UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

Representative Christopher Shays and Representative Martin Meehan, Plaintiffs, v. Federal Election Commission, Defendant.	)	Civil Action No. 04-1597 (EGS)

PLAINTIFFS' MEMORANDUM IN SUPPORT OF MOTION FOR FURTHER RELIEF

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PROCEDURAL STATUS AND REQUEST FOR FURTHER RELIEF

Plaintiffs Shays and Meehan respectfully submit this memorandum in support of their Motion for Further Relief, which requests the Court to order Defendant Federal Election Commission ("FEC") to issue an appropriate regulation focused on when 527 groups must register as "political committees" under the Federal Election Campaign Act ("FECA"). On April 29, 2005, Plaintiffs filed a motion for summary judgment, which argued that the FEC's failure to issue a rule concerning section 527 groups was arbitrary and capricious and contrary to law, and accordingly in violation of the Administrative Procedure Act ("APA"), 5 U.S.C. § 706(2)(A). In its Memorandum Opinion dated March 29, 2006, 424 F. Supp. 2d 100 (D.D.C. 2006), this Court granted Plaintiffs' motion on the ground that the FEC's November 23, 2004 "Explanation and Justification" ("E&J I") had failed to provide a reasoned explanation of the FEC's decision favoring *ad hoc* adjudication over rulemaking to address the rampant section 527 soft money abuses reflected in the record. 424 F. Supp. 2d at 115-16. The Court ordered the FEC either to promulgate a rule or to provide a new E&J that answered questions posed by the Court and that otherwise satisfied the APA. *Id.* at 117.

The FEC, after ten months, issued a Supplemental Explanation and Justification on February 2, 2007, 72 Fed. Reg. 5595 ("E&J II") (Ex. 26).[1] E&J II fails to pass APA muster for two principal reasons: first, as reflected in the FEC's failure to address specific deficiencies identified by the Court in E&J I, E&J II (like its predecessor) fails to provide a reasoned explanation for the asserted superiority of combating section 527 soft money abuses through sporadic *ad hoc* adjudications rather than by promulgating a rule (*see* Argument Point I, below); second, the FEC's conclusion in E&J II that a rule is inadvisable is fatally premised on a misinterpretation of the FECA and is thus "not in accordance with law" under the APA (*see* Argument Point II, below).

For these reasons, we respectfully urge the Court to conclude that the FEC is still in violation of the APA and that Plaintiffs are entitled to further relief. Because the FEC has now had two opportunities to provide a reasoned explanation and has failed to do so, and because there is an urgent public need for effective regulatory action to curb soft money abuses in the 2008 election and beyond, Plaintiffs further urge the Court to order the FEC to issue an appropriate regulation focused on 527 groups no later than 90 days after issuance of the Court's order.

BACKGROUND

A. Early reports of 527 soft money spending. In late 2003, press reports indicated that political operatives were organizing groups formed under section 527 of the tax code, 26 U.S.C. § 527, as vehicles to raise and spend tens of millions of dollars of soft money for television ad campaigns and other political activities designed to influence the 2004 presidential election.

[1] Exhibits not previously attached to Plaintiffs' April 29, 2005 Motion for Summary Judgment are numbered sequentially from these previous exhibits, and attached to the Declaration of Roger M. Witten, submitted herewith.

Although formed as "political organizations" under the tax code, these groups were claiming a right to avoid registration as "political committees" under the FECA, and thus to operate outside the FECA framework of federal contribution limits, source prohibitions, and disclosure requirements that apply to spending by political committees to influence federal elections.[2]

In January 2004, three reform organizations filed the first of several administrative complaints with the FEC, alleging that certain 527 groups, including America Coming Together ("ACT") and The Media Fund, "are attempting to replace the political parties as new conduits for injecting soft money into federal campaigns."[3] The complaint cited multiple press reports indicating that the respondent 527 groups "have either committed or are 'about to commit' massive violations of the law by spending millions, or tens of millions, of dollars of soft money . . . to influence the 2004 presidential and congressional elections." *Id.* ¶ 10.

