



FEDERAL ELECTION COMMISSION
Washington, DC 20463

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November 29, 2005

MEMORANDUM

AGENDA ITEM
For Meeting of: 12-01-05

SUBMITTED LATE

TO: The Commission

THROUGH: Robert J. Costa *AK*
Acting Staff Director

FROM: Lawrence H. Norton *LN*
General Counsel

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SUBJECT: Final Rules and Explanation and Justification: State, District, and Local Party Committee Payment of Certain Salaries and Wages

Attached are draft Final Rules and Explanation and Justification amending Commission rules regarding the payment of salaries and wages by State, district and local party committees for employees who spend 25% or less of their compensated time in a month on Federal election activity or activity in connection with a Federal election, pursuant to the Court of Appeals decision in Shays v. FEC, 337 F.Supp.2d 28 (D.D.C. 2004), aff'd, 414 F.3d 76 (D.C. Cir. July 15, 2005), reh'g en banc denied (October 21, 2005) (No. 04-5352).

Recommendation:

The Office of the General Counsel recommends that the Commission approve the attached Final Rules and Explanation and Justification for publication in the *Federal Register* and transmittal to Congress.

Attachment

1 **FEDERAL ELECTION COMMISSION**

2 **11 CFR Parts 106 and 300**

3 **[NOTICE 2005->]**

4 **State, District, and Local Party Committee Payment of Certain Salaries and Wages**

5

6 **AGENCY:** Federal Election Commission.

7 **ACTION:** Final Rules and Transmittal of Rules to Congress.

8 **SUMMARY:** The Federal Election Commission is amending its rules to
9 revise the method by which State, district and local party
10 committees (collectively “State party committees”) may pay
11 salaries and wages of employees who spend 25 percent or less
12 of their compensated time in a month on Federal election
13 activity or activity in connection with Federal elections
14 (“Federal-related activity” or “Federal-related activities”).

15 These final rules implement the decision of the U.S. Court of
16 Appeals for the District of Columbia Circuit in Shays v. FEC,
17 which held that the Commission had not provided an adequate
18 explanation for its former rules under the Administrative
19 Procedure Act. The Commission is also changing its
20 requirements as to the method State party committees must use
21 to pay fringe benefits of employees, as well as to how State
22 party committees may use certain funds raised where the costs
23 of fundraising are allocated between Federal and non-Federal

1 accounts. Further information is provided in the Supplementary
2 Information that follows.

3 **EFFECTIVE**
4 **DATE:**

5 These rules are effective on [INSERT DATE THAT IS 30 DAYS
6 AFTER THE DATE OF PUBLICATION IN THE FEDERAL
7 REGISTER].

8 **FOR FURTHER**
9 **INFORMATION**
10 **CONTACT:**

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12 Buckley, Attorney, 999 E Street NW, Washington, DC 20463,
(202) 694-1650 or (800) 424-9530.

13 **SUPPLEMENTARY**
14 **INFORMATION:**

15 The Bipartisan Campaign Reform Act of 2002, Pub. L. No. 107-155, 116 Stat. 81
16 (2002) (“BCRA”), amended the Federal Election Campaign Act of 1971, as amended (the
17 “Act”), 2 U.S.C. 431 et seq., in various respects. Under BCRA, State party committees
18 must pay the salaries and wages of employees who spend more than 25 percent of their
19 compensated time per month on Federal-related activities entirely with Federal funds.¹
20 2 U.S.C. 431(20)(A)(iv) and 441i(b)(1). However, BCRA does not address what type of
21 funds State party committees must use to pay the salaries and wages of employees who
22 spend some, but not more than 25 percent, of their compensated time per month on
23 Federal-related activities (“covered employees”). In 2002, the Commission promulgated
24 11 CFR 106.7(c)(1), (c)(5) and (d)(1), and 300.33(c)(2). Under these rules, State party

¹ “Federal funds” are funds that are subject to the contribution limitations, source prohibitions, and reporting requirements of the Act. 11 CFR 300.2(g).

1 committees were permitted to pay the salaries or wages of covered employees entirely
2 with funds that comply with State law. Id.

3 In Shays v. Federal Election Commission, 337 F. Supp. 2d 28 (D.D.C. 2004)
4 (“Shays District”), aff’d, 414 F.3d 76 (D.C. Cir. 2005) (“Shays Appeal”), reh’g en banc
5 denied (Oct. 21, 2005) (No. 04-5352), the District Court considered a challenge to the
6 regulations that permitted State party committees to use all non-Federal funds to pay the
7 salaries and wages of covered employees. The District Court recognized that the
8 Commission’s interpretation of 2 U.S.C. 431(20)(A)(iv) and 441i(b)(1), did not violate
9 the first step of Chevron U.S.A. Inc. v. Natural Resources Defense Council, Inc., 467
10 U.S. 837 (1984) (“Chevron”), because Congress had not directly spoken on this issue.
11 However, the District Court held that the Commission’s interpretation was not a
12 permissible reading of the statute under step two of Chevron.² Shays District at 113-114.

