FEDERAL ELECTION COMMISSION
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**MEMORANDUM**

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**SUBJECT:** Draft Final Audit Report on John Edwards for President, Inc. (LRA 743)

## I. INTRODUCTION

The Office of the General Counsel has reviewed the proposed Draft Final Audit Report ("DFAR") for John Edwards for President, Inc. ("the Committee"). Our comments address various aspects of Finding 1. We concur with the remaining findings not specifically discussed in this memorandum. If you have any questions, please contact Allison T. Steinle, the attorney assigned to this audit.

## II. FINDING 1 – MATCHING FUNDS RECEIVED IN EXCESS OF ENTITLEMENT

### A. THE COMMITTEE HAS NOT ESTABLISHED THAT CERTAIN PAYROLL EXPENSES PAID AFTER DOI ARE QUALIFIED CAMPAIGN EXPENSES

The Audit Division concluded that certain payroll expenses paid after DOI are non-qualified campaign expenses, and as a result did not include these expenses as a liability on the Statement of Net Outstanding Campaign Obligations ("NOCO Statement"). Specifically, the Committee made $761,192 in payments to staffers, and for associated payroll taxes, on February 7, 2008. Ninety-nine staff members received payments. The Committee's normal pay periods

for January 2008 ended on January 15, 2008 and January 30, 2008, but the Committee appears to have created an extra pay period that both began and ended on January 31, 2008 and was paid on February 7, 2008.

In response to the exit conference, the Committee submitted a written response and spreadsheet that broke down these payments as follows: (1) $204,322 in back pay owed from the January 30, 2008 pay period; (2) $205,182 in "salary increases" paid for December 23, 2007 to January 30, 2008; and (3) $351,688 in winding down expenses paid for January 31, 2008 to February 15, 2008. The Preliminary Audit Report ("PAR") concluded that everything but the back pay owed from the January 30, 2008 pay period was a monetary bonus paid after the candidate's date of ineligibility ("DOI"), and that this monetary bonus was not a qualified campaign expense because it was not provided for in a written contract made prior to DOI. *See* 11 C.F.R. § 9034.4(a)(5).

In response to the PAR, the Committee submitted another written response and an additional spreadsheet that appears to break down the payments differently. Specifically, it now characterizes the payments as follows: (1) $204,322 in back pay owed from the January 30, 2008 pay period; (2) $44,916 in back pay owed to six staffers for reduced salaries from August 16, 2007 to January 30, 2008; (3) $187,567 in staff salaries for winding down activities from January 31, 2008 to February 7, 2008; and (4) $320,659 in lump sum payments for lodging, fuel, and meal costs that the Committee made to staffers in lieu of reimbursements. The proposed DFAR concludes that $232,739 in back pay, which includes $28,417 in back pay owed to five of the six staffers for reduced salaries between August 16, 2007 to January 30, 2008, was a qualified campaign expense, but that the Committee has not established that the remaining amount was a qualified campaign expense. *See* 26 U.S.C. § 9033.1(a)(1); 11 C.F.R. § 9033.11(a).

We agree with the Audit Division that everything but $232,739 in back pay should be considered a non-qualified campaign expense. We address each part of the Committee's new breakdown below.

*Back Pay Owed from the January 30, 2008 Pay Period and to Six Staffers from August 16, 2007 to January 30, 2008*

The Committee claims that $249,238 of the payroll is back pay owed to staffers who received reduced salaries from the January 30, 2008 pay period, and to six staffers who received reduced salaries from August 16, 2007 to January 30, 2008. *See* Response of John Edwards for President to PAR at 2 (Dec. 14, 2010).

Qualified campaign expenses are defined as expenses "incurred by or on behalf of a candidate or his or her authorized committee from the date the individual becomes a candidate through the last date of the candidate's eligibility." 26 U.S.C. § 9032(9); 11 C.F.R. § 9039.9.

We agree with the Audit Division that the $232,739 of this amount was back pay and therefore was a qualified campaign expense. The auditors have verified that the Committee had incurred and owed $232,739 in salary expenses prior to DOI. Specifically, staffers were only

paid half of their normal net salary for the pay period that ended on January 30, 2008 and were therefore owed an additional $204,322 in ordinary salary prior to DOI. In addition, five staffers were only paid a portion of their normal net salary between August 16, 2007 to January 30, 2008, and were therefore owed an additional $28,417 in ordinary salary prior to DOI.[1]

*Staff Salaries for Winding Down Activities from January 31, 2008 to February 7, 2008*

The Committee claims that $187,567 in payroll was intended as "staff salaries" for winding down activities from January 31, 2008 to February 7, 2008.[2] The Committee states that these salaries were paid to all 99 employees, and were intended as an additional salary payment to help retain staff for necessary winding down activities such as returning cars to their required destination, closing offices and volunteer sites, and returning rental equipment. *See* Response of John Edwards for President to PAR at 2-3 (Dec. 14, 2010).