B. The rulemaking begins. In early 2004, the Commission initiated an "expedited" rulemaking to address when a group must register as a political committee. In March 2004, the Commission published a Notice of Proposed Rulemaking ("NPRM"). *See* Political Committee Status, 69 Fed. Reg. 11,736 (March 11, 2004) (A.R. 11).[4] Instead of focusing on the urgent problem before it -- when section 527 "political organizations" must register as political committees if they spend money to influence federal elections -- the NPRM considered rules for

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[2] A "political committee" is any group that has a "major purpose" to influence elections, *see Buckley v. Valeo,* 424 U.S. 1, 79 (1976), and meets a statutory test of making "expenditures" or receiving "contributions" in excess of $1,000 in a year, 2 U.S.C. § 431(4). *See* Argument Point II, *infra*. In its earlier opinion in this case, the Court canvassed the relationship between "political organizations" under section 527 of the Internal Revenue Code, 26 U.S.C. § 527(e), and "political committees" under the FECA. 424 F. Supp. 2d at 105-06. This law is also discussed in Plaintiffs' April 29, 2005 Memorandum in Support of Summary Judgment, at 2-5 and 26-29.

[3] Complaint, *Democracy 21 et al. v. America Coming Together et al.* (FEC Jan. 15, 2004) (MUR 5403) (Ex. 22) ¶3.

[4] "A.R." refers to the document number in the Administrative Record filed by the Commission in this case on April 29, 2005.

when *any* organization, including section 501(c)(3) and (c)(4) non-profit groups, might become political committees.

Three reform groups sent a prescient warning to the FEC:

> The Notice of Proposed Rulemaking adopted by the Commission is so lengthy, addresses so many issues, raises so many questions and proposes so many new rules that the Commission is unlikely to be able to conclude this matter by its mid-May deadline and promulgate new rules for the 2004 general elections. . . .
>
> A failure by the FEC to focus its rulemaking effort on the issues critical for the 2004 elections is likely to result in agency gridlock and inaction. This would leave the Commission in the position, once again, of subverting the federal campaign finance laws, as the Supreme Court in *McConnell* stated the Commission had done with regard to soft money . . . .[5]

The commenters reiterated that "the problem posed in *this* campaign, and which needs to be resolved in a way that is effective to meet the challenge of *this* election cycle, is how these rules apply in the specific context of section 527 groups that are conducting ad campaigns promoting and attacking federal candidates with soft money." *Id.* at 3.

Not surprisingly, the overly broad NPRM elicited a tidal wave of opposition, almost entirely from the non-profit community which opposed more restrictive application of the campaign finance laws to section 501(c)(3) and (c)(4) groups. Only a handful of comments actually addressed whether *section 527 groups* must register as political committees when they spend large sums of money to influence federal elections.

C. The rulemaking is postponed. In May 2004, Commissioners Thomas and Toner proposed a rule tailored to address the status of section 527 groups. FEC Agenda Doc. 04-44 (A.R. 341) (Ex. 10). It provided that any group organized under section 527 as a "political organization" -- *i.e.*, a group "organized and operated primarily for the purpose" of influencing

[5] Comment of Democracy 21, Campaign Legal Center, and Center for Responsive Politics to NPRM, Mar. 16, 2004 (A.R.13) (Ex. 27) at 2.

the selection of candidates for public office, 26 U.S.C. § 527(e) -- be deemed to meet the "major purpose" test for political committee status, unless it falls within one of several specific exemptions where the group's purpose is to influence the election of non-federal officials or the selection of non-elected officials. FEC Agenda Doc. 04-44 (A.R. 341) (Ex. 10) at 2-3 (proposed § 100.5(a)(2)). The proposed rule neatly used section 527 status as a proxy for meeting the "major purpose" prong of the political committee test, but carefully guarded against potential overbreadth by exempting certain groups. The FEC's General Counsel observed that the Toner-Thomas proposal has:

> . . . the virtue of taking an incremental approach to the issue, conferring political committee status on organizations that have made a statement of avowed purpose through the formal act of seeking 527 status under the Internal Revenue Code. Also, there appears to be substantial congruence between, on the one hand, organizations that under section 527 are "organized and operated primarily for the purpose of" influencing nominations or elections [to office], and on the other hand, groups "the major purpose of which is the nomination or election of a candidate." *Buckley*, 424 U.S. at 79. The exceptions in the Toner/Thomas proposal are crafted to exclude such 527 organizations as those focused on purely state-level activity or the election or selection of judges or other non-elected officials. The proposal seeks to defer some of the more controversial proposals in the NPRM, and is intended to leave organizations other than 527 groups in no different position than they are today under applicable law.

FEC Agenda Doc. 04-48 (A.R. 343) (Ex. 9) at 8-9.

