



FEDERAL ELECTION COMMISSION  
WASHINGTON, D.C. 20463

September 13, 2011

**MEMORANDUM**

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**FROM:** Christopher Hughey *pch*  
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**SUBJECT:** Interim Audit Report– California Republican Party/V8  
(LRA 829)

**I. INTRODUCTION**

The Office of the General Counsel has reviewed the proposed Interim Audit Report (“IAR”) on the California Republican Party/V8 (“Committee”).<sup>1</sup> Our comments address issues in Finding 3 (Extension of Credit by a Commercial Vendor). We concur with any findings not specifically discussed in this memorandum. If you have any questions, please contact Danita Lee, the attorney assigned to this audit.

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<sup>1</sup> We recommend 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 IAR. 11 C.F.R. §§ 2.4(a) and (b)(6).

## **II. EXTENSION OF CREDIT BY A COMMERCIAL VENDOR (Finding 3)**

Finding 3 addresses an extension of credit by Strategic Fundraising, Inc. (“SFI”), which the auditors conclude may have resulted in a prohibited contribution to the Committee. The proposed IAR concludes that SFI did not extend credit to the Committee in the ordinary course of business and that SFI failed to make a commercially reasonable effort to collect the debt. In these comments, we note that the contract between SFI and the Committee appears to present issues similar to those in other matters involving “no risk” or “limited risk” fundraising arrangements between direct mail or telemarketing vendors and political committees. *See, e.g.*, Memorandum From the Office of General Counsel to the Commission, Rightmarch Request for Early Consideration of Legal Question, March 14, 2011.

## **III. BACKGROUND**

The proposed IAR indicates that the Committee failed to pay several invoices for SDI voter/donor file prospecting, caging, fundraising and mailing services for periods ranging from approximately four months to two years. The invoices totaled \$1,171,002. The auditors contend that SFI failed to make a commercially reasonable effort to collect the debt because it did not submit weekly bills to the Committee or charge interest on the outstanding debt in accordance with the terms of the contract between SFI and the Committee. The Committee submitted a statement from SFI explaining that SFI reasonably attempted to collect the debt by negotiating a payment plan after the Committee was unable to pay for services consistent with the terms of the contract. The proposed Report notes that the Committee did not provide evidence of a negotiated payment plan and thus concludes that SFI did not engage in commercially reasonable efforts to collect the Committee’s debt. Neither the proposed Report nor the information the Committee submitted regarding its debt to SFI address whether SFI’s extension of credit was permissible. Therefore, we will discuss the standards the auditors should consider in their analysis of whether the extension of credit was permissible. We will then address whether SFI’s effort to collect the debt was commercially reasonable.

### **A. Initial Extension of Credit May Have Lacked Adequate Safeguards**

The terms of the contract between the Committee and SFI provide that SFI was to provide telephone fundraising services directed at both previous and prospective donors. The contract provided for weekly invoices. Prospecting invoices were to be payable upon receipt and invoices for proven donor efforts were to be payable within 30 days. The prospective donor fundraising included a “Break-Even Guarantee,” whereby the parties agreed that the Committee would not be expected to pay more for prospecting calls than the sum of all actual contributions generated by those calls. The Guarantee included a provision in which the parties acknowledged that SFI was “accepting significant business risk” by extending the Guarantee to the Committee and provided partial mitigation of the risk by granting to SFI the exclusive “right to conduct [the Committee’s telemarketing] programs over the course of an entire year.” The contract

also required the Committee to collect, deposit, and record all individual contributions generated by SFI and to provide SFI with regular reports “identifying all individuals who contributed to the Committee as a result of SFI’s efforts, along with the amount and date of each contribution.” The parties agreed that SFI would be paid for its prospecting services at “an amount equal to the gross receipts generated by each prospecting project.” The contract also indicated that if the “cumulative gross proceeds from all Prospecting campaigns performed in a calendar year exceeded the total of all prospecting calls . . . the positive difference [would] be credited to the Committee.” These terms raise a question of whether SFI’s extension of credit to the Committee was in the ordinary course of business.