13 On July 15, 2005, the U.S. Court of Appeals for the District of Columbia Circuit
14 affirmed the District Court’s ruling on this regulation, but on different grounds. The
15 Court of Appeals held that the regulations addressing the salaries and wages of covered
16 employees survived both steps of the Chevron analysis, but that the regulation failed for
17 lack of a sufficient explanation under the Administrative Procedure Act. See Shays
18 Appeal, 414 F.3d at 112.

19 Before the Court of Appeals decision, the Commission issued a Notice of
20 Proposed Rulemaking to determine the appropriate mix of Federal and non-Federal funds

² The first step of the Chevron analysis, which courts use to review agency regulations, is whether Congress has directly spoken to the precise questions at issue. The second step is whether the agency’s resolution of an issue not addressed in the statute is based on a permissible construction of the statute. See Shays District at 51-52 (citing Chevron).

1 that State party committees must use to pay the salaries and wages of covered employees.
2 Notice of Proposed Rulemaking on State, District and Local Party Committee Payment of
3 Certain Salaries and Wages, 70 FR 23072 (May 4, 2005) (“NPRM”). The comment
4 period closed on June 3, 2005. The Commission received comments from nine
5 commenters in response to this NPRM. The Commission held a hearing on this
6 rulemaking on August 4, 2005, at which four commenters testified.

7 After the hearing, the Commission reopened the comment period until
8 September 29, 2005. In reopening the comment period, the Commission noted that it was
9 doing so “to allow all interested persons to submit information or comments that may be
10 useful in this rulemaking in light of the Court of Appeals opinion.” Notice to Reopen
11 Comment Period for Rulemaking on State, District, and Local Party Committee Payment
12 of Certain Salaries and Wages, 70 FR 51302 (Aug. 30, 2005). Five additional
13 commenters submitted comments during this period. The names of all commenters and
14 their written comments, as well as a transcript of the public hearing are available at
15 www.fec.gov/law/law_rulemakings.shtml#party_salaries under “State Party Payment of
16 Salaries and Wages.”

17 Under the Administrative Procedure Act, 5 U.S.C. 553(d), and the Congressional
18 Review of Agency Rulemaking Act, 5 U.S.C. 801(a)(1), agencies must submit final rules
19 to the Speaker of the House of Representatives and the President of the Senate and
20 publish them in the Federal Register at least 30 calendar days before they take effect.
21 The final rules that follow were transmitted to Congress on ____, 2005.

22

1 **EXPLANATION AND JUSTIFICATION**

2 The Court of Appeals’ decision allows the Commission to attempt to justify the
3 rules allowing State party committees to use wholly non-Federal funds for the salaries
4 and wages of covered employees. However, the decision also indicates that a far more
5 substantial record would be necessary to support these regulations. Shays Appeal at 112.
6 Here, the Court found it “quite plausible that wealthy donors would swallow costs for
7 increased state and local campaigning . . . [for] an army of workers devoting more than a
8 day a week to federal elections.” Id.

9 Several commenters urged the Commission to retain the rules allowing State party
10 committees to pay the salaries and wages of covered employees with 100% non-Federal
11 funds. They argued that there is no evidence of abuse or circumvention of BCRA by
12 dividing Federal-related activities among many employees who each devote no more than
13 25% of their time to Federal races. In fact, one commenter testified that wealthy donors
14 interested in Federal elections would not give a penny if apprised that no more than 25%
15 of their donation would be used for these purposes. This commenter also urged the
16 Commission to retain these rules for party committees that have under seven employees
17 because it would be difficult for such small committees to engage in the kind of evasion
18 that concerned the District Court.

19 Thus, the record developed during this rulemaking, including the comments
20 submitted by the State and local party committees or their representatives, suggests that,
21 in general, State party committees may face practical obstacles in trying to use the rule to
22 circumvent BCRA in the way the court feared. While the record indicates that such
23 circumvention is unlikely, it is not sufficient to assure that it could never occur.

1 Furthermore, as explained below, the Commission has an alternative to the former rules
2 that addresses the Court of Appeals' concerns about circumvention and has the virtues of
3 familiarity, relative ease of administration, and a reasonable relationship to the State party
4 committees' level of Federal-related activities. Consequently, the Commission is not
5 retaining these rules. Instead, it is amending 11 CFR 106.7 and 300.33 to require State
6 party committees to allocate the salaries and wages of covered employees between their
7 Federal and non-Federal accounts as administrative costs.

8 **I. Allocation of State Party Wages**

9 A. Introduction

10 The NPRM presented three options for allocating the salaries and wages of
11 covered employees. The first proposal would adopt an allocation method that would
12 establish a fixed minimum of 25 percent that a State party committee would be required
13 to allocate to its Federal account. The NPRM contained proposed rules only for this
14 approach. The second proposal in the NPRM would adopt an allocation percentage
15 directly proportional to the amount of compensated time an employee spent on Federal-
16 related activities in a given month in relation to all compensated time in that same month.
17 This proposal would have resulted in different ratios for different employees.