Nonetheless, the Commission rejected the proposal by a vote of 2-4, FEC Agenda Doc. 04-51 (A.R. 351) (Ex. 28) at 5 (minutes), and decided to do nothing other than defer for 90 days a decision on the rulemaking, *id.* at 7. This vote to postpone was widely recognized as signaling that the Commission was abandoning any effort to interpose a timely rule to staunch the flow of soft money through section 527 groups into the 2004 election. A joint press release from the Republican National Committee Chair and the Bush-Cheney campaign called the postponement

a "green light" for 527 groups "to forge full steam ahead in their efforts to affect the outcome of this year's Federal elections, and, in particular, the presidential race."[6]

D. Soft money spending by 527 groups continues unabated in 2004. During this period in mid-2004, activity by section 527 groups to influence the ongoing presidential campaign was accelerating. In June 2004, reform groups filed a second complaint against ACT, stating new counts that ACT was impermissibly spending soft money to influence the presidential campaign.[7] In July, the same reform groups filed an FEC complaint against Progress for America Voting Fund ("PFA-VF"), a section 527 group "which has spent, or is planning to spend, millions of dollars [of soft money] for the announced purpose of influencing the 2004 federal elections."[8] The complaint quoted a press report stating that PFA-VF "seeks to 'become the main conduit for soft money contributions from GOP donors.'" *Id.* ¶8. In August, the reform groups filed a complaint against Swift Boat Veterans for Truth, quoting a press release stating that this section 527 group was "formed in order to bring the truth about [John] Kerry to the American people."[9] It had begun spending soft money to air television ads in battleground states (such as Ohio) "'as part of a multimedia effort to discredit Kerry's wartime record . . . .'" *Id.* ¶11 (quoting press report).

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[6] Peter H. Stone, *Republican 527s: Full Steam Ahead*, NAT'L J., May 29, 2004, at 2 (Ex. D to Complaint, *Democracy 21 v. Progress for America Voter Fund*) (FEC Jul. 20, 2004) (MUR 5487)) (Ex. 14).

[7] Complaint, *Democracy 21 et al. v. America Coming Together* (FEC June 22, 2004) (Ex. 29).

[8] Complaint at ¶4, *Democracy 21 et al. v. Progress for America Voter Fund* (FEC July 20, 2004) (MUR 5487) (Ex. 14).

[9] Complaint, *Democracy 21 v. Swift Boat Veterans for Truth* (FEC Aug. 10, 2004) (MUR 5511) (Ex. 23) ¶10.

Ultimately, section 527 groups raised more than $405 million in soft money and spent more than $398 million in the 2004 campaign.[10] Just 25 individual donors gave a total of $142 million in contributions to 527 groups, which was more than half of all money raised by 527 groups from individuals. *Id.* One donor, George Soros, gave $24 million to 527 groups; another, Peter Lewis, gave $22.5 million. In total, 52 individual donors each gave $1 million or more to 527 groups, and 265 gave $100,000 or more. *Id.*

E. The FEC's decision not to adopt a rule. In August 2004, the FEC's General Counsel proposed a rule using a "major purpose" test that would be applicable to all groups, based on an analysis of the group's receipts, disbursements, and public statements, along with an "additional rule for 527 organizations" that -- like the Toner-Thomas proposal -- relied on the group's tax status under section 527 as an indicator of its "major purpose" to influence elections. FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) (proposed § 100.5(a)(1)(ii)). The General Counsel described the important advantages of adopting a rule:

> First, the draft Final Rules are intended to *give clear guidance* to persons engaged in political activity *so that they will know with a high degree of certainty* whether their activities are subject to Commission regulation.

Id. at 2 (emphasis added). With regard to 527 groups, the General Counsel said:

> This Office believes that *it is advisable to clarify when 527 organizations are required to register as political committees* for two reasons. First, because all existing nonconnected political committees are 527 organizations, focusing on these organizations ensures that this rulemaking will have a predictable effect on existing organizations and will not cause committees that currently register and report to the Commission as political committees to cease doing so. . . . *Second, an organization's decision to avail itself of 527 status is inherently indicative of its choice to engage principally in electoral activity*.

[10] *See* discussion at page 6 of Plaintiff's Memorandum in Support of Motion for Summary Judgment, citing Exs. 3, 4, and 5.

Id. at 14 (emphasis added).

At the August FEC meeting, Commissioners Thomas and Toner re-submitted their proposal, FEC Agenda Doc. 04-75-A (A.R. 355) (Ex. 12). The Commission again rejected it by a vote of 2-4, FEC Agenda Doc. 04-77 (A.R. 366) (Ex. 30) at 9, and then rejected the General Counsel's proposal, also by a vote of 2-4. *Id.* The Commission adopted two collateral rules that were part of the General Counsel's overall proposal -- one dealing with a definition of the term "contribution," *see* 11 C.F.R. § 100.57, and one dealing with allocation of spending by groups that already are political committees, *see* 11 C.F.R. § 106.6, but neither addressed the core problem presented by 527 groups. FEC Agenda Doc. 04-77 (A.R. 366) (Ex. 30) at 9. In October 2004, the Commission issued E&J I. 69 Fed. Reg. 68056 (Nov. 23, 2004) (A.R. 375).

