Contributions to Politically Active Outside Groups: Risk Areas and Advice for Donors

October 9, 2018

Election and Political Law

As the midterm elections rapidly approach, contributions to nonprofits and other politically active organizations that support candidates and ballot initiatives will draw greater scrutiny from state and federal campaign finance regulators. Over the past few years, state enforcement against organizations accused of "earmarking" contributions for political purposes—and failing to register and report in compliance with campaign finance laws—has escalated, leading in some cases to record fines in multiple jurisdictions around the country. Both the organizations themselves—and in some cases their donors—face liability for failing to register as political committees and report contributions. And donors face the risk that regulators may compel public disclosure of donations that the donors thought would never be disclosed.

When making contributions to politically active nonprofits and LLCs, it is important for donors to properly vet the recipient organization to gauge whether it is complying with the law, and to assess their comfort with the uneven risk of enforcement across jurisdictions. This advisory will summarize some of the potential pitfalls facing companies and individuals that donate to politically active organizations, and provide some practical tips for avoiding missteps.

"Earmarked" Contributions

"Earmarking" in this context refers to the practice of donating to one organization—usually a tax-exempt organization such as a 501(c)(4) social welfare organization or 501(c)(6) trade association—and expressly or impliedly designating that the funds be used to support or oppose political campaigns. Federal tax law permits 501(c)(4) and 501(c)(6) nonprofits to keep the identify of their donors private while still maintaining their tax exempt status.

These organizations are generally permitted to participate in the political process, including by engaging in political campaign activities, subject to restrictions set by state and federal tax and campaign finance laws. Campaign finance laws in many states require an entity to register with a regulatory agency and file periodic reports of political activity when the organization reaches a certain threshold of political "contributions" or "expenditures"—payments of money made with the intent to influence an election. Many states apply this requirement to all entities that make contributions or expenditures, including for-profit and non-profit corporations, partnerships, associations, and LLCs (although some states categorically exclude certain types of corporations and businesses from making political contributions). In virtually all states, political committee registration requires disclosure of the identity of individual donors, and prohibits contributions through intermediaries or third parties that would shield the identity of the underlying donors from disclosure.

But many organizations avoid registration—and therefore donor disclosure—by engaging in pure issue advocacy, such as lobbying the legislature or distributing communications that do not advocate for the election or defeat of any candidates for public office or support or oppose any ballot measure. Organizations that scrupulously eschew campaign politics will also avoid enforcement scrutiny by campaign finance regulators.

However, over the past few years, state campaign finance regulators have aggressively pursued nonprofits and trade associations that mask the identity of individual donors by accepting contributions that they later spend on partisan politics. Where donors "know," directly or indirectly, that their dollars will be spent on political activity, the recipient organization faces increased risk of enforcement action in many jurisdictions.

Campaign finance authorities across the country have taken especially hard lines against organizations active in ballot measure campaigns that fail to register as political committees. Often acting as nonprofit "action" or "advocacy" groups, many of these entities accept unrestricted donations from a variety of sources, only to find themselves under the campaign finance microscope when they begin to contribute to ballot initiative committees or make expenditures to support or oppose ballot measures.

These failures to register have significant consequences for the donors and recipients alike. Campaign finance enforcers in Washington State, California, and Massachusetts alone have secured record-setting fines from nonprofits and trade associations that failed to register as ballot committees. In several cases, state agencies have sought fines and punitive damages into the millions and in others, the organizations were dissolved altogether to settle the litigation. Meanwhile, unwitting donors—who had been promised anonymity for their contribution—may find themselves embroiled in the enforcement process as witnesses or persons of interest.

Contributions to Politically Active Nonprofits and LLCs

Enforcement actions in this space generally fall into two categories: (1) failure to register as a "political committee" after receiving contributions or making expenditures for political activity, or (2) making or assisting with so-called contributions "in the name of another." Regulators have used both theories to scrutinize non-disclosed political activity.

Failure to Register Cases

One category of cases involves organizations that face enforcement for failure to register as a political committee. Most jurisdictions require entities that accept political contributions to register as a political committee and file disclosure reports. Some states require entities that make expenditures for political purposes, often over a certain spending threshold, to register as a political committee and file disclosure reports. Politically active nonprofits and other entities can therefore trigger registration by raising money to support political campaigns or ballot initiatives within a state, and in some states, by spending money on these causes.

Some states have secured significant penalties for this sort of activity. Just last year, the Massachusetts Office of Campaign and Political Finance (OCPF) reached a significant settlement with Families for Excellent Schools – Advocacy (FESA) and its affiliate Families for Excellent Schools (FES). Although both organizations had a separate legal structure, they shared an executive director, office space, and employees. FESA supported increasing the cap on charter schools in Massachusetts, which was the subject of a statewide ballot measure in 2016 ("Question 2"). According to the settlement agreement the OCPF reached with FESA, after

Question 2 was certified for the ballot, FESA contributed over $15 million to Great Schools Massachusetts (GSM), a ballot committee supporting Question 2 that took in $21 million in total receipts. OCPF found that FESA had solicited contributions directly for the purpose of contributing to GSM, a conclusion supported in part by large transfers from FESA to GSM that increased in size closer to the election.

