COVINGTON

COVINGTON & BURLING LLP

E-ALERT | Election and Political Law

January 31, 2013

FEC YEAR IN REVIEW - 2012

INTRODUCTION

It is sometimes said that the Federal Election Commission (FEC) is an agency without a friend in Washington, lacking any constituency group to support its mission: the implementation and enforcement of the Federal Election Campaign Act of 1971, as amended (FECA). In this report, we have tried to take a look at the work of the FEC over the last year, if not in friendship, at least with a sense of fairness. We have also looked at relevant court decisions in 2012 that have interpreted FECA, as well as the Justice Department's role in enforcing the statute.

We found that there are some things the agency has done quite well, such as providing clarity on the rules for texting contributions and donor-focused Internet fundraising, and defining who falls within a corporation's restricted class. The FEC has also taken on some difficult tasks, with moderate success, such as defining when an ad contains text akin to the "magic words" that make it "express advocacy" regulated by the agency's rules.

But in other, important areas, the agency was unable to provide much if any clarity on the law, and in some cases, destabilized established lines of cases. Issues on which the law remains muddy include:

- Can a Super PAC borrow video footage from a candidate's campaign for use in an ad and still remain "independent"?
- Does the agency regulate as "express advocacy" speech beyond *Buckley*'s magic words?
- Can a domestic subsidiary of a foreign national establish a PAC?
- If an independent group produces an ad that is not in "coordination" under the FEC's regulations, may it still be prosecuted under some other statutory standard?
- Can an employer compel its employees to participate in campaign activities to support candidates the company favors?

On these and other important issues, the Commission speaks with two voices, leaving these decisions to be made in other forums, or perhaps not at all. This divide is nowhere better illustrated than the fact that the FEC issued no substantive regulations, no guidance and no policies in 2012. In this vacuum, other entities with less experience and expertise are asked to step in to regulate: the SEC, the IRS, and state attorneys general to name just three.

In fairness, the FEC reflects the divisions within the bar on the proper role of government in regulating the spending of money on politics. There is also an active political strategy of deregulation through litigation, and at times, the FEC seems to do no more than create the factual record upon which the courts will ultimately rule. Yet even with all of that, there appears at times to be more the agency could do to find common ground, to do the best it can to interpret the law in the light of established precedent.

In the sections below, we detail the FEC's more important actions in enforcement, advisory opinions and audits, as well as relevant court decisions and criminal prosecutions. Those sections are as follows:

1. After *Citizens United*, Other Restrictions Upheld
2. The Regulation of Express Advocacy and Its Functional Equivalent
3. Technology and Fundraising
4. Corporate PACs and Candidate Appearances
5. Clarity in Enforcement
6. Muddling the Coordination Rules
7. No New Rulemaking or Policies
8. The Prospects for Fraud
9. Employees and Politics
10. The Lessons of John Edwards and John Ensign

1. AFTER *CITIZENS UNITED*, OTHER RESTRICTIONS UPHELD

In the wake of *Citizens United*, it seems that it is open season on campaign finance laws, with litigants challenging a myriad of campaign finance statutes and regulations. What do the decisions in 2012 teach us? That, by and large, lower courts are dutifully applying *Citizens United* in cases that deal with similar fact patterns or closely analogous legal principles, but have not expanded the decision beyond its moorings. The Supreme Court, it seems, will need to take the lead on this front, should it see fit.

There has been little erosion over the past year of laws that restrict who can make federal campaign contributions and in what amounts. Advocates in favor of peeling back these restrictions were met with an inauspicious start to the year when the Supreme Court on January 9 summarily affirmed the constitutionality of the foreign national contribution ban in *Bluman v. FEC*, rather than simply choosing not to take the case. The three-judge court from which the appeal was taken had expressly declined to reevaluate the ban based on *Citizens United*.

Two challenges to the biennial contribution limits were also unsuccessful.[1] In *McCutcheon v. FEC*, the 3-judge district court in Washington, D.C. concluded that these aggregate contribution limits were part of a "coherent system" of safeguards designed to prevent circumvention of limits on contributions to candidates.[2] A subsequent panel of the same court found the challenge in *James v. FEC* to be indistinguishable.-

Finally, in *Wagner v. FEC*, a different 3-judge district court panel in Washington, D.C., upheld the ban on contributions by federal contractors. The court concluded that the restriction was supported by the government's interest in preventing *quid pro quo* corruption, or the appearance thereof, and that the statute was narrowly drawn to advance this interest. But of particular interest, it also noted (without deciding) that "*SpeechNow* creates substantial doubt about the constitutionality of any limits on Super PAC contributions—including § 441c's ban on contributions by federal contractors."

[1] Federal law limits the total amount an individual may contribute to party committees and other political committees during a two-year period starting January 1st of an odd-numbered year and ending December 31st of the subsequent year. The statutory limits are indexed for inflation.

[2] The FEC reached the same result in an earlier Advisory Opinion requested by the plaintiff. FEC AO 2012-14 (McCutcheon).

Restrictions on federal contractors continue to be a topic before the FEC, but here, too, the Commission continued to follow its precedents. In FEC AO 2012-13 (Physician Hospitals of America), the agency concluded the hospitals and the physicians that are federal Medicaid and Medicare providers were not "contractors" prohibited from making contributions. In FEC AO 2012-16 (King, Pierce Atwood LLP), the agency concluded a law firm that was under contract with a federal corporation could provide services to a federal candidate's campaign, either as a paid vendor for non-compliance matters, or on a *pro bono* basis for assistance with compliance with the law.