F. Spending by 527 groups continues unabated in the 2006 election. Soft money spending by section 527 groups resumed unabated in the 2006 congressional races. According to one compilation, 527 group spending in the 2006 cycle totaled over $200 million.[11] In October 2006, reform groups filed two additional complaints with the Commission, against four section 527 groups engaged in soft money campaign spending to influence the 2006 elections.[12] One of the complaints noted that the Economic Freedom Fund, a 527 group, received $5 million from a single donor, Bob Perry (who, in 2004, had given $4.45 million to Swift Boat Veterans for Truth and $3 million to PFA-VF), and was spending those funds for television ads and direct mail to

[11] *See* Center for Responsive Politics, *An OpenSecrets Investigation: Advocacy Group Spending in the 2006 Elections*, available at http://www.opensecrets.org/527s/index.asp (Ex. 31). This amount, over $200 million, reflects that there was no presidential election that year, compared to the over $400 million raised in 2004.

[12] Complaint, *Democracy 21 et al. v. Economic Freedom Fund and Majority Action* (FEC Oct. 12, 2006) ("Economic Freedom Fund Complaint") (Ex. 32); Complaint, *Democracy 21 et al v. The Lantern Project and Softer Voices* (FEC Oct. 19, 2006) (Ex. 33).

influence selected congressional elections. Economic Freedom Fund Complaint, Ex. 32 ¶¶ 11-12, 14.

G. This Court's Memorandum Opinion. The Court held that E&J I violated the APA because of the Commission's "failure to provide a reasoned explanation" for its "refus[al] to promulgate a rule in favor of its purported preference for piecemeal adjudications . . . ." 424 F. Supp. 2d at 116. Relevantly to this stage of the proceeding, the Court identified several critical questions that E&J I had failed to address, including: (1) why case-by-case adjudication is an effective means of enforcement, (2) why case-by-case enforcement without a baseline rule is less complicated and more effective than enforcement based on a rule, and (3) whether case-by-case enforcement in the absence of a rule can provide adequate guidance to 527 groups. *Id.* at 115-16.

H. E&J II. On February 7, 2007, the FEC issued E&J II in purported compliance with the Court's Memorandum Opinion. E&J II begins by setting forth the FEC's underlying statutory analysis, which is a critical (but erroneous, *see* Argument Point II) premise for the FEC's decision not to promulgate a 527 rule. 72 Fed. Reg. at 5596-97, 5603-05 (Ex. 26). E&J II posits that, under the FECA, as construed by the Supreme Court in *Buckley v. Valeo*, 424 U.S. 1 (1976), and *McConnell v. FEC*, 540 U.S. 93 (2003), it must first determine whether an organization has engaged in "expenditures" that qualify as "express advocacy," or received contributions for the purpose of supporting federal candidates; that only if those criteria are met does it then consider whether the organization's "major purpose" is the nomination or election of a federal candidate; that these findings require a fact-specific analysis; and, therefore, that a rule that focuses on whether a group's 527 status indicates that its major purpose is the nomination or election of a federal candidate would not facilitate enforcement of the FECA as applied to soft money abuses by 527 organizations. *Id.*

Further, E&J II argues that section 527 status under IRS criteria does not equate to political committee status under the FECA, *id.* at 5597-99 (Plaintiffs have never argued that section 527 status by itself equates to political committee status). E&J II then argues that FEC determinations as to whether a 527 organization qualifies as a political committee requires case-by-case analysis "that is incompatible with a one-size-fits-all rule," *id.* at 5601 (Plaintiffs have never argued that a 527 rule would eliminate the need for some case-by-case analysis in individual enforcement cases brought pursuant to the rule). E&J II also contends that a rule would not remedy "any perceived shortcomings with the enforcement process identified by" this Court, *id.* at 5602 (the FEC thus seems to ignore the Court's finding of a "patent inadequacy" in the case-by-case approach, 424 F. Supp. 2d at 116). E&J II goes on to posit that the contribution and allocation rules the FEC promulgated in 2004 adequately alleviated 527 abuses, *id.* at 5602-03 (E&J II does not attempt to square this assertion with the voluminous evidence of 527 soft money spent during the 2004 and 2006 elections after the issuance of these two rules, *see* pp. 5-7 of Plaintiffs' Memorandum in Support of Summary Judgment, and *infra* at Argument Point 1, Part F). Finally, E&J II contends that the regulated community can glean sufficient guidance from a handful of highly fact-specific case settlements and other materials. *Id.* at 5603-06.