The Act defines a contribution as “any gift, subscription, loan, advance, or deposit of money or anything of value made by any person for the purpose of influencing any election for Federal office.” 2 U.S.C. § 431(8)(A)(i). Commission regulations further provide that an extension of credit to a political committee by a commercial vendor is a contribution unless the credit is extended in the ordinary course of business and on the same terms as extensions of credit to non-political debtors of similar risk and for an obligation of similar size. 11 C.F.R. §§ 100.55, 116.3(b). In determining whether an extension of credit was in the ordinary course of business, the Commission considers whether the vendor followed established procedures and past practices, whether the vendor received prompt payment in full for previous extensions of credit, and whether the extension of credit conformed to the usual and normal practice in the industry. 11 C.F.R. § 116.3(c). If a vendor extends credit and fails to make a commercially reasonable attempt to obtain repayment, a contribution will result. 11 C.F.R. §§ 100.55, 116.4(b)(2).

The Commission has addressed “no risk” or “limited risk” fundraising agreements like the one at issue here in enforcement matters and advisory opinions throughout the years. In at least one enforcement matter and in two advisory opinions the Commission has applied 11 C.F.R. §§ 100.55 and 116.3 (or their regulatory predecessors) to determine whether such arrangements were extensions of credit that resulted in in-kind contributions. *See, e.g.,* MUR 5635 (Conservative Leadership PAC) (addressing a “no risk” fundraising contract where the committee was not responsible for the costs of fundraising in excess of the money raised); AO 1991-18 (New York State Democratic Committee) (addressing a “limited risk” fundraising contract where the committee’s full payment of the vendor’s commissions was tied to the prospect that the fundraising would pay for itself over several years); AO 1979-36 (Committee for Fauntroy) (addressing a “limited risk” fundraising contract where the committee was only required to pay three-fourths of the total amount of contributions received irrespective of the actual amount of fees and expenses).<sup>2</sup> In these matters, the Commission has required committees to have

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<sup>2</sup> The Commission also has addressed contracts and dealings in contexts other than fundraising in which committees assumed no risk or limited risk. *See, e.g.,* MURs 5069 and 5132 (Comite Acevedo Vila Comisionado 2000) (determining that no contribution resulted when a Puerto Rico advertising agency bought television time on behalf of a candidate without first receiving payment based on evidence of common industry practice in Puerto Rico); MUR 4742 (Juan Vargas for Congress) (finding a reportable extension of credit, but no contribution, resulting from a “deferred compensation” contract with a

safeguards in place to ensure that committees in fact pay for all of the costs of the fundraising programs. See MUR 5635 (Conservative Leadership PAC); AO 1991-18 (New York State Democratic Committee); AO 1979-36 (Committee for Fauntroy). Specifically, the Commission has focused on whether a committee would receive anything of value without timely and proper compensation first being paid to the fundraising firm and any third-party vendors. See *id.* Safeguards proposed by the Commission have included requiring advance deposits by a committee to reimburse vendors for potential shortfalls, limiting the term of the contract, or allowing vendors to terminate the contract early and demand full payment as a result of poor fundraising performance. See *id.* More recently, however, in the Commission's audit of the Rightmarch committee, which presented similar issues, the Commission considered a memorandum from the committee requesting legal guidance, but was unable to provide guidance by the necessary four votes. See Memorandum From the Office of General Counsel to the Commission, Rightmarch Request for Early Consideration of Legal Question, March 14, 2011.