2. THE REGULATION OF EXPRESS ADVOCACY AND ITS FUNCTIONAL EQUIVALENT

The courts and the FEC continue to wrestle with how to identify what speech is subject to regulation without running headfirst into the First Amendment. There is a deep division within the FEC over whether the agency may continue to enforce a definition of "express advocacy" beyond the "magic words" described in *Buckley*, as well as what is necessary to "clearly identify" a candidate in an ad that otherwise qualifies as an electioneering communication.

Definition of Express Advocacy: There are two definitions in the FEC's regulations for "express advocacy": (a) communications that contain *Buckley*'s "magic words" such as "vote for," "re-elect," "support," "cast your ballot," "defeat," "reject," among other phrases; and (b) communications that contain the "functional equivalent" of express advocacy. 11 C.F.R. § 100.22. The more expansive nature of the latter test, found at § 100.22(b) of 11 C.F.R., has left it open to attack.

In a significant U.S. Court of Appeals decision, the Fourth Circuit in *Real Truth About Abortion v. FEC* upheld § 100.22(b) as consistent with the First Amendment even though it went beyond regulation of *Buckley*'s "magic words." In reaching this conclusion, the court relied heavily on the Chief Justice's controlling opinion in *FEC v. Wisconsin Right to Life, Inc.*, which rejected the notion that *Buckley* defined the full scope of permissible speech that could be regulated under the Constitution, and the majority opinion in *Citizens United*, which concluded as a threshold matter that *Hillary: The Movie* was subject to regulation because it was the functional equivalent of express advocacy. In addition, the Fourth Circuit panel concluded that § 100.22(b) was not unconstitutionally vague, again citing *Wisconsin Right to Life's* approval of similar language.

However, the Fourth Circuit's upholding § 100.22(b) against constitutional attack has had little effect at the FEC, where the three Republican Commissioners[3] maintain that § 100.22(b) is either statutorily infirm and must be augmented[4] or is unenforceable under the First Circuit's 1996 decision in *Maine Right to Life v. FEC*.

In FEC AO 2012-11 (Free Speech), issued before *Real Truth About Abortion*, the FEC was asked to evaluate eleven newspaper, radio, television, and Facebook advertisements. None of the initial

[3] Federal law mandates that no more than three of the six FEC Commissioners may be affiliated with the same political party. In practice, while the President nominates all six Commissioners, the leadership of the opposing political party has recommended three candidates to the President. *See* 2 U.S.C. § 437c(a)(2)(A). Currently, three of the Commissioners are Republicans, two are Democrats and one, a registered independent, was recommended to the President by the leadership of the Democratic Party. Thus, while it is a somewhat imprecise shorthand, we will refer to the Commissioners as "Democratic Commissioners" or "Republican Commissioners" throughout, though those party labels have not always been a particularly useful predictor of how particular Commissioners will vote.

[4] The Republican Commissioners have at times found the regulation defective for failing to require that communications regulated by § 100.22(b) contain a clear plea for "*electoral* advocacy or an electoral call to action" as articulated in the Ninth Circuit's decision in *Furgatch v. FEC*. Statement on Advisory Opinion 2012-11 (Free Speech): Chair Caroline Hunter and Commissioners Donald F. McGahn and Matthew S. Petersen at 13.

advisory opinion drafts that addressed all of the ads garnered four votes, but the agency ultimately did reach consensus about two categories of ads and disagreed as to a third.

First, the agency concluded that the following statements were express advocacy because they identified a candidate with a position on an issue and stated that viewers should vote against those who took that position. "What kind of person supports bailouts at the expense of average Americans? Not any kind of person that we would vote for and neither should you. Call President Obama and put his antics to an end." Although the last sentence could be read to ask viewers to take some action other than voting, that did not nullify the appeal earlier in the ad to vote.

Second, the agency concluded that four ads and two donation requests did not contain express advocacy because they each discussed an issue and a candidate's role in that issue as an officeholder, expressed the group's views on the issue, made no reference to a federal election, and often had a "call to action" for conduct other than voting. One ad specifically asked viewers to vote for candidates for state office. The FEC concluded that these ads contained neither "magic words" nor the functional equivalent of express advocacy. Similarly, the donation requests were not a "solicitation" of a "contribution" because they lacked language "clearly indicating that the contribution will be targeted to the election or defeat of a clearly identified candidate for federal office." *Id*. at 9 (quoting *FEC v. Survival Education Fund*, 65 F.3d 285, 295 (2nd Cir. 1995)).

Third, the agency deadlocked on the remaining ads, which generally praised or criticized an incumbent officeholder's character, qualifications or fitness for office (as opposed to the candidate's position on an issue) and some exhorted viewers to take action "this November" or "this fall" (*e.g.*, "Do everything you can to support Congresswoman Lummis this fall and work toward fiscal sanity."). None of these ads fit comfortably into *Buckley*'s "magic words" category, and the FEC could not reach consensus as to whether they were otherwise regulated by law.[5]

The FEC followed a similar pattern in FEC AO 2012-27 (National Defense Committee), issued after *Real Truth About Abortion*. Three advertisements that identified a Member of Congress and focused on a particular issue, but made no references to any election, were not considered to be express advocacy.[6] But several other advertisements, which mentioned a particular Member of Congress and contained phrases such as "[b]e heard this fall" or "[s]upport conservative voices and public servants ready to end ObamaCare's reign" did not garner four votes in either direction. Notably, the advisory opinion request asked whether "the Commission will continue to apply and enforce 11 C.F.R. § 100.22(b)," but the FEC deadlocked on whether this question qualified as an advisory opinion request at all.