18 The third proposal would follow the pre-BCRA rules by treating salaries and
19 wages of covered employees as administrative costs. This proposal would subject the
20 salaries and wages at issue to the allocation ratios at 11 CFR 106.7(d)(2) that were
21 developed as part of the BCRA soft money rulemaking. For the reasons stated below, the
22 Commission is adopting this allocation method for the salaries and wages of covered
23 employees.

1 B. 11 CFR 106.7(c)(1) and 300.33(c)(2) Allocation of Salaries and Wages as
2 Administrative Costs

3 The Commission is amending 11 CFR 106.7(c)(1) and 300.33(c)(2) to require that
4 State party committees either: (1) allocate the salaries and wages of covered employees,
5 or (2) pay these salaries and wages entirely from a Federal account. Allocation ratios for
6 administrative costs in 11 CFR 106.7(d)(2)(i) through (iv) were modified during the
7 BCRA soft money rulemaking. Final Rules on Prohibited and Excessive Contributions:
8 Non-Federal Funds or Soft Money, 67 FR 49064, 49079 (July 29, 2002) (“Soft Money
9 E&J”). As explained in the 2002 Soft Money E&J, the Commission derived the four
10 allocation ratios that range from 15% to 36% by taking the averages of the previous
11 ballot composition-based allocation percentages reported by State party committees in
12 four representative groupings of State party committees representing states of varying
13 sizes and geographic locations. Id. This approach was designed “to assure that activities
14 deemed allocable are not paid for with a disproportionate amount of non-Federal funds.”
15 Id. This approach reflects the variability of State party committee Federal spending from
16 election cycle to election cycle, depending on the types of Federal offices that are on the
17 ballot in one election cycle versus another. For example, State party committees are
18 required to use 15% Federal funds for administrative expenses in election cycles where
19 only Members of the U.S. House of Representatives are on the ballot in those states,
20 versus 36% when the offices of the President and U.S. Senate are also on the ballot.

21 The Commission has concluded that the use of these ratios will prevent
22 circumvention of the soft money rules, even though the ratios do not track precisely the
23 number of hours worked by employees. In addition, State party committees already use

1 these allocation ratios for a variety of administrative costs and they allocated their
2 employees' salaries and wages as administrative costs prior to BCRA's effective date.
3 Thus, their familiarity and experience with the administrative costs allocation method
4 will ease the transition and implementation of the new rules regarding the salaries and
5 wages of covered employees.

6 The Commission received comments supporting partial application of the
7 administrative cost allocation method. These commenters favored using the
8 administrative costs ratios in election cycles other than Presidential election cycles. They
9 argued that it would be inappropriate to apply Presidential election cycle allocation ratios
10 of 28% and 36% because they would apply to employees who spend no more than 25%
11 of their compensated time in a given month on Federal-related activities. The
12 Commission disagrees that such an application would be inappropriate.

13 Requiring a Federal allocation percentage that is higher than the corresponding
14 percentage of Federal-related activity is not inconsistent with BCRA. Under 2 U.S.C.
15 431(20)(A)(iv), Congress mandated that a person who spends as little as 26% of his or
16 her compensated time in a month on Federal-related activities must be paid entirely with
17 Federal funds. Congress was silent on how State party committees should pay the
18 salaries and wages of covered employees. Congress was aware, however, that at the time
19 it enacted BCRA, State party committees were required to allocate salaries and wages of
20 their employees as administrative costs. It is reasonable to conclude that Congress
21 expected that the Commission might continue to treat the salaries and wages of covered
22 employees as allocable administrative costs.

1 Another commenter objected to requiring allocation of covered employees'
2 salaries as administrative costs, maintaining that there is no rational relationship between
3 the time actually spent by employees on Federal-election activities and the amount of
4 Federal money required to be used to fund those employees. Neither FECA nor BCRA
5 requires that the allocation ratios be precisely proportional to the amount of time spent on
6 Federal-related activities. It is sufficient that the administrative costs allocation ratios
7 generally reflect the overall level of State party committees' Federal activity based on the
8 percentage of Federal candidates on the ballot.

9 Other commenters who opposed the administrative costs allocation method were
10 concerned that not enough Federal funds would be used to pay employees who spend
11 25% of their compensated time per month on Federal-related activities during any year in
12 which no Presidential or Senatorial candidate is on the ballot. They argued that the 15%
13 administrative costs allocation ratio for those years would allow State party committees
14 to pay the remaining 10% of the employees' compensated time spent on Federal-related
15 activities with non-Federal funds. According to these commenters, this approach is
16 inconsistent with Congress' overall scheme of requiring Federal-related activities to be
17 paid for with Federal funds.