The "Break Even Guarantee" in the contract between the Committee and SFI appears very similar to the type of "no-risk" or "limited-risk" provisions that the Commission has found in previous matters could constitute in-kind contributions in the absence of safeguards ensuring that the Committee would pay for all of the costs of the fundraising programs and that the vendor would bear all of the financial risk of programs not paying for themselves. Moreover, in an arrangement not seen before in the prior cases, the vendor, SFI, does not even do the "caging" of contributions resulting from the fundraising activity. Contributions were to be sent directly to the Committee, which was supposed to deposit them in its own account and then pay the invoiced amounts to SFI. This provision, in combination with the "Break Even Guarantee," raises questions as to whether the arrangement between the Committee and SFI was one in which "the committee retain[ed] contribution proceeds while giving up little, or assum[ing] little to no risk with the vendor bearing all, or nearly all the risk." See AO 1991-18 (New York State Democratic Party).

On the other hand, while the contract provided that the Committee would not have to bear any risk that prospecting calls would not generate contributions sufficient to cover SFI's costs in making them, the contract also contains a provision purporting to grant SFI, in consideration of that risk, an exclusive one-year right to conduct all telemarketing programs for the Committee. This raises a question regarding whether the exclusivity clause provided sufficient financial value to SFI such that it negated SFI's assumption of the risk that it would lose money on the prospecting calls. However, absent additional information showing that the value of the exclusivity clause was comparable to SFI's financial risk or information showing that "no-risk" or "limited-risk" agreements such as the Guarantee between the Committee and SFI conform to the usual and normal practice in the telemarketing industry, we conclude that SFI did not extend credit to the

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candidate's general consultant where the consultant's retainer was only to be paid if the vendor and the committee agreed that the committee could afford to pay it without harm to campaign's viability).

Committee in the ordinary course of business. We recommend that the auditors revise the proposed Report to fully address and analyze whether the SFI's extension of credit was permissible. We also recommend that the auditors give the Committee an opportunity to submit information regarding the value of the exclusivity clause and usual and normal practices within the telemarketing industry to show that it extended credit to the Committee in the ordinary course of business.

#### **B. Committee May Not have Undertaken Commercially Reasonable Debt Collection or Settlement Efforts**

Even where an extension of credit by a commercial vendor is legally permissible when made, it may ripen into a contribution over time through a lack of commercially reasonable attempts on the part of the vendor to collect the resulting debt. The Commission determines that these attempts are commercially reasonable if the vendor has pursued its remedies as vigorously as it would pursue its remedies against a non-political debtor in similar circumstances. 11 C.F.R. § 116.4(d)(3). The proposed report indicates that far from meeting this standard, there is no indication that SFI even billed the Committee according to the terms of the contract, much less that it made oral or written requests for payment beyond the initial invoices, withheld additional services from the Committee, imposed additional charges or penalties for late payment, referred the overdue debt to a commercial debt collection service or pursued litigation. 11 C.F.R. § 116.4(d)(3).

However, the letter that SFI submitted to the Audit Division provides some insight into actions that SFI may have taken to collect the Committee's debt. SFI's letter acknowledges that the Committee "maintained substantial accounts receivable." The letter also suggests that SFI may have renegotiated the payment terms of the original contract to ensure that it would be paid. In particular, the letter states that SFI "worked with [the Committee] in its mutual interests by allowing flexible payment plans." Although not explicitly stated, we believe that SFI presents the fact that it renegotiated the original contract terms as evidence that it made a commercially reasonable effort to collect from the Committee. The Commission determines whether settlement or renegotiation of a debt with an ongoing committee is or is not a contribution by the same standard of commercial reasonableness described above.

Notably, though, SFI indicates that its renegotiation was consistent with its treatment of political rather than nonpolitical clients; the regulatory standard is nonpolitical clients. See 11 C.F.R. § 116.4(d)(3). More significantly, however, neither the letter nor any other information provided by SFI contain any detailed information about the renegotiated terms of the extension of credit. Absent this information, there is no indication that SFI acted with commercial reasonableness. Thus, we concur with the proposed IAR that SFI did not undertake commercially reasonable efforts to collect the debt. The Committee should be given the opportunity in response to the IAR to provide details about the renegotiated terms of its debt to SFI and whether those terms are

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**consistent with SFI's treatment of nonpolitical debtors of similar size and risk of obligation.**