 people remained on the payroll for the closeout process. The February 7, 2008 payroll was in part to pay 99 staffers for closeout work performed January 31 thru approximately February 7. The Audit staff statement in the PAR regarding 14 employees on payroll for the closeout process apparently refers to the February 15 payroll. These individuals were mostly working in JEFP headquarters to prepare materials for the audit and to organize clean out and close down of those offices.

Reimbursements for Lodging, Fuel and Meal Costs

Staffers obviously incurred lodging, fuel and meal costs in the course of closing offices and returning rental vehicles. In addition, when the campaign ended abruptly, staff in the field had not turned in expenses incurred in January for reimbursement. Hence, to encourage staffers to remain with JEFPP to complete the wind down tasks, the Committee paid each staffer lump sum payment for lodging, fuel and meal costs. JEFPP opted to make a lump sum payment in lieu of going through a reimbursement process which would have entailed cumbersome accounting procedures.

Audit staff in the PAR infers that because JEFPP had procedures in place for handling travel reimbursements, the Committee did not have the option to choose to provide employees a lump sum salary payment in lieu of requiring them to go through the process of presenting receipts and obtaining reimbursements. The Committee clearly did have the right to do so, as well as the right to pay an increased salary to those willing to complete the tasks. For JEFPP, this was the most sensible solution to retaining employees to close out JEFPP operations, given that these employees were anxious to find positions with other campaigns. The Audit Staff's anecdotal statements regarding payroll taxes for the Committee and employees do not belong in the PAR – increased tax burdens have no bearing on whether a campaign expense is qualified and the auditors have no role as watchdogs in how or whether campaign funds are used in the most efficient way possible to avoid tax consequences. In December of 2007, JEFPP determined that those staying through the end of the campaign would receive a salary increase, which would be paid out as permitted by committee resources. This pay increase was intended primarily to compensate staff for the fact that JEFPP dispatched employees to many different field locations throughout the country for the January primaries and caucuses, placing them on an around-the-clock schedule. The increase in pay was also designed to cover increased costs that staffers were required to incur because they were on the road in the early caucus and primary states. Although JEFPP was not financially able to pay this increase when payrolls were issued in December and January, JEFPP maintains it had the right to pay those amounts at a later date if it funds became available.

The following chart summarizes the breakdown of the final payroll of \$761,193:

Make Up Pay for Missed Salary:	\$249,238.00
Salary Jan. 31 through Feb. 7, 2008	\$187,567 ⁸
Lump Sum Payment for Expenses	\$320,659 ⁹

Estimated Winding Down Expenses: With minor exceptions, Audit Staff and JEFPP's estimated winding down expenses are very similar.

⁸ Average pay per staffer was \$3,552.

⁹ Average reimbursement per staffer was \$3,239.

Entitlement to Matching Funds: JEPF's Overall Objection to the Repayment of Matching Funds:

Audit Staff asserts in the PAR that JEPF received more than \$2.3 million in excess of its entitlement. In essence, the Audit Staff concludes that JEPF is not entitled to receive matching funds for contributions that were received while Senator Edwards was an eligible candidate and were clearly matchable under statutory provisions at 26 U.S.C. §9034(a). This result does not comport with the law, which premises entitlement to public funds for eligible candidates solely on the source, size and timing of contributions received prior to the date of ineligibility. The PAR in essence imposes an additional criterion for matching contributions received by a candidate while he or she is an active candidate -- the size of a candidate's debt at the time of actual payment of the public funds.

Audit Staff 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. However, this statutory provision does not support such a conclusion. In fact, the statutory provision does nothing to affect the matchability of contributions received before a candidate's DOI -- instead, this provision extends the right of candidates to receive funds after ineligibility.¹⁰ 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.

Matching all contributions received by a candidate prior to the date of ineligibility is a far more equitable approach, particularly under the circumstances extant in early 2008 when two simultaneous, unforeseen events occurred at the same time: a shortfall in the Presidential Election Campaign Fund and the suspension of the Commission's ability to act due to the lack of a quorum. Audit Staff admits that the combination of these events delayed payments, but minimizes the impact of this delay by stating that matching fund recipients were able to obtain loans using the matching fund certifications as collateral. This is not entirely correct. JEPF was able to obtain loans, but its bank capped the overall amount that the Committee could borrow at \$10 million. This meant that once the cap was hit, JEPF could borrow no more, despite the fact that it had been certified to receive \$13 million in matching funds. Thus, during the campaign, JEPF was denied usage of nearly 25% of its matching fund entitlement.

The arbitrary denial of public funds to a candidate violates the First Amendment rights of both the candidate and those individuals who contributed to the candidate's committee. Such a denial creates inequities between candidates, whose entitlement to matching funds, under Audit Staff's approach, will be determined by external events not contemplated in the statute, including deficiencies in the Fund and the lack of a quorum at the Commission.

¹⁰ Any interpretation of this provision to deny entitlement of public funds to a candidate for matchable contributions received while an active and eligible raises serious constitutional issues.

The Audit Staff apparently bases its conclusion in the PAR that JEPF received over \$2.3 million in excess of its entitlement on 11 C.F.R. §9034.1(b), although this regulation is cited only in a footnote. (See PAR at Footnote 7.) Section 9034.1(b) premises a candidate's entitlement to public funds on the status of his or her net outstanding campaign obligations at the time of payment of public funds. This regulation was enacted many years ago and never contemplated the extraordinary circumstances that occurred in 2008.¹¹

Finding 2: Misstatement of Financial Activity: Amendments will be filed by JEPF pursuant to Audit Staff recommendation. As explained to Audit Staff during fieldwork, this situation resulted from an anomaly in the software of the Committee's merchant vendor.

Finding 3: Failure to Itemize Loan Repayments: Amendments will be filed by JEPF pursuant to Audit Staff recommendation.

Finding 4: Stale-Dated Checks: The Committee has reviewed the list of stale checks provided by the Audit Staff and has provided documentation showing that 83 checks totaling \$138,371.23 (out of \$267,529.00 identified by Audit Staff) have cleared the bank and should be removed from the list. Please see spreadsheet and attachments A-U. When this information is placed on the public record, all bank account information should be redacted.

Prepared by:

Lyn Utrecht
Eric F. Kleinfeld
Patricia A. Fiori
Karen A. Zeglis

¹¹ While the validity of 11 C.F.R. §9034.1(b) has been upheld by the Courts, it is clearly within the authority of the Commission to adopt a different interpretation of that regulation from that proposed in the PAR. Lyndon LaRouche v. Federal Election Commission, 28 F.3d 137 (1994 D.C. Cir.). This decision was issued over 15 years ago, and in that period, there have been a dramatic changes in the Supreme Court interpretations of the law in this area. Thus, the Commission should re-examine its interpretation of Section 9034 in light of current decisions.