Underlying these decisions is the refusal of the Republican Commissioners to enforce § 100.22(b). In FEC AO 2012-11, while the Commission agreed that certain advertisements contained "magic words" and thus, were express advocacy, and that other advertisements lacked sufficient ties to a federal election to be express advocacy, the final opinion did not articulate an analysis of the advertisements under the § 100.22(b) "functional equivalent" standard. The Republicans' Statement explained that they considered the regulation to be "statutorily infirm" and noted their support for a draft that would have announced the agency was no longer enforcing § 100.22(b).

---

[5] Free Speech subsequently challenged the FEC's decision and constitutionality of the statutory provisions that underlay it. In an oral ruling, the United States District Court for the District of Wyoming denied Free Speech's challenge to the definition of "express advocacy" and the major purpose test, as well as the FEC's solicitation rules and registration and reporting requirements. *Free Speech v. FEC* (D. Wy.) (emergency appeal denied).

[6] Even ads the FEC concluded were not express advocacy were harshly critical of the incumbents/candidates featured: "Nydia Velazquez. Ethically challenged. A key supporter of the Troubled Asset Relief Program. Calls bailed-out Wall Street greedy one day, but takes hundreds of thousands from it the next. A leader you can believe in? Call Nydia Velazquez and let's make sure we end the bailouts that bankrupt America." FEC AO 2012-27, at 3.

Statement on Advisory Opinion 2012-11 (Free Speech): Chair Caroline C. Hunter and Commissioners Donald F. McGahn II and Matthew S. Petersen at 1. Similarly, in FEC AO 2012-27, the Republican Commissioners voted in favor of an unsuccessful draft opinion that cited the First Circuit's decision in *Maine Right to Life*—concluding that promulgation of the regulation exceeded the agency's statutory authority—in refusing to apply the regulation in subsequent enforcement cases, irrespective of what the Fourth Circuit said in *The Real Truth About Abortion* about the constitutional permissibility of the regulation.

The upshot of these two advisory opinions is that although some communications are clearly express advocacy because they use magic words, and other communications are clearly not express advocacy because they contain no federal electoral references, there is a grey area in the middle where the FEC is split on whether the functional equivalent test in 11 C.F.R. § 100.22(b) is good law.

Electioneering Communications: In 2012, the FEC and the courts also evaluated when an ad referred to a "clearly identified" candidate for federal office, and hence met an essential prong in determining if it was as an electioneering communication, subject to certain disclosure obligations.[7] Although on paper the definition of an electioneering communication seems less subject to interpretive dispute than the definition of express advocacy, there are still ambiguities in the law.

For instance, a district court in *Hispanic Leadership Fund, Inc. v. FEC* confronted whether advertisements that did not name any particular candidate could nonetheless "refer to a clearly identified candidate for federal office." In parsing five advertisements, the court determined that it should "look both to the context of the reference as well as to the meaning of the reference itself." Under this context-specific standard, the terms "the White House" and "the Administration," coupled with images of the White House and the President's policies, were considered unambiguous references to President Obama. In contrast, an advertisement that included an unidentified audio clip of President Obama's voice was not a reference to a clearly identified candidate because there were no other references to the President in the ad and an objective listener might not recognize the voice as President Obama's.

The FEC likewise confronted the question of whether advertisements contained references to clearly identified federal candidates. FEC AO 2012-19 (American Future Fund). Like the district court in *Hispanic Leadership Fund*, the FEC considered the context of the references. Of note, the FEC determined that references to "Obamacare" were references to the President because the term, while a popular shorthand, was not officially part of the healthcare legislation's name. The same was true of references to "Romneycare," a shorthand for the 2006 Massachusetts Act that Governor Romney signed. However, unlike the district court, the FEC was unable to reach a conclusion as to whether reference to the "White House" or "this Administration," coupled with pictures of the White House or the Washington monument, referred to President Obama.

Finally, the FEC deadlocked on whether the agency should adopt a commercial products exception that would allow a congressional candidate's plumbing business to not file electioneering communications reports when it aired broadcast ads for the business. FEC AO 2012-20 (Mullin). The case was made somewhat more difficult to resolve by the alleged similarity between the campaign ads and the plumbing company's ads, the prominence of the candidate's success in the plumbing business in the campaign, and an allegation the plumbing company increased the frequency of its ads before the election.

---

[7] An electioneering communication is a broadcast, cable, or satellite communication that refers to a clearly identified candidate for federal office, is aired within 30 days of a primary election, convention or caucus, or 60 days before a general, special or run-off election, and in the case of a House or Senate candidate, is targeted to the relevant electorate. See 2 U.S.C. § 434(f)(3).