18 The Commission disagrees that using the administrative costs allocation ratios is
19 inconsistent with Congressional intent. The average of the allocation ratios of 15%, 21%,
20 28% and 36% is 25%, and the weighted average based on the frequency that State party
21 committees would use the various ratios over a number of election cycles is over 26%.
22 Moreover, when there is a Presidential candidate on the ballot, State party committees
23 must pay the salaries and wages of covered employees with at least 28% or 36% Federal

1 funds, depending on whether there is a Senatorial candidate on the ballot. Because the
2 administrative costs allocation ratios for State party committees will average at least 25%
3 over time, the allocation ratios will achieve one of the goals of the fixed minimum 25%
4 allocation ratio—ensuring that over time, State party committees will use sufficient
5 Federal funds to pay for employee time that is spent on Federal-related activities—
6 without imposing a new allocation regime on State party committees.

7 Furthermore, the Court of Appeals suggested its approval of this approach when it
8 noted that “the salary rule appears particularly irrational given the FEC’s recognition that
9 costs for voter registration, get-out-the-vote drives, and generic party advertising—all
10 matters, like salaries, that the FEA definition specifically addresses—may require
11 allocation even when the activities ‘do not qualify’ as FEA. See 11 CFR 106.7(c)(5).”
12 Shays Appeal at 112.

13 In addition to the changes to 11 CFR 106.7(c)(1) and 300.33(c)(2), corresponding
14 changes are being made to two other regulations. Section 106.7(d)(1)(i) is being revised
15 to state that these salaries and wages must be paid wholly from the Federal account, or
16 allocated as administrative costs. Similarly, section 106.7(c)(5) is being amended to
17 make clear that the salaries and wages of covered employees are not exempt from
18 allocation but rather are subject to allocation as administrative expenses.

19 C. Alternative Allocation Methods

20 1. Minimum Allocation of 25 Percent

21 An alternative in the NPRM’s proposed rule text would have required State party
22 committees either (1) to allocate at least 25% of salaries and wages of covered employees
23 to a Federal account, or (2) to pay those salaries and wages entirely with funds from a

1 Federal account. See proposed 11 CFR 106.7(c)(1)(i) and (ii), 70 FR at 23074. As stated
2 in the NPRM, a minimum allocation percentage of 25% would ensure that State party
3 committees use Federal funds to pay for all the compensated time covered employees
4 spend on Federal-related activity. 70 FR at 23073. In this way, this proposal effectively
5 prevents circumvention of the Act, which, according to the District Court and the Court
6 of Appeals, the challenged rules failed to ensure. See Shays District at 114; Shays
7 Appeal at 112.

8 Some commenters supported this proposal. They asserted that setting a fixed
9 allocation ratio has the advantage of providing a clear and readily administered rule that
10 would minimize the burdens of compliance on State party committees and simplify
11 enforcement for the Commission. Other commenters supported this proposal only for
12 election cycles when a Presidential candidate appears on the ballot. For election cycles in
13 which there is no Presidential race, these commenters believed that it was more
14 appropriate to use the same allocation ratio as is used for administrative costs.

15 In contrast, some commenters objected to this proposal in its entirety. One
16 commenter argued that a fixed 25% allocation would introduce another step into an
17 already complex process and required additional rules for determining how to manage
18 payroll operations over and above what is already required for administrative expense
19 allocation. Another commenter stated that the proposed 25% allocation sweeps too
20 broadly and unjustifiably interferes with the type of money State and local committees
21 may use to compensate their employees who work substantially on non-Federal issues.

22 Although a fixed minimum 25% allocation ratio on its face appears to be the
23 simplest, most straightforward method for allocating salaries and wages of covered

1 employees, it is not, given the other regulations that govern how State party committees
2 pay for their disbursements and experience with past allocation methods. State party
3 committees are already required to apply an allocation scheme to their administrative
4 costs if they do not use 100% Federal funds. Moreover, before BCRA's enactment, State
5 party committees were required to allocate their employees' salaries and wages as
6 administrative costs if they did not use entirely Federal funds. By including the salaries
7 and wages of covered employees as administrative costs, State party committees will use
8 an allocation scheme with which they are familiar and have experience applying. The
9 fixed minimum 25% allocation method would subject State party committees to an
10 additional and different allocation ratio that would apply to only one category of their
11 disbursements for which they would have to monitor, maintain records and report on a
12 different form. To avoid creating yet another allocation method for State party
13 committees to apply, the Commission is not adopting a fixed allocation ratio of 25% for
14 salaries and wages of covered employees.

15 2. Allocation Directly Proportional to Amount of Time Worked

16 This proposal would adopt an allocation percentage for salaries and wages of
17 covered employees directly proportional to the amount of compensated time these
18 employees spend on Federal-related activities in a given month in relation to all
19 compensated time in that same month. This proposal would probably have required State
20 parties to use different percentages for different employees in a given month. The
21 percentages would also be expected to vary for each employee from month to month.

22 Most commenters agreed that a direct proportionality allocation scheme would be
23 complicated, would require additional recordkeeping that could be burdensome, and

1 would be difficult to track, report, and enforce. The commenters who supported this
2 method only did so to the extent that this method would be an optional method available
3 to State party committees in lieu of another allocation method adopted by the
4 Commission.