OCPF cited FESA for failing to organize as a ballot committee, failing to timely file campaign finance reports, and making contributions designed to conceal the true source of the contribution. For these violations, FESA was required to register as a ballot question committee and disclose all contributions received (including the identity of donors) and expenditures made from July 1, 2016 to December 31, 2016. In addition, FESA agreed to pay nearly $430,000—the largest penalty in OCPF history—representing the total cash on hand for FESA *and* FES at the time of the settlement. FESA further agreed to dissolve, and FES agreed not to "engage in fundraising in Massachusetts, soliciting in Massachusetts, or engage in any ballot question or other election-related activity in Massachusetts" for a period of four years.

Earlier this year, the Montana Commissioner of Political Practices (COPP) reached a settlement with a nonprofit "issue advocacy" organization called the Montana Growth Network (MGN)—after six years of investigation and litigation. MGN agreed to pay just $30,000 to settle claims that, among other things, it failed to register as an independent expenditure committee, and failed to disclose over $140,000 in political expenditures related to various Montana state races. However, despite the relatively low penalty for the entity, the MGN case demonstrates the risk to individuals who donate to nonprofit organizations that promise anonymity. In this investigation, the COPP subpoenaed MGN's bank records and later released them to the media, revealing the names of MGN's donors to the public, and subjecting them to their own regulatory scrutiny.

"Name of Another" Cases

In 2013, the California Fair Political Practices Commission (FPPC) secured a record $1 million in penalties—and another $15 million in disgorgements of unlawful contributions—from two nonprofit organizations that had failed to disclose their donors when making contributions to independent expenditure committees ("super PACs") in connection with two 2012 California ballot propositions. After a lawsuit and an investigation, the FPPC uncovered a "nesting doll" arrangement: one nonprofit organization, Americans for Job Security (AJS), contributed $11 million to another nonprofit, called Americans for Responsible Leadership (ARL). ARL then contributed to the Small Business Action Committee, a California super PAC. Likewise, the Center to Protect Patient Rights (CPPR) had made a $4.08 million contribution to the California Future Fund, another super PAC, through the American Future Fund, another nonprofit. Because ARL and CPPR had made contributions intended to prevent disclosure of the underlying donors, the FPPC required them to pay a combined $1 million penalty, and ordered the recipient super PACs to disgorge the undisclosed contributions.

Individual donors also risk liability in many of these cases. In one 2015 California case, a Virginia resident was fined by the FPPC for making contributions to a PAC that supported term limits in California through a 501(c)(4) called "Citizens in Charge." The PAC disclosed Citizens in Charge as the source of a $200,000 contribution that the FPPC later learned was funded by the individual. Citizens in Charge was fined $5,000 and the donor was fined $9,000.

Trade Association Political Activity

Trade associations that represent entire industry groups also face heightened risk of enforcement by state campaign finance offices. In 2016, the Washington Attorney General secured a trial court ruling against the Grocery Manufacturers Association (GMA) for failure to register and report contributions and expenditures in opposition to a ballot initiative that would have required labeling of genetically modified organisms (GMOs) in food (I-522). Prior to the 2014 election, when the measure was to be considered by the voters, GMA solicited over $14 million in contributions from its member companies—above and beyond regular trade association dues—for a "Defense of Brands" account that would oppose ballot measures, including the GMO initiative, that affected GMA members. GMA then contributed over $11 million to oppose I-522, and ensured that GMA, and not its individual member companies, were listed as the donors to the "No on 522" ballot committee.

After trial, the court found that GMA had intentionally violated the campaign finance laws by failing to register its Defense of Brands account as a political committee, and for failing to disclose the true origin of the contributions. In what appears to be the largest campaign finance penalty ever imposed in any jurisdiction, the court ordered GMA to pay an $18 million fine ($6 million, tripled as a result of the alleged intentional violation), plus trial and investigative costs and attorney's fees. Last month, a state appeals court overturned the decision to award treble damages, but left the rest of the trial court's ruling intact. The attorney general has vowed to appeal the penalty issue to the state supreme court.

Though hardly as significant as the GMA case, other jurisdictions have also pursued cases involving the alleged unlawful earmarking of political contributions by trade associations. For example, in 2010, the Montana COPP found that a local builders' trade association that had failed to list contributions earmarked for ballot measures should have registered as a ballot committee. The Montana Cannabis Industry Association is also currently under investigation in Montana after a complaint alleged that the group failed to disclose its donors in connection with a marijuana legalization ballot measure in Montana in 2016.

Federal Earmarking Rules

While state regulators aggressively enforce their campaign finance laws against entities that act as intermediaries for donors, the Federal Election Campaign Act and Federal Election Commission regulations carefully define earmarked contributions and prescribe rules for reporting the true source of political contributions.