APPLICABLE LEGAL STANDARDS

As before, the Court must determine whether the FEC's decision is "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law." 5 U.S.C. § 706(2)(A); *see, e.g., Massachusetts v. EPA*, No. 05-1120, slip op. at 25, 32 (U.S. April 2, 2007) (Ex. 53) (finding that an agency's refusal to promulgate a rule is "susceptible to judicial review" and that the EPA had "offered no reasoned explanation" for denying a petition seeking regulation of greenhouse gases); *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 294 (1974) (holding that an agency's

decision to choose either rule-making or case-by-case adjudication is subject to reversal where the agency committed an "abuse of discretion or a violation of [law]."); *see also* pp. 25-26 of Plaintiffs' Memorandum in Support of Summary Judgment, and pp. 6-7 and 12-13 of Plaintiffs' Reply Memorandum in Support of Summary Judgment.

ARGUMENT

I. E&J II Does Not Provide a Reasoned Explanation for the Commission's Failure To Promulgate a Baseline 527 Rule.

E&J II fails to provide a reasoned explanation for the FEC's decision not to issue a rule focused on 527 organizations that would stem the rampant soft money abuses associated with those organizations that plagued the 2004 and 2006 elections -- and, in the absence of prompt and effective FEC action, will do so again in 2008 and beyond. Notably, E&J II fails to answer the very questions that led the Court to hold that E&J I was arbitrary and capricious -- most fundamentally, how a purported program of *ad hoc* enforcement will be more effective than promulgation of a rule. Moreover, the reasons the FEC does advance are illogical, unsupported in fact and experience, and otherwise unpersuasive.

A. The Commission Has Failed To Explain How, in the Absence of a Rule, Case-by-Case Adjudication Can Be an Effective Means of Enforcement at All.

It its Memorandum Opinion, the Court criticized E&J I for its failure to explain how case-by-case adjudication can be an effective means of enforcing federal campaign finance laws vis-à-vis 527 organizations in the absence of a baseline rule:

> The FEC also did not explain how piecemeal adjudication could be executed on a sufficiently timely basis to be effective. The FEC's track record indicates the opposite is true. Cases arising from the 2004 campaign have languished on the Commission's enforcement docket for as long as 23 months, with no end in sight, even as the 2006 election campaign has begun. Indeed, the Commission itself emphasizes that it has no legal obligation to bring a case to the close in an election cycle. *This merely demonstrates the patent*

> *inadequacy of the case-by-case approach*. The FEC can take years to complete an administrative action, and penalties, if they come at all, come long after the money has been spent and the election decided.

424 F. Supp. 2d at 116 (citation omitted) (emphasis added). The Court also observed that "judging from [the] FEC's track record in the 2004 election, case-by-case adjudication appears to have been a total failure." *Id.* at 115.

Despite this clear invitation to explain how "piecemeal adjudication could be executed on a sufficiently timely basis to be effective," E&J II does not address this aspect of the Court's criticism of the case-by-case approach. Nothing in E&J II factually supports a conclusion that the Commission can enforce the law vis-à-vis 527 organizations in a remotely timely manner -- for example, within an election cycle -- without first promulgating a prophylactic 527 rule. E&J II neither defends the timeliness of the Commission's enforcement actions (nor could it), nor explains how case-by-case enforcement -- which occurs, as the Court correctly observed, years after the relevant election is over -- can sufficiently deter 527 groups that seek to spend soft money to influence federal elections. Nor does E&J II dispute that the Commission's statutorily mandated enforcement procedures make expeditious action in relevant electoral time-frames virtually impossible.[13]

The point is illustrated by the *Club for Growth* case, cited by the Commission in E&J II, 72 Fed. Reg. at 5605 (Ex. 26), as an example of the success of its case-by-case approach. In that case, the Commission is still seeking remedies for the Club's failure to register as a political

[13] *See* discussion of the FEC's enforcement procedures at pp. 10-11 of Plaintiffs' Reply Memorandum in Support of Summary Judgment.

committee several elections ago in *2000*.[14] The Commission did not even file suit until 2005, and the case is still pending. *FEC v. Club for Growth*, Civ. No. 1-05-cv-01851 (RMU) (D.D.C.).