5 State party committees must maintain logs of employee time spent on
6 Federal-related activities under current 11 CFR 106.7(d)(1). These same logs could serve
7 as the basis for allocating these employees salaries and wages between Federal and
8 non-Federal funds. While in most cases such a method could be expected to produce an
9 allocation that most closely matches the proportion of employees' time spent on Federal-
10 related activities, it suffers from a number of practical deficiencies. Under the current
11 system, the logs only serve to distinguish covered employees from those over the 25%
12 threshold. This division has legal consequences, while the particular percentage does not.

13 It would also introduce into the allocation scheme for State party committees the
14 problems with computing complicated allocation ratios that the Commission sought to
15 eliminate for SSFs and nonconnected committees when it amended the allocation
16 regulations in 11 CFR 106.6. See Final Rules on Political Committee Status, Definition
17 of Contribution, and Allocation for Separate Segregated Funds and Nonconnected
18 Committees, 69 FR 68056, 68059 (Nov. 23, 2004). When the Commission examined the
19 allocation scheme for SSFs and nonconnected committees, it found that it was difficult
20 for these committees to calculate a precise ratio because the calculation was based on
21 predicting accurately the amount of time spent on certain activities. The calculation was
22 further complicated when these committees predicted incorrectly the amount they spent
23 on certain activities.

1 Based on the comments and Commission experience with allocation methods, an
2 allocation method directly proportional to the amount of time worked would be complex
3 and likely to engender confusion, and would be unduly burdensome to State party
4 committees. For these reasons, the Commission is not adopting this allocation method.

5 D. Employees Who Spend No Compensated Time on Federal-Related Activities

6 In the NPRM, the Commission stated that it is continuing to interpret BCRA as
7 allowing committees to pay the salaries and wages of employees who spend no time in a
8 given month on Federal-related activities entirely with non-Federal funds. All
9 commenters who addressed this issue supported this interpretation. Some of these
10 commenters recommended that the Commission incorporate this interpretation into its
11 regulations, as some committees might otherwise interpret the Commission’s regulations
12 as requiring them to allocate such salaries and wages. Consequently, the Commission is
13 adding new 11 CFR 106.7(d)(1)(iii), which states that, notwithstanding section
14 106.7(d)(1)(i), salaries and wages paid for employees who spend none of their
15 compensated time in a given month on Federal election activities or activities in
16 connection with a Federal election may be paid entirely with non-Federal funds.

17 **II. Allocation of Fringe Benefits of Employees**

18 The NPRM also sought comment on whether the methods for allocating salaries
19 and wages should be applied to fringe benefits of employees. Specifically, the NPRM
20 sought comment on whether the rules should be amended to permit, but not require, State
21 party committees to use the same allocation rules for fringe benefits as are used for
22 salaries and wages, instead of allocating fringe benefits as administrative costs. In
23 Advisory Opinion (“AO”) 2003-11, the Commission advised a State party committee that

1 it may pay the costs of fringe benefits for covered employees with non-Federal funds.
2 Fringe benefits were described by the State party committee as medical, dental, and
3 prescription drug insurance coverage; coverage for short-term disability (wage loss) and
4 long-term disability insurance benefits; coverage for life insurance benefits; and
5 employer matching contributions to the 401(k) retirement plan. The Commission
6 determined in AO 2003-11 that amounts spent on fringe benefits fell into the category of
7 compensated time, and thus concluded that the State party committee could use entirely
8 non-Federal funds to pay for the fringe benefits under the rules for payment of salaries
9 and wages that were in effect at that time.

10 Some commenters urged the Commission to give State party committees the
11 option of treating fringe benefits as administrative costs, while other commenters urged
12 the Commission to treat fringe benefits as compensated time.

13 Because the salaries and wages of covered employees are treated as
14 administrative costs under the revised rules at 11 CFR 106.7(c)(1) and (d)(1)(i), and
15 fringe benefits are a form of compensation, it is appropriate for State party committees to
16 treat fringe benefits for covered employees as administrative costs. Accordingly, State
17 party committees must now treat fringe benefits as they would salaries and wages,
18 depending on the time spent per month on Federal-related activities: either by paying for
19 them entirely from the Federal account, or by allocating the costs of the fringe benefits as
20 administrative costs. Consistent with the new rules' approach to salaries and wages, the
21 fringe benefits of employees who spend no time in a month on Federal-related activity
22 may be paid with funds that comply with State law. Commission regulations at 11 CFR
23 106.7(c)(1), 106.7(d)(1), and 300.33(c)(2) are being revised to reflect that salaries, wages,

1 and fringe benefits are treated the same. AO 2003-11 is hereby superseded to the extent
2 it stated that State party committees may pay for fringe benefits of covered employees
3 entirely with non-Federal funds.

