



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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MEMORANDUM

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SUBJECT: Preliminary Audit Report on Nader for President (LRA # 755)

I. Introduction.

The Office of General Counsel has reviewed the Preliminary Audit Report ("Proposed Report") on Nader for President ("Committee"). We concur with the findings in the Proposed Report and offer the following comments regarding Finding 1 (Net Outstanding Campaign Obligations), and Finding 2 (Misstatement of Financial Activity). If you have any questions, please contact Albert R. Veldhuyzen, the attorney assigned to this audit.¹

¹ The Office of General Counsel recommends that the Commission consider this document in Executive Session because the Commission may eventually decide to pursue an investigation of matters contained in the proposed Report. 11 C.F.R. §§ 2.4(a) and (b)(6).

II. Our Regulations Do Not Allow the Committee to Use Primary Matching Funds for Primary Winding Down Activities Until 31 Days After the General Election (Finding 1).

The Proposed Report recommends that the Committee repay \$57,591 to the United States Treasury for receiving funds in excess of entitlement. This repayment is based on the Audit Division's calculation of the Statement of Net Outstanding Campaign Obligations ("NOCO Statement"). As a general matter, a committee's net outstanding campaign obligations ("NOCOs") are the difference between its assets and its liabilities. 11 C.F.R. § 9034.5(a). Winding down expenses are included as a liability on the NOCO Statement, 11 C.F.R. § 9034.5(b)(2), but candidates who run in the general election cannot include winding down expenses unless those expenses were incurred 31 days after the general election. 11 C.F.R. § 9034.11(d). Thus, under this regulation, Nader, who participated in the general election, could only include on his NOCO statement those winding down expenses that were incurred after December 5, 2008. However, the Committee argues that notwithstanding the regulation, the liabilities on the NOCO Statement should also include primary winding down expenses incurred between the candidate's date of ineligibility ("DOI"), which was September 5, 2008, and December 5, 2008. If the Commission accepts the Committee's argument that its purported primary winding down expenditures during the period from DOI to 31 days after the election should be counted as liabilities in its NOCO Statement, this increased liability for the winding down expenses would eliminate the finding that the Committee received federal funds in excess of entitlement. *See* 11 C.F.R. § 9038.2(b)(1)(i).

The Committee's specific arguments address three distinct time periods: 1) Date of Ineligibility (September 5, 2008) to November 4, 2008; 2) November 5 until December 5, 2008, and 3) the period after December 5, 2008. With respect to the first two time periods, the Committee makes two related arguments. First, the committee argues, the regulation is arbitrary in its application to candidates like Nader who successfully receive the nomination of minor parties but do not receive federal funds for the general election. Because such a candidate's DOI is the date of the last major party convention, the Committee appears to argue, the rules effectively apply an arbitrary date that has nothing to do with the candidate's actual campaign. Second, the Committee argues that between September 5 and December 5, 2008, it incurred actual primary winding down costs that were clearly identifiable as such, and so it ought to be able to receive partial public funding for those expenses. With respect to the last time period, the Committee argues that it should be allowed to allocate 100% of its expenses after December 5 as primary winding down costs if the Commission fails to agree with its arguments about the period between September 5 and December 5, 2008.

In effect, the Committee is explicitly asking the Commission to ignore its own regulation and to use this audit to fashion a special rule for itself and other publicly funded minor party primary committees that subsequently participate in a general election without public funds. However, there is simply no basis for the Commission consciously to ignore its own regulation.

Moreover, the Committee's argument ignores the purpose of the regulation. Section 9034.11(d) was designed to prevent "the use of primary matching funds for non-qualified expenses related to the general election" by any candidate, whether the nominee of a major or

minor party, and whether receiving public funds for the general election or not. *See Explanation and Justification for 11 C.F.R. § 9034.11(d)*, 68 Fed. Reg. 47,409-10 (Aug. 8, 2003). In promulgating the regulation, the Commission explained that expenditures incurred during the period after the primary election are almost always going to be general election expenses, rather than primary winding down costs. It acknowledged that the rule “may result in general election campaigns incurring a small amount of administrative costs related to terminating the primary campaign during the general election period,” but determined that “in practice, these expenses are offset by general election start up costs that are incurred and paid by the primary committee prior to the candidate’s DOI.” *Id.* at 47,409. Consequently, the Commission has imposed a bright-line rule for the sake of administrative efficiency and to avoid consuming time and resources to delineate between primary and general expenses – precisely the sort of delineation the Committee asks it to undertake here. Additionally, the provision applies explicitly “regardless of whether the candidates receive public funds for the general election.” 11 C.F.R. § 9034.11(d).