E&J II points to two recent settlements in cases brought against 527 groups that spent money to influence the elections two cycles ago in *2004*, 72 Fed. Reg. at 5603-06. In the 2004 election, these 527 groups -- without registering as political committees in the wake of the Commission's aborted rulemaking -- illegally spent tens of millions of dollars to influence the presidential election by paying for ads that might well have had a determinative impact on the election. The FEC's reliance on the proposition that a few "too little, too late" settlements prove the efficacy of an *ad hoc* enforcement program founders for several reasons.

First, E&J II has not shown that the belated settlement of these cases will deter 527 groups set on spending unlimited soft money to influence federal elections in 2008, or beyond. Certainly no fact in the record or cited in E&J II supports that conclusion. Indeed, experience suggests just the opposite. Given the stakes in a presidential campaign, the possibility that 527 groups may have to settle a complaint years later might well strike those groups as an acceptable cost of doing business.

Second, the asserted deterrent effect of these few settlements is particularly dubious in light of the fact that the Commission has still taken no public action on complaints filed in January 2004 against two other 527 groups that together spent more than $100 million in the *2004* race -- ACT and The Media Fund[15] -- and also has failed to take public action against *any*

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[14] *See, e.g.,* Complaint at ¶ 44, *FEC v. Club for Growth, Inc.*, Civ. No. 1-05-cv-01851 (D.D.C.) (Ex. 34) ("Beginning no later than 2000, the Club violated 2 U.S.C. 433 by failing to register with the Commission as a political committee.").

[15] *See* Complaint, *Democracy 21 v. America Coming Together et al.* (FEC Jan. 2004) (MUR 5403) (Ex. 22); *see also* Complaint, *Bush-Cheney '04 v. The Media Fund, Inc*. (FEC Mar. 10, 2004) (Ex. 17); Complaint, *Bush-Cheney '04 v. The Media Fund, Inc.* (FEC Mar. 31, 2004) (Ex. 18). Plaintiffs also

of the 527 groups that raised and spent tens of millions of dollars of soft money in the 2006 federal elections.[16] Indeed, when the Commission announced in May 2006, in response to this Court's Memorandum Opinion, that it would issue a new E&J instead of a new rule, 527 groups took that announcement as a sign that they were free to continue their soft money practices for the 2006 election.[17] Contrary to the FEC's argument, its announcement that it would eschew a rule in favor of *ad hoc* adjudication encouraged more 527 activity and had no discernible deterrent effect at all.

Finally, E&J II fails to discuss why compliance would not be significantly enhanced by promulgation of a baseline "major purpose" rule that makes clear when 527 groups should register as political committees. As recognized by this Court in its Memorandum Opinion, "'[r]ulemaking is an essential component of the administrative process and indeed is often the preferred procedure for the evolution of agency policies. Rulemaking permits more precise definition of statutory standards than would otherwise arise through protracted, piecemeal litigation of particular issues.'" 424 F. Supp. 2d at 114 (*quoting Trans-Pac. Freight Conference*

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discussed the election-related activities of these groups in their Memorandum in Support of Summary Judgment at pp. 43-44.

[16] *See, e.g.*, Complaint, *Democracy 21 et al. v. Economic Freedom Fund et al.* (FEC Oct. 12, 2006) (Ex. 32) (alleging soft-money abuses by two 527 groups); Complaint, *Democracy 21 et al. v. The Lantern Project et al.* (FEC Oct. 19, 2006) (Ex. 33) (same).

[17] *See, e.g.*, Kate Ackley & Matt Reynolds, *527 Groups Mostly Breathe Sigh of Relief,* ROLL CALL, June 5, 2006 (Ex. 35) ("Now that the Federal Election Commission last week opted not to take its rules on 527 political groups back to the drawing table, most of these groups are expressing satisfaction with the decision. And, some say, they can move ahead with activities without fear of having the FEC rules change on them as the 2006 election approaches."); Kenneth Doyle, *Soros, Lewis Contributing Again to 527 Groups Favoring Democrats*, BNA MONEY & POLITICS REPORT, July 17, 2006 (Ex. 36) ("George Soros and Peter Lewis, the biggest contributors to Democratic-leaning political organizations in the 2004 election campaign, have begun to move money into so-called Section 527 groups again, gearing up for the 2006 congressional elections by contributing more than $2 million so far this year. . . . The new contributions provide concrete evidence that the nonparty groups could continue to get substantial funding in this year's campaign despite the controversy over their past activities and proposals to limit their activities debated in Congress and the Federal Election Commission.").