4 **III. Use Of Funds Raised Through Joint Federal and Non-Federal Fundraising**
5 **Events**

6 The NPRM sought comment on whether to amend 11 CFR 106.7(c)(4) to clarify
7 that Federal funds raised through a joint fundraising activity or a joint fundraiser
8 (collectively “joint fundraiser”) may be used for Federal election activity.³ The statutory
9 basis for section 106.7(c)(4) is 2 U.S.C. 441i(c), which reads: “An amount spent by a
10 [national committee of a political party or a State party committee] to raise funds that are
11 used, in whole or in part, for expenditures and disbursements for a Federal election
12 activity shall be made from funds subject to the limitations, prohibitions, and reporting
13 requirements of this Act.” In AO 2004-12, the Commission determined that a State party
14 committee could pay for Federal election activity with Federal funds raised at events
15 where the costs of such events had been paid for with a combination of Federal and non-
16 Federal funds, allocated through the use of the funds received method. See 11 CFR
17 106.6(d).

18 Some commenters supported amending the rule to reflect the interpretation in AO
19 2004-12. These commenters argued that the current regulation, strictly interpreted,
20 would have required State party committees to pay all of their fundraising expenses with
21 Federal dollars in order to use the Federal funds raised at a fundraiser to pay for Federal

³ Joint fundraisers include events where a State party committee raises both Federal and non-Federal funds on its own, or together with another organization under 11 CFR 102.17.

1 election activities. These commenters asserted that such a result was unduly burdensome
2 for, and unfair to, State party committees. Other commenters who opposed any revision
3 argued that the regulation “captures one of the essential elements of BCRA: to provide
4 for clear separation between hard money and soft money for the funds to be used by state
5 parties for Federal election activities.” They asserted that 2 U.S.C. 441i(c) mandates
6 such a rule and interpretation.

7 The Commission disagrees that 2 U.S.C. 441i(c) requires this construction. The
8 Commission interprets the statute to require only that the costs of raising funds to pay for
9 Federal election activities must be paid for with Federal funds. Allocation and the use of
10 the funds received method accomplish this because they ensure that Federal funds are
11 used to raise federal funds. Indeed, with respect to the funds received method, the
12 Commission has previously noted that it “provides the most accurate basis for division of
13 [fundraising] costs.” Explanation and Justification on Methods of Allocation Between
14 Federal and Nonfederal Accounts; Payments; Reporting, 55 FR 26058, 26065 (June 26,
15 1990).

16 Further, interpreting 2 U.S.C. 441i(c) to mandate special fundraising rules when
17 raising Federal funds for Federal election activity would result in an anomalous treatment
18 of Federal funds raised at joint fundraisers. Under this interpretation, State party
19 committees could not use Federal funds raised at a joint fundraiser to pay for Federal
20 election activities directly, but they could transfer the Federal funds to the national party
21 committee to pay for Federal election activities in their own states; they could also
22 transfer Federal funds to other State party committees to pay for their Federal election
23 activities.

1 Furthermore, this interpretation of 2 U.S.C. 441i(c) would create a new class of
2 Federal funds that must be used to pay for Federal election activity. This new class of
3 Federal funds would be subject to fundraising restrictions that would not be applicable to
4 other Federal funds including those used to make direct contributions to Federal
5 candidates. The Commission does not believe that Congress intended these anomalous
6 results.

7 In order to avoid any confusion concerning fundraising costs, the Commission is
8 amending 11 CFR 106.7(c)(4) to state specifically that State party committees may
9 allocate the direct costs of joint fundraising between their Federal and non-Federal
10 accounts according to the funds received method described in 11 CFR 106.7(d)(4). All
11 other statements in section 106.7(c)(4) suggesting otherwise are being deleted.

12 Corresponding changes are being made to other Commission regulations.
13 Sections 106.7(e)(4) and 300.33(c)(3) are being removed, because neither indicates that
14 direct costs of fundraising may be allocated. Also, section 300.32(a)(3) is being amended
15 to state that State party committees that raise Federal and non-Federal funds at a joint
16 fundraiser, where the Federal funds raised are to be used for Federal election activity,
17 must either pay the direct costs of the fundraiser entirely with Federal funds, or must
18 allocate the costs according to the funds received method. That rule is also being revised
19 to state explicitly that if a State party committee raises only Federal funds at a fundraising
20 activity it must pay the entire direct costs of the fundraising activity with Federal funds.
21 The language in amended section 300.32(a)(3) closely tracks the new language at section
22 106.7(c)(4).

1 The Commission is also amending the description in 11 CFR 106.7(c)(4) of what
2 is included in the direct costs of fundraising to conform to the descriptions at 11 CFR
3 106.6(b)(1)(ii) and 300.32(a)(3). This amendment is not a substantive change; rather, the
4 Commission seeks to avoid any potential confusion by having two different descriptions
5 of “direct costs of fundraising” in its regulations.

6 **IV. Additional Issues**

7 A commenter urged the Commission to address three issues not discussed in the
8 NPRM. These issues are: (1) establishing a payroll holding account into which both
9 Federal and non-Federal funds are deposited for the sole purpose of transmitting payroll
10 through a payroll company; (2) permitting allocation of fundraising costs among Federal,
11 non-Federal and Levin accounts; and (3) providing guidance on how State party
12 committees should remedy a situation in which they make a mistake in estimating the
13 amount of time an employee spends on Federal-related activities. The first two issues are
14 beyond the scope of this rulemaking.