Regarding the period from DOI until November 4, 2009, the auditors note that the Committee in fact could include on its NOCO statement obligations for 99% of the primary election expenses paid during the period in question because those expenses were incurred prior to DOI. Consequently, the Committee was credited \$101,513. The auditors estimate that only 1% of expenditures related to the primary were incurred after DOI. For the period of November 4 to December 5, the auditors identified to this Office expenditures totaling \$5,758 that were related to the Primary. The amount of \$5,758 represents 0.02% of the total amount spent on the primary and general campaigns.² Such an insignificant amount is what the Commission clearly contemplated as an amount that could be offset by expenses paid from the primary that were related to the general election start-up cost. Absent the presentation of additional compelling evidence that the bright line rule should not apply, the Committee has not met its factual nor legal burden. *See Explanation and Justification for 11 C.F.R. § 9034.11(d)*, 68 Fed. Reg. 47,409 (Aug. 8, 2003).

Finally, the Committee’s alternative argument to the above is to request a 100% allocation of expenses after December 5 as primary winding down expenses, arguing that the timing of the audit in November 2008 justifies an allocation of 100% to the primary. The Committee argues that our regulations permit the expenditure of all general election winding down costs within 31 days of the general election and that it would be reasonable to credit any expenses incurred after December 5, 2008 as 100% primary related. *See Letter from Nathan Coppernoll to Sheraline Thomas*, at 7 (Jan. 5, 2009). Although the Committee is correct that it may be able to allocate 100% of expenditures to the primary after December 5, it will have to demonstrate that its allocation is reasonable. Reasonableness is presumed when the total winding down costs between the primary and general election committees “results in no less than one third of total winding down costs allocated to each committee.” 11 C.F.R. § 9004.11(c). As a result, it may be possible for the Committee to allocate 100% of expenditures to the primary

² The Committee spent a total of \$2,561,190 for the primary election and \$129,481.38 for the general election for a total of \$2,690,671.38.

election if it can show that its allocation method is reasonable and warranted by its actions.³ The auditors have not been provided with specific evidence showing that incurred winding down expenditures during the period in question are all related to the primary. Consequently, it would not be reasonable to allocate 100% of Committee wind down expenditures to the Primary election at this time.

III. More Information Needed To Precisely Determine the Nature of the Relationship Between the Committee and the Progressive Store (Finding 2)

In its cover memo to the Report, the Audit Division seeks guidance on an issue arising from the audit and exit conference of Nader for President 2008 ("Committee"). The issue concerns the Committee's relationship with the Progressive Store, a business that produces campaign materials for political campaigns.

The Progressive Store ("PS"), which is a for-profit unincorporated sole proprietorship, financed, produced, and marketed promotional products as a vendor to the Committee. The items, such as T-shirts, signs, and headwear, were sold online at "naderstore.com" as fundraising premiums. The Committee would contact PS whenever it wanted to introduce a new design or product and PS would then finance the associated costs. Once PS produced the products for the Committee, PS sold the items on a website created for the Committee. This website was linked to the Committee's own page and PS handled all operations to include obtaining the goods, maintaining the website, filling orders and processing all the transactions. It treated the purchasers as contributors, and transferred the contributor information (including their names, addresses, telephone numbers and email addresses) to the Committee. The information was uploaded onto the Committee's main database. The Committee reported the sales as both receipts from the purchasers (in the form of contributions) and disbursements to the Progressive Store (reflecting that the Progressive Store retained the proceeds) on its Commission reports.

According to an unsigned Agreement between the parties, PS proposed to transfer to the Committee a percentage of the net sales of items sold by PS on behalf of the Committee. However, the Committee has represented to the Audit Division that it subsequently verbally agreed to receive 15% of the profit from sales made by PS. Documentation provided by PS to the Committee indicates that, between April 2008, when the venture began, and August 21, 2008, the venture made no net profit; instead, it incurred a net loss of \$507.17. There was apparently an additional \$10,000 in sales between August 22 and August 31, but there is no information regarding whether these sales moved the venture into a profit-making position, nor is there any information stating whether there were any sales at all after August 31, 2008. PS never provided any actual funds to the Committee and the Committee apparently never sought any transmittal of funds from PS.

³ Whereas the Committee Treasurer proposed a 70% primary/30% general split which the auditors accepted as a reasonable allocation, Committee Counsel now argues for a 100% allocation to primary wind down. See *Letter from Nathan Coppernoll to Sheraline Thomas*, at 6 (Jan. 5, 2009).

The issues raised by PS' relationship with the Committee are: 1) whether the amounts collected from individuals for the merchandise were contributions to the Committee, and if so, by whom; 2) did the financing of costs for the production of the merchandise result in a contribution from PS to the Committee; and 3) was the oral agreement allocating 15% of profits to the Committee properly reported to the Commission?

We conclude that the amounts collected for the merchandise were contributions to the Committee from the individual purchasers. PS had the actual authority to create, produce, and distribute fundraising items for the Committee; its relationship to the Committee was that of a vendor. As such, the full purchase price of the fundraising items sold on behalf of the Committee was a contribution. 11 C.F.R. § 100.53. The amounts received for the purchased fundraising items were contributions from individual purchasers, rather than contributions from PS. Thus, the Committee correctly reported the gross receipts from sales through "naderstore.com" – receipts that were retained by PS – as contributions from the purchasers of the items.

