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FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Report of the Audit Division on the Washington State Democratic
Central Committee (LRA 737)

I. INTRODUCTION

The purpose of this memorandum is to address issues raised in the Report of the Audit Division ("Proposed Report") on the Washington State Democratic Central Committee ("Committee"). We offer the following comments regarding Finding 4 (Reporting of Apparent Independent Expenditures) and Finding 5 (Federal Telemarketing Activity). We note developments in the law that have created uncertainty in the analysis of the issues regarding Finding 5, which pertains to whether certain funds raised through telemarketing are Federal contributions, and we recommend no finding on this issue in light of this uncertainty: We concur with the remaining findings and issues in the Proposed Report not specifically addressed in this memorandum. If you have any questions, please contact Danita C. Lee, the attorney assigned to this audit.¹

¹ The Office of General Counsel recommends that the Commission consider this document in open session since the Proposed Report does not include matters exempt from public disclosure. See 11 C.F.R. § 2.4.

II. DIRECT MAIL EXPENSES DID NOT MEET THE VOLUNTEER MATERIALS EXEMPTION (Finding 4)

The Proposed Report concludes that the Committee failed to properly disclose as independent expenditures disbursements totaling \$516,854 for direct mail advertisements. The Committee reported the expenditures on Schedule H6 (Disbursement of Federal and Levin Funds for Allocated Federal Election Activity), but because the advertisements expressly advocated the election or defeat of one or more clearly identified Federal candidates, the auditors conclude that the Committee should have reported the disbursements on Schedule E. The auditors also conclude that the Committee failed to file associated 24 and 48-hour notices. The Committee indicated, however, that it considered the direct mailings to be exempt volunteer activities. See 2 U.S.C. §§ 431(8)(B)(ix) and (9)(B)(vii); 11 C.F.R. §§ 100.87 and 100.147. In determining whether mailings qualify for the volunteer materials exemption, the Commission has considered whether there was sufficient volunteer involvement based on the specific facts and circumstances of the case. The Interim Audit Report ("IAR"), therefore, requested that the Committee provide documentation supporting the volunteer materials exemption.

In response, the Committee submitted an affidavit from Michael King, a regional field director for the Patty Murray for U.S. Senate campaign. Mr. King was responsible for overseeing the Committee's volunteers who were assisting in the production of a Patty Murray mail piece entitled "Extreme." Mr. King said in his affidavit that, "I cannot recall the exact particulars of what each volunteer did. However, I can recall, generally, that the volunteers played an extensive role in the preparation of this mailing." The Committee also submitted nine undated photographs of unidentified men and women in an unidentified location. The Committee did not make any statements describing the activities of the individuals in the photographs. Four photographs appear to depict individuals wearing "Patty Murray" t-shirts. Three photographs appear to show boxes in the background labeled either "Property of U.S. Postal Service" or "United States Postal Service." Two photographs appear to depict individuals with their hands in boxes labeled "United States Postal Service." The Committee also stated that several of the mailings were undertaken on behalf of John Kerry. The Committee said it believed that the mailings were intended as volunteer exempt activities but that it was "unable to locate any documentation regarding the volunteer participation with respect to these communications."

Following the Commission's approval of the IAR, the Commission considered the volunteer materials exemption in the context of Matter Under Review ("MUR") 5598. See Statement of Reasons of Commissioners Petersen, Bauerly, Hunter and Weintraub in MUR 5598, Utah Republican Party, et. al (April 9, 2009) ("MUR 5598 SOR"). In the Utah Republican Party ("URP") case, this Office concluded that the volunteer activity was not sufficient to meet the volunteer materials exemption. URP claimed that its mailers met the volunteer materials exemption because volunteers processed, sorted, and hand-stamped the mail pieces and delivered them to the post office for mailing. But, this Office's investigation found that URP's volunteers only stamped the bulk mail permit indicia on the mailers and helped load boxes of mailers into a truck that took the mailers

back to the mail vendor, which then printed addresses, sorted them by postal route and delivered them to the post office for mailing. *Id.* at 3. The majority of the Commission neither accepted nor rejected this Office's legal analysis but instead, concluded that there is great confusion in the regulated community about how much volunteer involvement is necessary to qualify for the exemption. The four Commissioners in the majority concluded that they "voted to dismiss this matter against all parties in an exercise of our prosecutorial discretion." MUR 5598 SOR at 2, citing *Heckler v. Chaney*, 470 U.S. 821, 831 (1985). The Commissioners explained:

The Office of the General Counsel concluded that the URP's mailers did not qualify for the exemption. URP stated that it believed that its actions were consistent with the exemption, and given the complicated history of the application of the volunteer materials exemption, we voted to dismiss this matter in an exercise of our prosecutorial discretion. See *Heckler v. Chaney*, 470 U.S. 821, 831 (1985). We plan to issue more detailed guidance to clarify the volunteer materials exemption and the circumstances in which it applies.