Winding down expenses are considered qualified campaign expenses so long as they are "associated with the termination of political activity related to a candidate's seeking his or her election," and can include staff salaries. 11 C.F.R. §§ 9034.4(a)(3)(i); 9034.11. However, the Commission's regulations place the burden on a committee to prove that an expense is a qualified campaign expense, and candidates agree in writing to "obtain and furnish to the Commission any evidence it may request of qualified campaign expenses." 26 U.S.C. § 9033.1(a)(1); 11 C.F.R. § 9033.11(a). In *LaRouche's Comm. for a New Bretton Woods v. FEC*, 439 F.3d 733, 738 (D.C. Cir. 2006), the court concluded that the Commission was not required to find that an expense was a qualified campaign expense where the committee failed to produce any document by which the Commission could either quantify or determine the reasonableness of the expense.

Here, the Committee has not provided any documentation or a verifiable basis to support its assertion that $187,567 was an additional salary payment to compensate employees for winding down activities. It has not produced any written contracts or other contemporaneous documentation to verify this claim, and has stated that no employment contracts that specified staff salaries existed. In fact, the Committee has provided several conflicting breakdowns and explanations for what various elements of the payment were intended to compensate staffers for over the course of the audit. *See, e.g.*, note 2 *supra*. Accordingly, we conclude that the Committee has not met its burden of proving that the $187,567 was a qualified campaign expense.

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[1] The Audit Division did not include one staffer listed by the Committee as receiving a reduced salary from August 16, 2007 to January 30, 2008, and subsequently owed $16,500 in back pay, because that back pay was not included in the February 7, 2008 payroll in question.

[2] The Committee has apparently abandoned the theory that $205,182 of the $761,192 in payroll was intended as "salary increases" for the period between December 23, 2007 and January 30, 2008, "primarily to compensate staff for the fact that [the Committee] dispatched staff to many different field locations throughout the country for the January primaries and caucuses, placing them on an around-the clock schedule." *See* Response of John Edwards for President to Supplemental Exit Conference Preliminary Audit Findings at 1-2 (Apr. 16, 2009).

The Audit Division has informed this Office that 85 of the 99 staffers did not receive any other salary payments in February because they did not remain on the payroll after DOI. Therefore, to the extent to the $187,567 represents a salary payment to those staffers, the Committee should provide any written contracts, memoranda, payroll records, e-mails, or other contemporaneous documents that establish this amount was intended as an ordinary salary payment to reimburse staff for winding down activities. However, 14 staffers remained on the payroll after DOI and continued to receive ordinary biweekly salary payments throughout the month of February. Therefore, to the extent that the $187,567 represents an increase in these 14 staffers' ordinary salary, the Committee should document that this amount was intended as a permanent increase in ordinary salary to compensate staff for winding down activities, or provide a written contract made prior to DOI that provided for a monetary bonus pursuant to section 9034.4(a)(5).[3]

*Reimbursements for Winding Down Activities*

The Committee claims that the remaining $320,659 in payroll was intended to reimburse employees for the lodging, fuel, and meal costs they incurred while conducting winding down activities "in lieu of any attempt to have employees turn in receipts for reimbursement." *See* Response of John Edwards for President to PAR at 4 (Dec. 14, 2010).

Again, however, the Committee has not provided any documentation or a verifiable basis to support its assertion that $320,659 was for salary payments to reimburse staff for winding down activities. 26 U.S.C. § 9033.1(a)(1); 11 C.F.R. § 9033.11(a); *LaRouche*, 439 F.3d at 738. Accordingly, we conclude that the Committee has not met its burden of proving that $320,659 was a qualified campaign expense. To establish that the $320,659 was a qualified campaign expense, the Committee should provide any written contracts, memoranda, payroll records, e-mails, or other contemporaneous documents that establish this amount was intended as an ordinary salary payment to reimburse staff for winding down activities.