15 Regarding the third issue, the commenters noted that some State party committees
16 are required to pay their salaries, wages, and fringe benefits in advance because of their
17 vendor contracts or payroll systems. Thus, these State party committees must estimate
18 whether particular employees will spend more or less than 25 percent of their
19 compensated time on Federal-related activity, and that these estimates are sometimes
20 wrong. As a result, salaries, wages, and fringe benefits for employees may sometimes be
21 prepaid with an allocable mix of Federal and non-Federal funds (under the new rule),
22 when they should be prepaid entirely with Federal funds. Conversely, the salaries,
23 wages, and fringe benefits for other employees might be prepaid entirely with Federal

1 funds when they could have been paid with an allocable mix of Federal and non-Federal
2 funds. The commenter sought guidance on how a State party committee could remedy
3 these situations after the fact.

4 Commission regulations at 11 CFR 106.7(f) govern transfers from a non-Federal
5 to a Federal account, or from Federal and non-Federal accounts to an allocation account,
6 to cover allocable expenses. When a State party committee uses a Federal or allocation
7 account to prepay salaries, wages, and fringe benefits and later determines that these
8 amounts could have been paid from a non-Federal account, *i.e.* the salaries, wages, and
9 fringe benefits for covered employees, the non-Federal account may reimburse the
10 Federal account or the allocation account pursuant to the 70-day time window in that
11 rule. In contrast, the salaries, wages, and fringe benefits of employees who spend more
12 than 25 percent of their compensated time per month on Federal-related activity are not
13 allocable expenses. Thus, the Commission believes it is essential for State party
14 committees to comply with section 106.7(f) by transferring funds in a timely manner
15 from the Federal account to the non-Federal or allocation account to rectify the improper
16 payment of non-Federal funds for these Federal expenses, thereby avoiding an improper
17 loan or contribution from the non-Federal account to the Federal account.

18 **Certification of No Effect Pursuant to 5 U.S.C. 605(b)**

19 **[Regulatory Flexibility Act]**

20 The Commission certifies that the attached final rules will not have a significant
21 economic impact on a substantial number of small entities. The basis for this
22 certification is that the organizations affected by these final rules are State, district, and
23 local party committees, which are not “small entities” under 5 U.S.C. 601. These

1 not-for-profit committees do not meet the definition of “small organization,” which
2 requires that the enterprise be independently owned and operated and not dominant in its
3 field. 5 U.S.C. 601(4). State party committees are not independently owned and
4 operated because they are not financed and controlled by a small identifiable group of
5 individuals, and they are affiliated with the larger national political party organizations.
6 In addition, the State party committees of the Democratic and Republican parties have a
7 major controlling influence within the political arena of their State and are thus dominant
8 in their field. District and local party committees are generally considered affiliated with
9 the State party committees and need not be considered separately. To the extent that any
10 State party committees representing minor political parties might be considered “small
11 organizations,” the number affected by these final rules is not substantial.

12

13 **List of Subjects**

14 11 CFR Part 106

15 Campaign funds, political committees and parties, reporting and recordkeeping
16 requirements.

17 11 CFR Part 300

18 Campaign funds, nonprofit organizations, political committees and parties,
19 political candidates, reporting and recordkeeping requirements.

20

1 For the reasons set out in the preamble, Subchapters A and C of Chapter 1 of title
2 11 of the Code of Federal Regulations are amended as follows:

3 **PART 106 – ALLOCATIONS OF CANDIDATE AND COMMITTEE**
4 **ACTIVITIES**

5 1. The authority citation for part 106 continues to read as follows:

6 Authority: 2 U.S.C. 438(a)(8), 441a(b), 441a(g).

7
8 2. Section 106.7 is amended by:

9 a. Removing paragraph (e)(4); and

10 b. Revising paragraphs (c)(1), (c)(4), (c)(5), (d)(1)(i), (d)(1)(ii), and adding
11 paragraph (d)(1)(iii) to read as follows:

12 **§ 106.7 Allocation of expenses between Federal and non-Federal accounts by**
13 **party committees, other than for Federal election activities.**

14 * * * * *

15 (c) Costs allocable by State, district, and local party committees between Federal and
16 non-Federal accounts.

17 (1) Salaries, and wages, and fringe benefits. State, district, and local party
18 committees must either ~~must~~ pay salaries, ~~and wages, and fringe benefits~~
19 ~~from funds that comply with State law~~ for employees who spend 25% or
20 less of their time in a any given month on Federal election activity or
21 activity in connection with a Federal election with funds from their
22 Federal account, or with a combination of funds from their Federal and
23 non-Federal accounts, in accordance with paragraph (d)(2) of this section.