3. TECHNOLOGY AND FUNDRAISING

This past year, there was frequent agreement at the FEC over how to handle advances in technology that have made their way into the campaign finance world. In particular, the FEC devised a framework for evaluating the permissibility of text messaging fundraising operations. It also added to the growing body of advisory opinion guidance relating to web-based fundraising platforms.

Text Messaging: The FEC's advisory opinions from 2012 gave a hearty endorsement to fundraising programs that use text messaging either to make the contribution or to initiate the process. The FEC not only approved of such fundraising vehicles, but more importantly it described for the first time in real detail how its rules relating to anonymous donations, disclaimers, and processing fees would apply to this technology.

One important line was drawn between contributions of $50 dollars or less, and contributions that exceed $50. In FEC AO 2012-17 (m-Qube I), the FEC initially explained that contributions that aggregated to a sum of $50 or less could be made anonymously by text messaging because there is no statutory requirement to collect names and addresses from contributors of sums below that level. m-Qube proposed capping contributions at $50 on a monthly wireless bill and using the phone number to track aggregate contributions to ensure that figure was not exceeded during the year. Concomitantly, in FEC AO 2012-30 (Revolution Messaging), the FEC approved text message contributions that exceed $50, provided that the vendor sought the donor's identifying information. Revolution Message represented that it would "send a confirmation text thanking and asking the contributor to provide the information required [by federal law] via a series of text messages or by completing a form on the website of Revolution Messaging."

The wireless carriers then sought an advisory opinion that made clear that the treasurer of the campaign, party, or political committee bears responsibility for ensuring that the contributions are lawful under federal laws (such as the ban on foreign national contributions). FEC AO 2012-28 (CTIA). This was important, for often the identity of the payor of the bill, and hence the ultimate source of the funds for the contribution, would only be known to the wireless carrier. The FEC concluded that the statute imposed that duty only on the treasurer of a political committee:

> [The Wireless Association] and the wireless service providers are not responsible for determining the eligibility of a contributor or for ensuring compliance with (1) the $50 monthly limit on contributions; (2) the recordkeeping obligations for contributions in excess of $200; or (3) the limitation of one short code per campaign. Such responsibilities rest with political committees.

Put another way, the FEC later said: "the Committee is solely responsible for determining the eligibility of its contributors." FEC AO 2012-26 (m-Qube II).

Web-Based Fundraising: In what seems to be an uncontroversial move, the FEC approved of ActRight.com soliciting unlimited, earmarked contributions through its website, and forwarding them to Super PACs. FEC AO 2012-3 (ActRight). Because Super PACs are permitted to receive unlimited contributions under the D.C. Circuit's decision in *SpeechNow.com*, and ActRight would comply with federal regulations regarding forwarding contributions, no law precluded its proposal.

The FEC's other pronouncement on web-based fundraising platforms involved an intricate website run by Skimmerhat that would allow users to search for candidates based on geographic location, ideology, or single-issue positions. FEC AO 2012-22 (Skimmerhat). Once matched with a candidate, the user would be directed to the candidate's page where they could make a contribution that Skimmerhat would forward to the candidate, while taking an 8% processing fee. This advisory opinion shows how the law in this area has become quite settled. Drawing on numerous advisory

opinions, some of which concerned the Internet and some of which did not, the FEC concluded: (1) Skimmerhat could transmit the contributions to candidate committees without making an in-kind contribution because it provided a delivery service to the fee-paying user, not the candidate; (2) the 8% processing fee would not count toward the user's contribution limit to the candidate, again because the fee paid was a product of a contractual relationship between the user and Skimmerhat, rather than with the candidate; (3) Skimmerhat could provide candidate information to its users because it was a "corollary" to building the website, and candidates could even be granted limited access to edit their information because it furthered informational accuracy and was not for an electoral purpose; and (5) Skimmerhat was not required to file a report with the FEC because it was simply a commercial service provider.

4. CORPORATE PACS AND CANDIDATE APPEARANCES

The FEC issued a number of helpful decisions relevant to corporate and trade association PACs, especially in defining the restricted class and on the use of "cash-like" credits to make political contributions. Yet the agency also showed a startling lack of consensus on whether a domestic subsidiary of a foreign national corporation could sponsor an SSF. In December, three Democratic Commissioners chose not to follow agency precedent in this area, concluding instead that in light of the Supreme Court's January 2010 decision in *Citizens United,* rulemaking was necessary to determine the appropriate role of U.S. subsidiaries of foreign corporations.

Who falls within the restricted class: This has been a bright spot in the realm of FEC decision-making over the past several years, with the agency producing a significant number of clear and useful decisions on the scope of the restricted class. Having won approval to solicit certain office headquarters personnel in a 2010 advisory opinion, FEC AO 2010-04 (Wawa), the convenience retailer Wawa returned to the FEC, seeking approval to solicit Area Managers and General Managers. FEC AO 2012-02 (Wawa).

The FEC obliged, concluding that store managers (who are called General Managers at Wawa) are within the company's restricted class. While these individuals primarily supervise hourly, part-time workers, and performed manual duties when necessary, the agency concluded that on balance, their job duties were primarily managerial in nature and required the exercise of discretion in matters affecting the store, including the authority to hire and fire employees, to receive or refuse inventory shipments, to manage safety programs, and to analyze store profit and expense estimates. The agency concluded the positions were more akin to executive or administrative personnel than "salaried foremen," and hence were within the restricted class.