of Japan/Korea v. Fed. Mar. Comm'n, 650 F.2d 1235, 1244-45 (D.C. Cir. 1980)); *see also Am. Airlines, Inc. v. CAB*, 359 F.2d 624, 629 (D.C. Cir. 1966) ("[R]ule making is a vital part of the administrative process, particularly adapted to and needful for sound evolution of policy in guiding the future development of industries subject to intensive administrative regulation in the public interest."). Indeed, rulemaking clarifies the line between allowable and impermissible conduct:

> Although courts have not generally balked at allowing administrative agencies to apply a rule newly fashioned in an adjudicative proceeding to past conduct, a decision branding as "unfair" conduct stamped "fair" at the time a party acted, raises judicial hackles. . . . And the hackles bristle still more *when a financial penalty is assessed for action that might well have been avoided if the agency's changed disposition had been earlier made known or might even have been taken in express reliance on the standard previously established.*

NLRB v. Majestic Weaving Co., 355 F.2d 854, 860 (2d Cir. 1966) (emphasis added).

A rule would undoubtedly provide greater clarity for 527 groups than now exists, and such clarity in itself should promote voluntary compliance just as the FEC's General Counsel said it would in 2004. *See* FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 2 (a rule will "give clear guidance" so groups "will know with a high degree of certainty" whether they are regulated). And the existence of a clear and explicit rule should provide a further deterrent by laying a foundation for the FEC to pursue a "knowing and willful" -- and therefore criminal -- violation of the statute. 2 U.S.C. § 437g(d). E&J II does not address why a rule would not in this manner serve these important law enforcement purposes, even if the FEC is right that promulgation of a rule would not speed completion of individual enforcement actions.

The Court's Memorandum Opinion relatedly identified as a shortcoming in the E&J I its failure to "discuss whether First Amendment or due process concerns might impair its ability to

bring enforcement actions against 527 groups in the absence of a regulation providing clear guidance as to when those groups must register as a political committee." 424 F. Supp. 2d at 115. Surprisingly, E&J II offers no response to the Court's observation.

The potential problem, however, is illustrated by the *Club for Growth* case that the Court cited. 424 F. Supp. 2d at 116 (*citing FEC v. Club for Growth,* Civ. No. 1:05-cv-01851-RMU (D.D.C.)). There, the Commission brought an enforcement action against the Club for Growth, a 527 group, for failing to register as a political committee. In its answer to the FEC's complaint, Club for Growth specifically asserted that "the FEC has refused to provide concrete guidance [about political committee status] and, indeed, recently abandoned a rulemaking on the subject, declaring it would work out the meaning of the law on a case-by-case basis."[18] On this basis, Club for Growth then raised precisely the First Amendment and Due Process defenses anticipated by the Court's Memorandum Opinion:

> The FEC's unreasonable decision to refuse to clarify the vague "political committee" restrictions by rulemaking, but to establish new policies via retroactive case-by-case adjudication violate the Administrative Procedure Act and the First and Fifth Amendments. Such new policies cannot be applied to the Club.

Id. ¶ 65. As noted, this case is still pending.

The 2008 election cycle is now underway, with substantial -- and unsurprising -- evidence that 527 groups are gearing up for these elections as well.[19] Nothing in E&J II,

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[18] *See* Answer at 1, *FEC v. Club for Growth, Inc.*, Civ. No. 1-05-cv-01851 (June 22, D.D.C.) (Ex. 37).

[19] *See, e.g.*, John Solomon, *Casino Executive Contributes $1 Million to Gingrich Group*, WASH. POST, Jan. 23, 2007 (Ex. 38) (reporting on a casino executive's contribution to American Solutions for Winning the Future, a 527 group formed by prospective 2008 presidential candidate Newt Gingrich); Nina Easton, *Get Ready for the $3 Billion Campaign*, FORTUNE, Mar. 5, 2007 (Ex. 39) (reporting on 527 groups preparing to spend money to influence the 2008 elections); Robert Vitale, *Brooks Takes First Step in Possible Run for Congress*, COLUMBUS DISPATCH, Jan. 14, 2007 (Ex. 40) (reporting on a candidate's creation of a 527 group to pursue a 2008 congressional run); Wayne Slater, *Big-money Texans Paying to Derail Clinton*, DALLAS MORNING NEWS, Dec. 4, 2006 (Ex. 41) (reporting on efforts to raise funds for

however, adequately explains why or how the Court's finding as to the "patent inadequacy of the case-by-case approach," 424 F. Supp. 2d at 116, was erroneous or should be reconsidered. The FEC -- referring smugly to "*any* perceived shortcoming with the enforcement process identified" by this Court, 72 Fed. Reg at 5602 (Ex. 26) (emphasis added) -- still has not given a reasonable explanation how it can effectively stem 527 group abuses on a case-by-case basis without a baseline rule. Accordingly, the E&J II fails to pass APA muster.