MUR 5598 SOR at 4.

More recently, we commented on the proposed Final Audit Report for the Tennessee Republican Party (LRA 745). There, as here, the Interim Audit Report recommended that the Committee provide more detail regarding the specific involvement of volunteers in the mailers at issue and why, in the committee's view, the mailers qualified for the volunteer exemption. In that matter, the Committee's response to the Interim Audit Report described in great detail the specific involvement of the volunteers, which turned out to be extremely similar to the volunteer involvement in MUR 5598. We advised the Audit Division there that in our view, the involvement of volunteers in the Tennessee Republican Party audit was not sufficient to qualify for the volunteer materials exemption. However, we noted the outcome of MUR 5598, and given the factual similarities between MUR 5598 and LRA 745, we recommended that the finding be less definitive about the potential violation, and that the audit report conclude that the committee there may have violated the law, but that no further corrective action was necessary.

The Commission has not decided the volunteer materials exemption issue in the Tennessee Republicans Final Audit Report, and the Commission has not issued any further clarification on the exemption.² Given this uncertainty about the volunteer materials exemption, we reiterate our advice in LRA 745. Specifically, we recommend that the report in this case describe the state of the law on the volunteer materials exemption and conclude that the committee may have violated the law, but that no further corrective action is necessary.

² As of this writing, the draft Final Audit Report on the Tennessee Republican Party has been circulated but not acted on by the Commission.

III. RECENT DEVELOPMENTS IN THE LAW AFFECT FINDING 5

The Proposed Report concludes that the Committee conducted telemarketing activity costing a total of \$190,951, which should have been paid with Federal funds because the telemarketing solicitation script expressly advocated the election and defeat of specific Federal candidates. The Proposed Report also concludes that the funds raised through the telemarketing, totaling \$331,772, were contributions under the Act, which should have been deposited in the Committee's Federal account. The Court of Appeals' decision in *EMILY's List v. FEC*, No. 08-5422 (D.C. Cir. Sept. 18, 2009) may have an impact on the conclusion that the funds raised in this telemarketing were contributions under the Act.

The auditors determined that the Committee failed to properly disclose both the receipts and disbursements associated with the telemarketing fundraising. In determining that the telemarketing funds were contributions, the auditors rely on *Federal Election Commission v. Survival Education Fund, Inc.*, 65 F.3d 285, 295 (2d Cir. 1995) ("*SEF*"). The auditors believe that *SEF* should be applied to the Committee since the content of its telemarketing script mirrors the solicitation language the Commission relied on in MURs 5403 and 5466 to determine that funds raised pursuant to solicitations were Federal contributions. The IAR noted some uncertainty as to whether the script submitted during audit fieldwork was the one actually used to raise the funds in question, and requested that the Committee submit a different script if a different script was actually used. It also recommended that if the script submitted during fieldwork was the one actually used, the Committee transfer \$331,772 from its non-Federal account to its Federal account to cover the amount of contributions that should have been deposited in the Federal account, and transfer \$190,951 from the Federal account to the non-Federal account to pay for the expenses associated with the telemarketing. The IAR also requested the Committee provide correct memo entries for the receipts received and disbursements paid.

The Committee did not comply with the IAR recommendations. The Committee indicated that since it considered the telemarketing expenditures and receipts non-Federal, it properly deposited funds raised by the telemarketing in its non-Federal account and used non-Federal funds to pay the associated expenses. It also asserted that it had obtained an opinion from the Washington State Public Disclosure Commission stating that it would violate state law if it used non-Federal funds classified as "exempt" under state law to comply with the IAR's recommendation that it transfer \$331,772 from the non-Federal account to the Federal account, and asserts that it has insufficient non-Federal funds classified as "non-exempt" under state law to comply with the recommendation at this time.

These facts raise two principal issues. First, were the proceeds of the telemarketing effort contributions? Second, if so, what should be the effect on the recommendation, if any, of the Committee's representations regarding Washington state law? Recent developments in the law, including the decision in *EMILY's List*, lead us to recommend that Finding 5 be removed from the Proposed Report.

A. Receipts As Contributions

Survival Education Fund, by itself, would support a conclusion that the telemarketing receipts are contributions under the Act. A contribution is defined as a gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office. 2 U.S.C. § 431 (8)(A)(i). The Commission has not applied *SEF* to state party committees. Thus, applying *SEF* to a state party committee would be a matter of first impression for the Commission. Nevertheless, the court's holding does not suggest that its analysis and application should be limited to the type of entity that made the solicitation and received the contributions in that case.