24 See 11 CFR 300.33(c)(2).

1

2 * * * * *
3

4 (4) Certain fundraising costs. State, district, and local party committees may
5 allocate the direct costs of ~~certain joint~~ fundraising programs or events
6 between their Federal and non-Federal accounts according to the funds
7 received method described in paragraph (d)(4) of this section. ~~provided~~
8 ~~that none of the proceeds from the activities or events will ever be used for~~
9 ~~Federal election activities. The proceeds of fundraising allocated pursuant~~
10 ~~to this paragraph must be segregated in bank accounts that are never used~~
11 ~~for Federal election activity. The direct costs of a fundraising program or~~
12 event include expenses for the solicitation of funds and for the planning
13 and administration of actual fundraising programs and events. ~~Direct costs~~
14 ~~of fundraising include disbursements for the planning and administration~~
15 ~~of specific fundraising events or programs.~~

16
17 (5) Voter-drive activities that do not qualify as Federal election activities and
18 that are not party exempt activities. ~~Other than for salaries and wages as~~
19 ~~described in paragraph (c)(1) of this section, expenses~~ Expenses for voter
20 identification, voter registration, and get-out-the-vote drives, and any other
21 activities that urge the general public to register or vote, or that promote or
22 oppose a political party, without promoting or opposing a candidate or
23 non-Federal candidate, that do not qualify as Federal election activities
24 and that are not exempt party activities, must be paid with Federal funds or

1 may be allocated between the committee's Federal and non-Federal
2 accounts.

3
4 (d) Allocation percentages, ratios, and record-keeping.

5 (1) * * *

6 (i) Salaries, and wages, and fringe benefits paid for employees who
7 spend 25% or less of their compensated time in a given month on
8 Federal election activities or on activities in connection with a
9 Federal election must either be paid only from the Federal account
10 or be allocated as administrative costs under paragraph (d)(2) of
11 this section, shall be paid from funds that comply with State law.

12 (ii) Salaries, and wages, and fringe benefits paid for employees who
13 spend more than 25% of their compensated time in a given month
14 on Federal election activities or on activities in connection with a
15 Federal election must be paid only from a Federal account. See 11
16 CFR 300.33(c)(2), and paragraph (e)(2) of this section.

17 (iii) Notwithstanding paragraph (d)(1)(i) of this section, salaries,
18 wages, and fringe benefits paid for employees who spend none of
19 their compensated time in a given month on Federal election
20 activities or on activities in connection with a Federal election may
21 be paid entirely with funds that comply with State law.

22 (e) Costs not allocable by State, district, and local party committees between Federal and
23 non-Federal accounts. * * *

1 * * * * *

2 ~~(4) Fundraising Costs. Expenses incurred by State, district, and local party~~
3 ~~committees directly related to programs or events undertaken to raise~~
4 ~~funds to be used, in whole or in part, for activities in connection with~~
5 ~~Federal and non-Federal elections that are Federal election activities~~
6 ~~pursuant to 11 CFR 100.24 must not be allocated between Federal and~~
7 ~~non-Federal accounts. Except as provided in 11 CFR 300.32(a)(4), all~~
8 ~~such disbursements must be made from a Federal account.~~

9 * * * * *

10 **PART 300 – NON-FEDERAL FUNDS**

11 3. The authority citation for part 300 continues to read as follows:

12 Authority: 2 U.S.C. 434(e), 438(a)(8), 441a(a), 441i, 453.

13
14 4. Section 300.32 is amended by revising paragraph (a)(3) to read as follows:

15
16 **§ 300.32 Expenditures and disbursements.**

17
18 (a) Federal funds. * * *

19 (3) State, district, and local party committees that raise Federal funds through
20 an activity where only Federal funds are raised, must pay the direct costs
21 of such fundraising only with Federal funds. State, district, and local party
22 committees that raise Federal funds and non-Federal funds through a joint
23 fundraising activity under 11 CFR 106.7(d)(4) or a joint fundraiser under
24 11 CFR 102.17, where the Federal funds are to be used, in whole or in
25 part, for Federal election activities, must either pay the direct costs of such
26 fundraising only with Federal funds or allocate the direct costs in

1 accordance with the funds received method described in 11 CFR
2 106.7(d)(4). The direct costs of a fundraising program or event include
3 expenses for the solicitation of funds and for the planning and
4 administration of actual fundraising programs and events.

5 * * * * *

6 5. Section 300.33 is amended by:

7 a. Removing paragraph (c)(3); and

8 b. Revising paragraph (c)(2) to read as follows:

9 **§ 300.33 Allocation of costs of Federal election activity.**

10 * * * * *

11 (c) * * *

12 (2) ~~Salaries, and wages, and fringe benefits.~~ Salaries, and wages, and
13 fringe benefits for employees who spend more than 25% of their
14 compensated time in a given month on Federal election activity or
15 activities in connection with a Federal election must not be
16 allocated between or among Federal, non-Federal, and Levin
17 accounts. Only Federal funds may be used. For allocation of
18 §salaries, and wages, and fringe benefits for employees who spend
19 25% or less of their compensated time in a given month on Federal
20 election activity or activities in connection with a Federal election,
21 see 11 CFR 106.7(c)(1) and (d)(1)(i). ~~shall be paid from funds that~~
22 ~~comply with State law.~~