As to the second issue, PS' financing of the costs for the production of merchandise is an extension of credit to the Committee. The Committee hired PS to produce merchandise for the Committee to be sold as fundraising premiums. PS bore all initial costs, and the agreement between PS and the Committee apparently was that PS would retain all proceeds until those initial costs were recovered and would retain 15 percent of the proceeds thereafter. An extension of credit "will not be considered a contribution to the candidate or political committee provided that the credit is extended in the ordinary course of the commercial vendor's business and the terms are substantially similar to extensions of credit to nonpolitical debtors that are of similar risk and size of obligation." 11 C.F.R. § 116.3(a).

A vendor engaged in the "ordinary course of business" is one that 1) follows its established procedures and past practice; 2) receives prompt payment in full from the same candidate or committee if it extended credit in the past; and 3) conforms to the usual and normal practice in the trade or industry. 11 C.F.R. § 116.3(c).

The Committee has relayed to the Audit Division that PS confirmed that the financing of the production costs is within its ordinary course of business. The Audit Division believes that PS' arrangement with the Committee was an arms-length arrangement and that PS was normally involved in fronting production costs for its clients. PS apparently confirmed to the Committee that it worked with other campaigns and was acting in the ordinary course of business in financing the production costs of the merchandise.⁴ PS' production and distribution of political literature was not an isolated incident; rather PS provided these types of political services to

⁴ The Progressive Store appears active in marketing its political merchandise to political committees as well as other organizations that wish to project a "progressive" message. According to its website, its "pinback business has been called 'The Best In LA' by the L.A. Weekly, has been praised in the L.A. Business Journal, and has been mentioned in the Wall Street Journal, the Dow Jones News Service and his political pinbacks have been touted on numerous progressive web sites." See *The Progressive Store* (visited June 12, 2009) <<http://progressive2008.com/html/about.html>>.

different campaigns as a matter of course in the pursuit of business. Furthermore, there is no indication that PS' practice of paying for the production costs of political merchandise does not conform to the usual and normal practice in the industry. For these reasons, this Office believes that PS' payment of production costs was in the ordinary course of business.

Although PS' up-front payment of production costs was legitimate, the vendor's possible sustaining of a loss may be considered a reportable in-kind contribution to the Committee. In AO 1989-21, the Commission addressed the issue of whether the financing of costs for the production of merchandise on behalf of a political committee resulted in a contribution. The AO Requestor proposed a fundraising plan whereby each campaign would be guaranteed 10 percent of the retail price of goods sold. The Commission found that an arrangement in which a committee was guaranteed a percentage of proceeds from each sale regardless of whether the vendor's costs were covered would result in a contribution. AO 1989-21, at 3. In AO 1991-18, the Commission did not approve a particular prospecting program that placed the risk of financial shortfall solely on the vendor while there was a payment guarantee for the Committee. AO 1991-18 at 6. These Advisory Opinions suggest that PS should not bear the full risk of loss and that any shortfall not repaid by the Committee to PS could result in an in-kind contribution from PS' sole proprietor to the Committee. If the venture's profitability remained unchanged after August 21, 2008, the amount of the in-kind contribution would be \$507.17, which is within the limitation of 2 U.S.C. § 441a(a)(1)(A). However, any loss also should have been reported as either an in-kind contribution received from PS' sole proprietor or, alternatively, as a net debt owed by the Committee to PS.

Conversely, if the post-August 22, 2008 sales/expenses data revealed a net PS profit, as subsequently alleged, a question arises as to why the Committee did not receive any actual funds from PS, much less the 15% of profits it bargained for, or why, if PS wrongly retained proceeds owed to the Committee, the Committee did not report a debt owed to it by PS. Our regulations provide that, "a debt or obligation . . . shall be reported as of the date on which the debt or obligation is incurred." 11 C.F.R. § 104.11(b). In the past, the Commission has found that even oral agreements to provide advertising and related services producing a debt should be recorded on Commission reports. See MUR 4621, Factual and Legal Analysis at 4 & 17. Although an oral agreement was made that the Committee was to receive 15% of profits, this never materialized as PS kept all monies received.

At any rate, whether a profit or loss was sustained in this venture, either a debt owed, an account receivable, or a contribution should arguably have been reported. It is only if the venture neither made a profit nor a loss that it would be unnecessary to amend the Committee's reports.

Given that there is missing information and that the Commission cannot possibly determine the facts until clarifying information is obtained, this Office recommends a finding that the Committee needs to amend its reports in this regard to fully reflect the profitability of the

Memorandum to Joseph F. Stoltz
Nader for President Preliminary Audit Report
LRA # 755
Page 7

venture including post-August 22, 2008 transactions, and provide information that will clarify whether there was a loss, a profit, or neither.