Non-registered entities, such as 501(c)(4)s, that accept donations for the purpose of contributing to a super PAC or making their own independent expenditures or electioneering communications, should keep in mind several issues that might arise when engaging in these activities.

First, Federal law prohibits persons from making, and political committees from accepting, "contributions in the name of another person." 52 U.S.C. § 30122. In other words, a donor that gives to a nonprofit, non-political entity with the expectation that it will be contributed to a super PAC, may violate this statute by attempting to shield its contribution to the super PAC from disclosure.

Second, federal regulations provide that a contributions that are "earmarked or otherwise directed to [a] candidate through an intermediary or conduit, are contributions from the person to the candidate." 11 C.F.R. § 110.6(a). The FEC further defines "earmarked" contributions as donations that bear "a designation, instruction, or encumbrance, whether direct or indirect, express or implied, oral or written, which results in all or any part of a contribution or expenditure being made to, or expended on behalf of, a *clearly identified candidate or a candidate's authorized committee*." *Id.* § 110.6(b)(1) (emphasis added).

Third, a new federal district court decision has changed the regulatory environment surrounding independent expenditures. This past summer, Chief Judge Beryl Howell of the U.S. District Court for the District of Columbia issued a ruling in *Citizens for Responsibility and Ethics in Washington (CREW) v. FEC* that requires all non-political committee entities that make an independent expenditure in excess of $250 to disclose all donors who gave more than $200 to the group for the purpose of influencing a federal election, as well as to identify which of the organization's donors gave for the purpose of funding any of its independent expenditures. The court's ruling vacated the FEC's previous interpretation of its regulations, which only required disclosure of the identity of donors who contributed to the group for the purpose of funding the specific ad being reported.

Just last week, the FEC issued guidance on the *CREW* decision clarifying that a person making independent expenditures need only disclose certain donors who contributed during the reporting period in which the organization paid for the independent expenditure, not *all* donors ever. Although the Commission's guidance is ambiguous, it seems that contributions may not be reportable if they were not "earmarked" for independent expenditures, contributions to candidates, or for other political purposes. We expect that this ambiguity will require further guidance from the Commission in the coming weeks and months.

The *CREW* decision represents a potential sea change in political disclosure law for politically active nonprofits and LLCs, and the corporations and individuals who contribute to them. Because of the expansive interpretation of the disclosure requirements, any donation to an organization that makes independent expenditures is potentially subject to disclosure, depending on a number of factors, such as how the group solicits donations and the donor's intent when making the donation.

In light of these considerations, federal campaign activity conducted by non-registered organizations presents an additional risk area for donors, at least with respect to the possibility that their donations may need to be publicly disclosed.

Advice for Donors

Corporations and individuals who contribute to politically active nonprofit organizations risk getting drawn into enforcement actions if the organization is alleged to violate state or federal campaign finance laws. Particularly if the issue area is high-profile or controversial, opponents of the organization are likely to file complaints with regulators, and the ensuing investigation may lead to burdensome discovery requests. Moreover, if the entity is found to have violated the campaign finance laws, the agency may require these organizations to register as a political committee and disclose donors. In some cases, as in MGN, the investigation process itself may lead to donor disclosure. If a group is unpopular or engaging in risky campaign finance activities, negative publicity surrounding the investigation may also present optics issues for donors.

Nevertheless, despite these risks, there are steps that corporate and individual donors can take to ensure that their spending decisions are based on proper vetting of the organization and weighing of the risks involved.

First, the donor—whether an entity or an individual—must consider its own goals as a donor and evaluate its own risk profile. A contribution to a 501(c) organization may have tax implications for the donor. Contributions to politically active organizations or causes may arouse scrutiny from shareholders or members concerning transparency and disclosure of corporate contributions, or invite shareholder and media attention to the company's substantive political spending decisions. If the donor is an investment advisor or government contractor, federal, state, and local pay-to-play rules may also restrict the contribution.

Second, donors should examine the organization and structure of the group receiving the funds. Groups that are professionally managed, have engaged political law compliance counsel, and have an experienced board of directors are better positioned to adhere to campaign finance regulations. In addition, recipient groups will face different strictures depending on their organizational structure. 501(c)(3) organizations, for example, have limits on lobbying, and are prohibited from partisan political activity. 501(c)(4) social welfare organizations and 501(c)(6) trade associations may make political expenditures, as long as political activity is not the "primary purpose" of a 501(c)(4) or the "sole purpose" of a 501(c)(6).

Third, donors should look to the group's activities. Does the group have a history of running educational or issue campaigns? Does the group make independent political expenditures? Is it at risk of triggering political committee status due to its political activities? Has it ever been subject to a regulatory enforcement action or fine?

After conducting due diligence on a potential contribution, donors should consider seeking an assurance letter from the organization to memorialize the donor and group's common understanding of how the contribution will be used and provide some measure of protection to the donor. Outside counsel can assist donors with vetting of contributions to identify and weigh any of these potential risks.

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