In *SEF*, the court considered whether proceeds received in response to a fundraising solicitation mailed to the general public by two 501(c)(4) organizations during the 1984 Presidential race constituted "contributions" under the Act. In analyzing language associated with the solicitation, the Second Circuit considered whether the solicitation sought "contributions" and was therefore subject to the Act's disclaimer requirements under 2 U.S.C. § 441d(a). Stating that it was unnecessary to consider whether the mailer constituted express advocacy, the court analyzed whether the mailer solicited "contributions" based on the Supreme Court's statement in *Buckley v. Valeo*, 424 U.S. 1 (1976), that contributions made to other organizations but earmarked for political purposes were contributions made "for the purpose of influencing elections" and, thus, were properly covered by the Act. See *SEF* at 294 (quoting *Buckley*, 424 U.S. at 78 (1976)). The court held that the mailer was a solicitation for contributions within the meaning of section 431(8), citing the mailer's statement, "your special election-year contribution will help us communicate your views to the hundreds of thousands of members of the voting public, letting them know why Ronald Reagan and his anti-people policies must be stopped." *Id.* According to the court, this statement "leaves no doubt that the funds contributed would be used to advocate Reagan's defeat at the polls, not simply to criticize his policies during the election year."

In this matter, the Committee's telemarketing script contains language similar to the language the Second Circuit relied upon to conclude that funds raised pursuant to the solicitation would be used in connection with a Federal election and were therefore contributions. Specifically, the Committee's telemarketing script states that, "if we can raise the resources we need to implement our campaign, we will defeat George W. Bush and take back control of our country once and for all." Due to the similarities between the language in the solicitations and the Committee's telemarketing script, an *SEF* analysis would indicate that funds the Committee raised using the script should be considered contributions under the Act.

1. *SEF*, Section 106.57, *EMILY's List* and The November Fund

As a consequence of the decision in *EMILY's List v. FEC*, No. 08-5422 (D.C. Cir. Sept. 18, 2009), we doubt that the Commission can rely on *SEF* to conclude that funds raised using certain solicitations are contributions under the Act. The

Commission's interpretation of *SEF*, which the Proposed Report relies on for this finding, was effectively codified for subsequent election cycles by 11 C.F.R. § 100.57. See Explanation and Justification, *Political Committee Status, Definition of Contribution, and Allocation for Separate Segregated Funds and Nonconnected Committees* 69 Fed. Reg. 68,056 (Nov. 23, 2004); Supplemental Explanation and Justification, *Political Committee Status*, 72 Fed. Reg. 5,595 (Feb. 7, 2007). Section 100.57 was recently found invalid on both constitutional and statutory grounds by a three-judge panel of the U.S. Court of Appeals for the D.C. Circuit in *EMILY's List v. FEC*, No. 08-5422 (D.C. Cir. Sept. 18, 2009). Because section 100.57 is a codification of the principles found in *SEF*, we must address whether *EMILY's List* would have any impact on this audit. We think that it does.

In *EMILY's List*, the panel majority concluded that "non-profits" that make expenditures, even if they also make contributions, "are entitled to make their expenditures . . . out of a soft-money or general treasury account that is not subject to source and amount limits," as long as they use hard money for contributions and administrative costs attributable to those contributions, and do not use funds from for-profit contributions and unions to finance express advocacy.³ *Id.*, slip op. at 19 & n. 11. Applying this view of the Constitution to 11 C.F.R. § 100.57, the *EMILY's List* majority read the regulation as a restriction on the speech of persons soliciting contributions. The majority viewed the regulation as preventing solicitors from truthfully stating that their contributions in response to a covered solicitation could be made in an unlimited amount, and therefore found the regulation unconstitutional.

In an alternative holding, the panel unanimously held that section 100.57 was inconsistent with the statutory definition of contribution at 2 U.S.C § 431(8) in that in some circumstances it requires funds that might have been given for non-Federal purposes to be treated as all, or in some cases no less than half, Federal contributions made "for the purpose of influencing a Federal election" even when the terms of the solicitation indicates that a portion of the funds received from the solicitation would be used for a purpose that is other than influencing Federal elections. In neither the constitutional nor the statutory holding did the panel appear to consider that Section 100.57 also applied to political party committees.