Franchisors: The FEC continued a line of decisions that have treated franchisors as "affiliated" with the parent company, and consequently, within the solicitable class. FEC AO 2012-12 (Dunkin' Brands). Dunkin' Brands, the parent of Dunkin' Donuts and Baskin Robins ice cream shops, asked the FEC for permission to solicit franchisees/licensees, including franchisee's/licensee's executive and administrative personnel. Relying on decisions going back to the 1970s the FEC unanimously concluded Dunkin' Brands had sufficient control over the business policies, practices, and procedures of the franchisees/licensees and sufficient contractual obligations between the parties to treat them as "affiliated" entities.

But precedent was no help when Yamaha Motor Corporation, U.S.A. made a similar request to establish a separate segregated fund (SSF) and solicit the restricted class of its dealers and service centers. FEC AO 2012-37 (Yamaha Motor Corporation). In the final advisory opinion of the year, the FEC on December 20th split 3-3 both on the question of whether Yamaha Motor Corporation, U.S.A. had sufficient control over the dealers and service centers to be considered "affiliated," as well as on

the more basic question of whether Yamaha Motor Corporation, U.S.A. could sponsor an SSF at all because of its relationship to a foreign corporation.

The FEC has long held that domestic subsidiaries of foreign corporations could establish an SSF and solicit contributions from executive and administrative employees who were U.S. citizens or lawful resident aliens, so long as certain safeguards were established to ensure there was not foreign national control or direction of the SSF. Citing the uncertainty in the law created by *Citizens United*, and the failure of the FEC to begin rulemaking during the intervening years, the Democratic Commissioners refused to support even a narrow decision that would have affirmed Yamaha Motor Corporation USA's right to establish an SSF. While the FEC Commissioners failure to reach consensus on this one request does not invalidate earlier decisions finding domestic subsidiaries of foreign corporations may sponsor an SSF, it highlights the consequences of continued instability in this area of law.

Affinity Programs and PAC Contributions: The FEC concluded an Internet provider could provide services to corporate sponsored loyalty programs (such as frequent buyers' clubs) that allowed participants to convert their "points" into political contributions. FEC AO 2012-09 (Points-for-Politics). Points-for-Politics proposed serving as an interface between the sponsors of the corporate loyalty programs and the political committees, processing contributions made by participants in the program. The opinion reinforced earlier FEC decisions that vendors following routine commercial practices and relying on some simple safeguards, could process contributions without running afoul of the bar on corporate contributions or corporate facilitation. For the first time, Points for Politics also allowed the vendor to form a contractual relationship with the candidate committees.

The decision also supports the principal that individuals can convert a "cash-equivalent" into a political contribution. *See also* FEC AO 2009-31 (Maximus) (approving a corporation soliciting employees to allocate compensation "credits" that could be converted into sick leave or vacation leave into contributions to the corporate PAC).

Candidate Appearances: There were not, however, four votes at the FEC to determine whether a corporation could host events at which the major candidates in a Senate race could meet with a small number of company executives and prominent local business leaders (who fell outside the restricted class) to discuss each candidate's views on the issues of the day. FEC AO 2012-29 (Hawaiian Airlines, Inc.). Three Commissioners concluded the regulatory exceptions for the presence of "guests" and "participants" at a restricted class event were broad enough to permit non-restricted class members to participate in the roundtable discussions. However, the remaining Commissioners concluded that in creating the exception, the Commission did not envision a roundtable discussion at which the restricted class constituted a minority of attendees, and consequently, it would be an impermissible in-kind contribution for the corporation to host such events.

Other Notable Decisions and Actions.

- FEC AO 2012-15 (American Physical Therapy Association): A membership organization may pre-pay the cost of a payroll deduction plan for PAC contributions from members employed by non-member corporations.
- FEC AO 2012-23 (Snake River Sugar Company): Sugar beet growers associations are affiliates with a co-op and thus, the associations may solicit members for contributions to the co-op's separate segregated fund.
- Audit of Johnson & Johnson Political Action Committee—2010: No material non-compliance.
- Audit of Council of Farmers Cooperatives CO-OP/PAC—2010: (1) Some misstatement of receipts, disbursements, and cash on hand; (2) Lack of required disclosure information.

5. CLARITY IN ENFORCEMENT

While the FEC is often maligned for insufficient vigor in enforcement, the agency's record for 2012 made it clear that there are two categories of violations that still routinely garner penalties from all six Commissioners: contributions from an impermissible source and reporting violations. In addition, the FEC's *sua sponte* policy appears to continue to meet its goals of encouraging entities to identify violations the agency would not otherwise discover, and reducing penalties when corrective actions have been taken to remedy the problem and prevent future violations.

Impermissible Source: The FEC and the Justice Department continue to treat impermissible source cases seriously. These cases can involve straw donors (a donor giving funds to a second person to permit the straw donor to make a campaign contribution), reimbursed contributions (an employer refunding an employee's contribution), and contributions from entities that are not otherwise permitted to give (corporations and certain LLC's). These cases often involve evidence of an effort to mask the transaction, which can imply an awareness that the conduct is illegal.