Moreover, we note the Committee's claim that it made lump sum payments averaging $3,239 to each of its 99 staffers, which were intended as reimbursements for the lodging, fuel, and meal costs they incurred while conducting winding down activities, could create additional

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[3] The Committee argues that "there is no regulation or other provision that gives the Audit Staff the authority to bar [the Committee] from paying employees more than the half pay that was missed by increasing their pay for that January 30 payroll period." *See* Response of John Edwards for President to PAR at 3 n.5 (Dec. 14, 2010). However, the Commission's regulations do establish which salary payments after DOI are qualified campaign expenses. Specifically, they state that monetary bonuses paid to staff after DOI in recognition of campaign-related activities or services are considered qualified campaign expenses only if they are paid no later than 30 days after DOI and are provided for in a written contract made prior to DOI. 11 C.F.R. § 9034.4(a)(5). The Commission specifically promulgated section 9034.4(a)(5) to prevent "publicly funded campaigns [from] paying large monetary bonuses after [DOI] upon discovery of excess public funds." *See* Explanation and Justification for Public Financing of Presidential Candidates and Nominating Conventions, 68 Fed. Reg. 47,386, 47,390 (Aug. 8, 2003). Therefore, we believe the Committee must either document that the $187,567 was intended as an ordinary salary payment to compensate staff for winding down activities, or produce a written contract made prior to DOI that provided for the monetary bonuses pursuant to section 9034.4(a)(5).

issues. Commission regulations limit how committees may reimburse staff for costs incurred from their personal funds in the course of providing services to or on behalf of a campaign. 11 C.F.R. §§ 100.79(a), 116.5. Specifically, payments made from staffers' personal funds for transportation and usual and normal subsistence expenses that exceed an aggregate of $1,000 per election or $2,000 per calendar year are considered contributions unless they are reimbursed by the Committee within 30 days after the expense was incurred or 60 days after the closing date of the billing statement if they were put on a credit card. *Id.* Committees are required to treat and report the obligations arising from these staff payments as debts until they are reimbursed. 11 C.F.R. § 116.5(c), (e). Accordingly, here, the Committee could have potentially been in violation of section 116.5 if it paid lump sum amounts that were not sufficient to cover the staffers' actual lodging, fuel, and meal costs. 11 C.F.R. §§ 100.79(a), 116.5. Conversely, if the Committee paid lump sum amounts that were in excess of staffers' actual lodging, fuel, and meal costs, those excess amounts were not, by definition, reimbursements of costs. *See* Black's Law Dictionary 1312 (8th ed. 1999) (defining reimbursements as repayments or indemnifications). Rather, they were simply salary payments paid after DOI, which, as discussed above, have not been properly documented.

## B. DISPUTED WINDING DOWN COSTS ARE NOT CURRENTLY MOOTED BY THE COMMITTEE'S LIMIT ON WINDING DOWN EXPENSES

Finding 1 in the proposed DFAR includes a statement that "[e]ven if the Commission were to accept [the Committee's] position with respect to the [winding down amounts] in question, [the Committee] has reached the limit on winding down expenses." The proposed DFAR states that including any disputed winding down expenses "would not affect the amount of matching funds determined to be in excess of the candidate's entitlement. [The Committee] would still be required to make a repayment of matching funds, totaling $2,136,507."

It is our understanding that the Committee has not, in fact, reached its limit on winding down expenses as of the date of this memorandum, and that the Audit Division's statement was only intended to reflect the fact that the Committee may eventually reach its limit on winding down expenses, mooting its dispute on whether $556,871 of the salary payment in question qualifies as a winding down expense and hence a qualified campaign expense. However, there is still a possibility that the inclusion of this amount could impact the Committee's total repayment determination. If the Committee did not spend the remainder of its undisputed estimated winding costs listed on the NOCO Statement through October 31, 2012, the disputed winding down costs may have an impact on the NOCO and affect the amount the Committee received in excess of entitlement. Accordingly, we recommend that the Audit Division revise the proposed DFAR to reflect this fact.