The Commission did not seek rehearing of *EMILY's List* before the *en banc* D.C. Circuit. At the direction of the Court of Appeals, the United States District Court for the District of Columbia ordered Section 100.57 vacated. See *Final Order, EMILY's List v. FEC*, No. 05-0049 (D.D.C. Nov. 30, 2009). The Commission has published an Interim Final Rule inserting in the Code of Federal Regulations, at 11 C.F.R. 100.57, a note

³ *EMILY's List* was decided before the Supreme Court's recent decision in *Citizens United v. FEC*, No. 08-205 (U.S. Jan. 21, 2010), holding unconstitutional Section 441b's prohibition on independent expenditures by corporations and labor organizations. In *EMILY's List*, the court stated that if *Citizens United* reached this outcome, "then non-profits would be able to make unlimited express-advocacy expenditures from their soft-money accounts even if they accepted donations from for-profit corporations or unions to those accounts." See *EMILY's List* slip. op. at n.11.

describing the District Court's final order. 78 Fed. Reg. 68,661 (Dec. 29, 2009). It has also published a Notice of Proposed Rulemaking in which it proposes to strike section 100.57 entirely. 78 Fed. Reg. 68,720 (Dec. 29, 2009). However, the NPRM specifically seeks comment "on whether the D.C. Circuit Court's opinion is subject to a reading that the ruling, as well as the District Court's order that the rules are vacated, is limited only to nonprofit non-connected entities." *Id.* at 68,721. While the Commission went on to state that it was most interested in whether the opinion and order should be applied to separate segregated funds in addition to nonconnected committees, *id.*, the same question would seem to arise regarding the application of Section 100.57 (and the *SEF* analysis underlying it) to state and local party committees. This is especially so considering that, as the NPRM points out, much of the *EMILY's List* majority's constitutional analysis was based on the difference it perceived between party committees, which may constitutionally be subject to limitations on the amounts of contributions they use to make independent expenditures, and "non-profit, non-connected organizations," which the *EMILY's List* court said could not constitutionally be subject to such limitations. See also *EMILY's List*, slip op. at 10 ("This case does not involve regulation of . . . parties.").

Even prior to *EMILY's List*, however, three Commissioners indicated that they may be unwilling to apply *SEF* to reach a conclusion that funds raised through solicitations referring to Federal candidates always constitute contributions under the Act. After the Commission relied on *SEF* in MURs 5403 and 5466, the Commission reached a split decision in MUR 5541 (The November Fund), which addressed whether The November Fund was a political committee. MUR 5541 is relevant here because, in determining political committee status, the Commission considered the appropriateness of using *SEF* to determine whether funds raised through solicitations were contributions under the Act. In a Statement of Reasons, three Commissioners addressed whether and/or the extent to which *SEF* should be used to define "contribution" based on solicitations. See Statement of Reasons ("SOR") of Commissioners Petersen, Hunter, and McGahn in MUR, 5541, The November Fund (January 22, 2009) ("MUR 5541"). Though not explicit, the Commissioners appear to take the position in the SOR that whether a donation is a contribution or not depends on how the donation is eventually spent by the recipient. *Id.* at 5 n. 17 (emphasizing the words "will be converted" in the *SEF* court's phrase, "that will be converted to expenditures under FECA") and 9 n.32 (reading the phrase as rejecting a contention in the Commission's brief in *SEF* that actual use of the funds donated cannot affect whether the solicitation was a solicitation for Federal contributions.)

This Office believes that this approach could create practical problems for committee treasurers as well as for the Commission. The approach might be problematic because of the need for committee treasurers, Commission staff, and donors to be able to identify whether funds given in response to a solicitation are contributions. Determining whether funds are contributions (before they are expended) allows donors to give in accordance with the Act's limitations and prohibitions, enables treasurers to account for and properly disclose contributions, and assists the Commission in determining compliance.

Nevertheless, given the extreme uncertainty in the law at this time regarding the standards by which the Commission will determine whether a given donation not otherwise deposited in a Federal account is or is not a contribution, and given the age of the activity, we suggest that the final Audit Report not include Finding 5.

2. Effect of Washington State Law

If the Audit Division nevertheless includes Finding 5 in the Final Report, we see no reason for the Audit Division to change its recommendations solely based on the Committee's representations as to the impact of Washington state law. The Committee has asserted that it would likely violate Washington state law if it used its non-Federal "exempt" funds to comply with the auditors' recommendation that the amount of the contributions be transferred back to the Federal account. The Committee's response to the IAR does not give the basis for this conclusion, but we assume that it has to do with the restricted purposes for which "exempt" funds may be used under state law. There apparently would be no such restriction on the transfer of non-Federal "non-exempt" funds, but the Committee claims it has insufficient non-Federal "non-exempt" funds to make the transfer at this time. Likewise, it claims that it has insufficient Federal funds to make the recommended transfer of fundraising costs to the non-Federal account. As there is apparently no restriction on the use of non-Federal "non-exempt" funds, the Committee could comply with the auditors' recommendation by transferring such non-Federal "non-exempt" funds as it has on hand to the Federal account, and making additional transfers with the first such funds it has available; and by doing likewise with respect to the transfer of Federal funds to the non-Federal account.