- MUR 6234 (Arlen B. Cenac, Jr., Cenac Towing): A towing company made several contributions by cashier's check to candidates' campaigns in the names of employees and associates. Civil penalty of $170,000.
- MUR 6515 (Professional Fire Fighters of Wisconsin): A *sua sponte* submission by a union admitting that it had reimbursed eleven officers $18,263.34 for contributions to the union's PAC. Civil penalties of $58,000 and agreement that former officers not hold union office until June 30, 2013 and June 30, 2015.
- MUR 6249 (Karen Pletz, Kansas City University of Medicine and Biosciences): Dismissal after primary respondent died after initiation of investigation and indictment. Complaint involved $15,700 in contribution reimbursed from university funds.
- MUR 6504 (William E. Gardner): A *sua sponte* submission regarding president of a company who used corporate and personal funds to reimburse employee contributions. Civil penalty of $8,500.
- MUR 6618 (United Power, Inc.): A *sua sponte* submission regarding company's reimbursement of Director's $37,462 in contributions over 9 years. Civil penalty of $2,400.

The Department of Justice reached a plea agreement with Los Angeles lawyer Pierce O'Donnell, in which he was sentenced to sixty days in prison, a year of supervised release, 500 hours of community service, and a $20,000 fine for organizing a series of conduit contributions to a presidential campaign. This ended a five year legal fight in the trial and appellate courts.

Reporting Violations: Almost half of the cases resulting in a civil penalty in excess of $50,000 involved reporting violations. Three factors tend to produce the largest penalties.

First, there was often not much to argue over. One either filed the report on time or not, and the report either contained all the transactions or it did not. There is not much room to argue over the meaning of the First Amendment in these cases. Second, cases involving significant dollar amounts produced significant reporting violations, even if the penalty is calculated using a very small percentage of the amount in violation. Third, the FEC assesses a more substantial penalty in cases that involve election sensitive reports (those filed shortly before an election).

- MUR 6508 (RNC): Failure to disclose $9 million in newly incurred debts. Civil penalty of $96,000.

- MUR 6587 (United Association Political Education Committee): PAC fails to report independent expenditures properly. Civil penalty of $39,000.
- MUR 6632 (U.S. Chamber of Commerce): A *sua sponte* submission for failure to file 24-hour electioneering reports. Civil penalty of $11,000.
- MUR 6593 (American Hospital Association): Trade association sponsors electioneering communications that contain no disclaimer and are not reported. Civil penalty of $11,000.
- MUR 6443 (Americans for Common Sense Solutions): 501(c)(4) group sponsors electioneering communications that contain no disclaimer and are not reported. Civil penalty of $9,000.
- MUR 6555 (Freedom's Defense Fund): Non-connected PAC fails to file independent expenditure report. Civil penalty of $3,700.
- MUR 6581 (American Future Fund): A *sua sponte* submission for electioneering communications that contain no disclaimer and are not reported. Civil penalty of $1,000.

Other Notable Cases:

- MUR 6040 (Charles B. Rangel): Excessive in-kind contributions from Fourth Lenox Terrace Associates and failure to report excessive in-kind contributions. Civil penalties of $23,000 and $19,000.
- MUR 6463 (Jack Antaramian): Joint fundraising committee accepted excessive in-kind contribution relating to rental/lease agreement of office space and other items. DNC and Obama Victory Fund civil penalty of $16,000; Antaramian civil penalty of $15,000.
- MUR 6466 (Robert Aderholt for Congress): Misstatement of financial activity (up to $129,681.43 in disbursements) and failure to deposit $272,852 of contributions within 10 days of receipt. Civil penalty of $13,000.
- MUR 6524 (Biden for President): Audit concludes there was a failure to maintain records regarding re-designation letters. Civil penalty of $50,000.
- MUR 6539 (Joe Green): Former campaign treasurer involved in misappropriation of $7,343.03 in campaign funds and reporting and recordkeeping violations. Civil penalty of $8,800.

6. MUDDLING THE COORDINATION RULES

Can an independent expenditure group use photos or video taken from a candidate's ads?

The FEC agrees it can, but is divided as to how much content Super PACs and other groups making independent expenditures can take from a candidate's ads. Independent spending groups cannot "coordinate" with the candidates or political parties they are independent of, and Congress has specifically prohibited them from the "republication, in whole or in part" from a candidate's campaign material. 2 U.S.C. § 441a(a)(7)(B)(iii). What does "in whole or in part" mean in practice?

The FEC has closed a number of enforcement cases that involve an independent spending group taking a small picture or "head shot" of a candidate off the candidate's website and including it in the group's ads, either finding no violation, exercising its prosecutorial discretion, or sending an admonishment letter. The question has become harder for the agency to answer when the independent group takes more extensive footage and weaves it into a campaign ad.

The FEC deadlocked again on this question in a matter involving American Crossroads (MUR 6357), as it did in a 2010 case involving the DCCC (MUR 5879). While the three Democratic Commissioners found "incidental" use of a candidate's material permissible, such as the use of a

small picture next to a description of a candidate's biography or views, they concluded that an outside group incorporating 10 to 15 seconds of footage from a candidate's ad in the group's 30 second commercial constituted republication of a candidate's campaign material.