## C. THE COMMITTEE'S GENERAL OBJECTION TO REPAYMENT OF MATCHING FUNDS

Based on a review of the Committee's NOCO Statement, the Audit Division recommends that the Commission determine that the Committee repay $2,136,507 to the United States Treasury because the Committee received public funds in excess of entitlement. The Committee,

however, argues that repayment is not due because entitlement to public funds for eligible candidates must be based "solely on the source, size, and timing of the contributions received prior to the date of ineligibility." *See* Response of John Edwards for President to PAR at 5 (Dec. 14, 2010). We understand this to mean, in essence, that in the Committee's view, if it received a matchable contribution prior to the candidate's DOI, it is entitled to a matching payment for that contribution, regardless of when it submitted the contribution for matching and regardless of whether the matching payment was made prior to or after DOI. Accordingly, the Committee argues that the size of the Committee's Net Outstanding Campaign Obligations ("NOCOs") at the time the United States Treasury actually paid the public funds was irrelevant to the Committee's entitlement and the "[m]atching all contributions received by a candidate prior to the [DOI] is a far more equitable approach." *Id.*

This is not an issue of first impression. Contrary to what we understand to be the Committee's position, the Commission's regulations specifically provide that that an ineligible candidate without NOCOs has no entitlement to additional matching payments "*regardless of the date of deposit of the underlying contributions.*" 11 C.F.R. § 9034.1(a) (emphasis added). The Commission has consistently rejected arguments similar to the Committee's, and concluded that for an ineligible candidate to receive matching funds, not only must the matched contributions be matchable—a requirement that applies both before and after DOI—but the ineligible candidate must also have remaining debts on the most recent NOCO Statement. *See, e.g.*, 11 C.F.R. 9034.1(a) and (b); Explanation and Justification for 11 C.F.R. § 9034.1, 48 Fed. Reg. 5,224, 5,227 (Feb. 4, 1983); Mondale for President Committee Final Audit Report ("FAR") at 57-58, 64-68 (Oct. 28, 1986); Dukakis for President Committee FAR at 31-33 (Dec. 17, 1991); Clinton/Gore '92 Committee FAR at 12-13 (Dec. 27, 1994).

As the Commission noted at length in the Clinton/Gore '92 Committee FAR, the Commission has a long and consistent history of conditioning a candidate's remaining entitlement after DOI on the candidate's NOCOs at the time the matching funds are paid. Section 9034.1(b) of the Commission's regulations states that after DOI, candidates may continue to receive payments only to the extent they have sufficient NOCOs. Section 9034.1(b) dates to a December 1976 memorandum from the Office of General Counsel to the Commission proposing an amendment to then section 134.3(c)(2) of the Commission's regulations. The proposed rule stated that "a candidate shall be entitled to no further matching funds if, at the time of any submission for certification, the total contributions and matching funds received after the ineligibility date equals or exceeds the net obligations outstanding on the date of ineligibility." The 1979 Explanation and Justification for section 9034.1 explained that for candidates who have NOCOs after DOI, "[b]asically, these candidates are entitled to payments only if the private contributions received between the date of ineligibility and the date of submission are not sufficient to discharge the net debt." Explanation and Justification for 11 C.F.R. § 9034.1, 44 Fed. Reg. 20,336, 20,338 (Apr. 4, 1979). The Commission explained that this regulation "furthers the policy that the candidate should use private contributions to discharge campaign obligations wherever possible." *Id.* Most importantly, in 1983, the Commission revised these regulations to make clear "that to receive matching funds after the date of ineligibility, candidates must have net outstanding campaign obligations as of the date of payment rather than the date of submission. Thus, if the candidate's financial position changed between the date of

his or her submission for matching funds and the date of payment, reducing the candidate's net outstanding campaign obligations, that candidate's entitlement would be reduced accordingly." Explanation and Justification for 11 C.F.R. § 9034.1, 48 Fed. Reg. 5,224, 5,227 (Feb. 4, 1983); *see also* Explanation and Justification for 11 C.F.R. § 9034.5, 60 Fed. Reg. 31,854, 31,868 (June 16, 1995). Accordingly, the Commission has repeatedly rejected the position advanced here by the Committee as contrary to the plain meaning of the Commission's regulations, as well as long standing Commission practice and policy. *See, e.g.*, Mondale for President Committee FAR at 57-58, 64-68 (Oct. 28, 1986); Dukakis for President Committee FAR at 31-33 (Dec. 17, 1991); Clinton/Gore '92 Committee FAR at 12-13 (Dec. 27, 1994).

The Committee also argues that the unique circumstances of 2007 and 2008 demonstrate why the position taken by the Commission over the years is wrong, and why its position is the only fair approach to determining the Committee's entitlement to public funds. To evaluate the Committee's argument, it is necessary to begin by briefly recounting what those circumstances were.