The three Republican Commissioners adopted a more novel reading of the law. Consistent with their earlier votes in the *DCCC* matter, they see the question turning on whether the independent group's spending contained a message that is distinct from the message in the candidate's ad. Even when the campaign's footage appeared on the screen during between a third and a half of the duration of the independent expenditure, the Super PAC's addition of its own "text, graphic, audio, and narration" causes the ad to become the outside group's "own message," and consequently, outside the regulatory scope of the law. Statement of Reasons: Chair Caroline C. Hunter and Commissions Donald F. McGahn II and Matthew S. Petersen at 4. In these Commissioners' view, the fact that the outside group and the campaign ads touch on the same themes is not "materially significant" to the analysis. *Id*. The ad appears to need to be "close to a carbon copy" of the candidate's ad to run afoul of the law under this analysis. *Id*.

How do we know when an outside group, such as a Super PAC, has "coordinated" its independent expenditure ads with a candidate?

Coordination remains one of the most difficult "murky" areas of campaign finance law. The FEC made a significant effort to define it with precision in 2003, providing by regulation that a "public communication" was "coordinated" if it met a three-part test that included who paid for it, its content, and the conduct of the parties involved. 11 C.F.R. § 109.1 *et seq*. And in 2012, in a case involving the Super PAC Turn Right USA, (MUR 6477), the FEC unanimously concluded that the group had not "coordinated" its ads with the candidate it supported, in part because the content test in the agency's coordination rules does not include videos placed for free on the Internet.[8]

But this past year also saw the continuing of a 3-3 split among the FEC Commissioners over whether a group's ad that is not "coordinated" under the agency's three part test might still violate the law under a more general statutory standard of "coordination."

In an enforcement matter involving ads aired by the Nebraska Democratic State Central Committee (MUR 6502) that featured Senator/candidate Ben Nelson, the three Democratic Commissioners issued a Statement of Reasons that concluded the law permits the agency to find a "public communication" to be "coordinated" even if the communication fails to meet the three-part test in the agency's regulations. Statement of Reasons of Vice Chair Cynthia L. Bauerly and Commissioners Ellen L. Weintraub and Steven T. Walther. Rather, they would apply a two-step analysis, first assessing whether the ad met the FEC's regulatory test, and if not, then looking to the plain meaning of the statute to see if that text leads to a different result. For the NDSCC, the result was the same, for the Democratic Commissioners concluded that the ads were not "for the purpose of influencing" a federal election. The three Republican Commissioners and the FEC's Office of General Counsel continued to apply only the agency's regulations on "coordinated communications" in this case.

The three Democratic Commissioners reached a similar conclusion in late 2011 in an advisory opinion involving American Crossroads. FEC AO 2011-23. There, a Super PAC sought approval of its right to run ads that technically did not meet the FEC's three part test for "coordinated communications," but which in every other way, involved the greatest imaginable involvement of the candidates in the group's activities. Proving the adage that bad facts make bad law, two Democratic Commissioners concluded the regulations do "not forestall application of the statutory definition of "contribution" in a case such as this, where the [Super PAC] acknowledged that the ads would be

[8] A similar result was reached in MUR 6414 (Russ Carnahan in Congress Committee), where the Commission concluded that there was no reason to believe a violation of the law had occurred because the ad on a website did not satisfy the context standard of Commission's coordinated communication test.

"fully coordinated" and for the purpose of influencing federal elections." Statement on Advisory Opinion Request 2011-23 (American Crossroads): Chair Cynthia L. Bauerly and Commissioner Ellen L. Weintraub at 1.[9]

7. NO NEW RULEMAKING OR POLICIES

Continuing a trend, the FEC in 2012 made no substantive additions or amendments to Title 11 of the Code of Federal Regulations. It also issued no policy statements, interpretive rules, or other guidance during the past calendar year. There are, however, two pending items that at least present the potential for action in the new year.

The first arises out of the ongoing *Van Hollen v. FEC* litigation. Congressman Van Hollen brought suit to invalidate the regulation specifying that corporations or unions that fund electioneering communications must disclose donors who gave for the purpose of funding the electioneering communication, but otherwise were not obligated to disclose their funding sources. 11 C.F.R. § 104.20(c)(9). The district court agreed on the theory that that statute requires "every person" making an electioneering communication to either establish a segregated fund to pay for the communication and disclose the donors to that fund, or to disclose all donors to the organization. The D.C. Circuit reversed and instructed the district court to determine whether the FEC's regulation was a reasonable interpretation of an ambiguous law. The lawsuit has progressed no further since then. However, the FEC has accepted comments on a petition for rulemaking, filed by the intervenors in the lawsuit, to update section 104.20(c)(8) and (9) by clarifying that they apply equally to electioneering communications that contain the functional equivalent of express advocacy.

The second is a proposed rulemaking initiated by the FEC at the end of the year. The draft regulation would treat a limited liability partnership as a corporation or a partnership for purposes of campaign finance laws depending on how the LLP chose to be treated under the Internal Revenue Code. Previously, the FEC had determined that, in the absence of any regulations addressing LLPs, these entities should be treated as partnerships (as they are under state law), despite electing for corporate federal tax treatment. *See, e.g.*, FEC AO 2008-5 (Holland & Knight). The comment period on this notice of proposed rulemaking closes in February 2013.

8. THE PROSPECT OF THE RISE OF FRAUD

The growth of Super PACs and the use of social media for fundraising may make the problem of fraud more immediate. The FEC resolved one enforcement case this year, MUR 5951 (Californians for Change) involving an unauthorized committee that raised funds in President Obama's name and failed to include disclaimers on its fundraising website. The FEC assessed no civil penalty in light of the financial hardship of those involved. The agency also renewed its request for Congress to amend the statute to give it greater authority to pursue cases of fraud in campaign fundraising. *Legislative Recommendations of the Federal Election Commission 2012*, at 5.