The Commission first determined Senator Edwards to be eligible for and entitled to matching funds in December 2007. Under normal circumstances, the United States Treasury would have made the initial payment of matching funds to the Committee on January 2, 2008, the first business day of the election year. *See* 11 C.F.R. §§ 9037.1, 9037.2. However, a shortfall in the Presidential Election Campaign Fund meant that there were no funds available in the Matching Payment Account for the Treasury to pay to Senator Edwards or any other candidate on January 2. In fact, the United States Treasury did not make the first payment to the Committee until February 14, 2008. Senator Edwards withdrew from the campaign on January 30, 2008, making that date his DOI. *See* 11 C.F.R. § 9033.5. At that time, of course, he had received no payments at all from the Treasury and would not for another 15 days.

Moreover, on December 31, 2007, the Commission lost its quorum. As a result, it could not certify Senator Edwards' entitlement to any amounts in addition to those it had certified earlier that month. *See* 26 U.S.C. § 9036; 2 U.S.C. § 437c(c). As it happened, the Commission was unable to certify Senator Edwards' entitlement to any additional amounts until July 2008, months after the candidate's DOI.

The Committee asserts that even under the Commission's longstanding approach to post-DOI payments, but for the shortfall in the Presidential Election Campaign Fund and the lack of a Commission quorum, it would have already received by January 30 all but $2.9 million of the $12.8 million in matching funds it was eventually paid. Because of that, it notes, none of the amount it would have received prior to DOI would have been subject to repayment for having been received in excess of entitlement. *See* Response of John Edwards for President to PAR at 5 (Dec. 14, 2010). Thus, the Committee appears to argue that the Commission should change its approach and pay matching funds for all matchable contributions deposited by the Committee prior to DOI, because otherwise shortfalls in the Presidential Election Campaign Fund and unique circumstances like the lack of a Commission quorum will shortchange committees in the end, preventing them from receiving funds they otherwise would have received, or in some

instances, like this one, requiring them to repay funds that they otherwise would not have had to repay. *See id.*

The question, then, is whether, as the Committee claims, the unique circumstances of 2007 and 2008 call for the Commission to ignore the plain meaning of 11 C.F.R. § 9034.1 and change its long standing practice and policy. We conclude they do not. The Committee's claim that section 9034.1(b) "never contemplated the extraordinary circumstances that occurred in 2008," *see* Response of John Edwards for President to PAR at 6 (Dec. 14, 2010), is incorrect.[4] When drafting the regulations, the Commission considered that a shortfall in the Presidential Election Campaign Fund might prevent a committee from being paid the full amount the Commission had certified prior to DOI. Explanation and Justification for 11 C.F.R. § 9034.1, 56 Fed. Reg. 35,898, 35,904-05 (July 29, 1991). The Commission nevertheless concluded that post-DOI entitlement would be based on the candidate's NOCO at the time of payment of public funds rather than the date the matchable contributions were received or the date of submission. In particular, the Commission's regulations provide that "[a]fter the candidate's date of ineligibility, if the candidate does not receive the entire amount of matching funds on a regularly scheduled payment date due to a shortfall in the matching payment account, the candidate shall also submit a revised statement of net outstanding campaign obligations," on which basis the Commission may "revise the amount previously certified for payment." 11 C.F.R. §§ 9034.5(f)(3), 9036.4(c)(2). If, therefore, a shortfall delays payment, any eventual payment will be based on any subsequent NOCO statement, and this may result in a reduction even to amounts already certified by the Commission. The Committee may wind up not receiving amounts it otherwise would have received but for the shortfall. The Commission was well aware of this when it promulgated the regulation. *See also* 56 Fed. Reg. at 35,904-05 (noting that candidates' receipt of matching funds "could be affected by the amount of funds available in the matching payment account").

Regardless of whether the Committee was paid the full amount the Commission had certified prior to DOI, the Committee should not be permitted to receive public funds after DOI unless it has NOCOs that those funds will be used to pay. In this instance, the Committee's NOCO Statements at the time of payment appeared to support further payment of public funds, but the audit has revealed that the NOCOs were in fact overstated. Consequently, the Committee received funds in excess of entitlement.

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[4] The Committee also argues that, although section 9034.1 was upheld in *LaRouche v. FEC*, 28 F.3d 137 (D.C. Cir. 1994), "there have been a [sic] dramatic changes in the Supreme Court interpretations of the law in this area" and "the Commission should re-examine its interpretation of section 9034 in light of current decisions." *See* Response of John Edwards for President to PAR at 6 n.11 (Dec. 14, 2010), The Committee, however, does not cite to any specific cases on which the Commission could base such a re-examination, and there are not any recent Supreme Court cases that have directly addressed or interpreted candidate entitlements or repayment determinations under section 9034.