The growth of Super PACs highlight the risk. Often, there is no legitimate campaign activity behind the name of the group. According to one press report, over 60% of all Super PACs raised no funds whatsoever in 2012, and over 90% raised less than $100,000.[10] While many of these groups may have been frivolous or mirthful efforts to repeat Steven Colbert's joke, some have deceptively appealing names: Alabama Republican Trust PAC; Committee for the Re-Election of the President; U.S. Senate Victory Fund; Suntrust Bank Customers Super PAC. Going forward, ubiquitous Internet

[9] Commissioner Walther had more longstanding objections to the agency's 2003 rulemaking. See, Statement of Commissioner Steven T. Walther

[10] David Levinthal, *The Un-Super PACs*, Politico, Nov. 26, 2012.

fundraising and the ability to text contributions may bring back into vogue that favorite maxim of first-year contracts law students: *caveat emptor*.

9. EMPLOYEES AND POLITICS

One important unresolved issue in the wake of *Citizens United* is how a corporation's right to engage in independent express advocacy on behalf of a candidate applies when the audience is the corporation's own employees. FECA and the FEC's regulations have long held a corporation can make express advocacy communications to members of its "restricted class" but not beyond.[11] Certainly, after *Citizens United*, that is not strictly the case. But in the case of employer-employee communications, there may also be a government interest in preventing coerced political activity, which would not generally be present in evaluating corporate speech. How does that impact the balancing of interests?

The one FEC decision on this question may provoke more questions than it answers. MUR 6344 (United Public Workers, AFSCME Local 646, AFL-CIO). In that case, a union's in-house lawyer alleged she and others were compelled as a condition of employment to support certain candidates by standing on street corners and waving signs bearing the candidate's name or participating in partisan phone banks. She refused and subsequently was discharged.

A divided FEC ultimately reached a conciliation agreement with the union, not for coercing the employee's participation, but for the union's failure to report the value of her services as an independent expenditure. The parties agreed to the union paying a civil penalty of $5,500 for this reporting violation. The three Republican Commissioners concluded that while "coercing" a contribution was illegal, Congress had not envisioned that an employer might use its paid workforce to campaign for a federal candidate, and consequently, had not regulated compelled participation in an independent expenditure. Statement of Reasons of Chair Caroline C. Hunter and Commissioners Donald F. McGahn II and Matthew S. Petersen at 2. The three Democratic Commissioners concluded that a more serious violation of the law had occurred, but lacking a fourth vote, voted to support the penalty for the reporting violation. Statement of Reasons of Vice Chair Ellen L. Weintraub and Commissioners Cynthia L. Bauerly and Steven T. Walther at 2-3.

The case begins the debate rather than ends it. Almost everyone would agree that an employer may make political activities part of some employee's work duties, to achieve the employer's lawful ends. An example might be requiring a bookkeeper to reconcile the PAC's financial records. But does that right extend to compelling attendance at a candidate's rally, or otherwise making what appears to be a personal expression of support a condition of continued employment? And does it matter if the employee is paid hourly, and thus directly compensated for that work, or salaried, and consequently, subject to a call on her or his time outside of the normal workday? Also, some state laws prohibit compelled political activity. Does FECA preempt these laws?

All of these questions remain, with little clarity for now from Congress, the courts, or the FEC. As companies look towards 2014, these questions will need to be asked, and answered.

10. THE LESSONS OF JOHN EDWARDS AND JOHN ENSIGN

People sometimes forget that the Department of Justice shares with the FEC the statutory power to enforce the federal campaign finance laws. In two notable instances this year, the Department exercised this authority. Both involved Senators, one former and one then sitting, and payments by

[11] Generally, a corporation's restricted class consists of its stockholders and their family members, and its executive and administrative personnel, and their family members.

third parties to the women involved in adulterous affairs with those men.[12] While the details of those cases were at times salacious and at times sordid, and the legal issues arcane, what remains unclear and important is what lessons the Department has learned from these cases and how it will apply them going forward.

The Department has long held that it will act when the violation of FECA crosses a monetary threshold and is committed with specific criminal intent. In addition, it should involve a situation where the application of the law to the facts is clear, the violation touches on one of the "heartland" provisions of the Act, and there is evidence that the violation was knowing and willful. Certainly for some, the notion that payments to the mistress of a politician fell into the realm of campaign finance law was a surprise.

There are those close to the Department of Justice and Public Integrity Section that detect an ongoing willingness to take cases beyond those alleging unambiguous violations of the core provisions of the Act, and perhaps even a sense at the Department that if the FEC is unlikely to enforce the law, the Justice Department must play a more vigorous role in doing so. Time will tell if these prosecutions reflect a trend, or simply the product of the facts and circumstances of those cases.

If you have any questions concerning the material discussed in this client alert, please contact the following members of our election and political law practice group:

Bob Lenhard	202.662.5940	rlenhard@cov.com
Robert Kelner	202.662.5503	rkelner@cov.com
Julius Chen	202.662.5139	jchen@cov.com

[12] Lawyers in Covington's Election and Political Law practice group were involved on behalf of defendants in both of these matters.