B. The Commission Has Failed To Explain Why Case-by-Case Adjudication Without a Rule Is a More Effective Means of 527 Enforcement than Enforcement Based on a Rule.

In its Memorandum Opinion, the Court observed that E&J I "did not discuss whether, or why, case-by-case adjudication would be more effective than a rule at preventing the flow of soft money into federal campaigns." 424 F. Supp. 2d at 115. The Memorandum Opinion elucidated the concern the FEC needed to address:

> The Court is troubled, however, by [the] FEC's lack of explanation for its conclusion that adjudication is preferable to rulemaking for regulating 527 groups. . . . [T]he single paragraph that comprises the FEC's reasoning meekly notes what appear to be only three reasons that rulemaking "may be inadvisable" . . . .
>
> These "reasons," while perhaps sufficient to summarize the complexities of rulemaking, *do not explain why adjudication avoids these or additional complexities*. Indeed, the only conclusion that can be drawn from this reasoning is that the regulation of 527 groups is complicated. The Court does not disagree with that conclusion. *What the E&J fails to explain, however, is how the problem becomes any less complicated or any more manageable if the FEC pursues case-by-case adjudication.*

Id. (emphasis added).[20]

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527 groups in an effort to defeat Sen. Hillary Clinton's presidential candidacy, including the formation of a 527 group called "Stop Her Now").

[20] *See also* 424 F. Supp. 2d at 116 ("The question, therefore is not whether the Commission has statutory authority to bring enforcement actions, but whether it acted rationally here by refusing to promulgate a rule in favor of its purported preference for piecemeal adjudications to enforce the FECA and BCRA

Although the Court thus made abundantly clear that any new E&J must explain *how* case-by-case enforcement of campaign finance laws against 527 groups without a baseline rule is *less* problematic than a rulemaking would be, E&J II once again fails to answer the question. It does not, for instance, address why the issuance of a rule would necessarily sweep beyond 527 groups to affect "hundreds or thousands" of non-profit groups, but adjudication inherently would not, *id.*; *i.e.*, why a rule cannot be tailored to the problem posed by 527 groups (and avoid non-profit groups) in just the same way case-by-case enforcement can be (and indeed, in the same way that the rules proposed in 2004 by Commissioners Thomas and Toner, and by the General Counsel (*see* Background, Part C, *supra*), were so tailored). Moreover, as discussed above, E&J II does not address the point that a 527 rule, by providing clarity and guidance, should enhance both voluntary self-compliance and deterrence, thereby reducing the number of enforcement actions the FEC may have to pursue.

C. The Commission Has Failed To Explain How It Can Provide *Ex Ante* Guidance To 527 Groups in the Absence of a Rule.

The Memorandum Opinion stated that the Commission's original E&J never "discussed whether the adjudication of individual cases that are resolved on particular facts and legal theories would be effective as a means to provide guidance to 527 groups generally." 424 F. Supp. 2d at 116. E&J II also fails to provide an adequate answer to this important point beyond asserting that the FEC is providing guidance to the regulated community through the cases it settles. *See* 72 Fed. Reg. at 5604 (Ex. 26) ("Any organization can look to the public files for the Political Committee Status Matters and other closed enforcement matters, as well as advisory opinions and filings in civil enforcement cases, for guidance as to how the Commission has

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prohibitions on the spending of soft money in federal elections. The Commission's failure to provide a reasoned explanation is simply fatal here under hornbook administrative law.").

applied the statutory definition of 'political committee' together with the major purpose doctrine.").

But even assuming that it could ever be rational to suggest that the regulated community can obtain clear legal guidance by leafing through an untold number of Federal Register notices, General Counsel reports in closed enforcement actions, prior conciliation agreements, advisory opinions, and court filings, doing so would be unavailing for two reasons. First, as can be seen from the recent settlements, the FEC seems to be going out of its way to avoid reliance on 527 status as a basis for decisions, and thus provides no guidance that would illuminate the relevance of 527 status for the regulated community.[21] Second, the conciliation agreements which the Commission points to are not statements of law issued by the Commission, but rather the product of negotiations between the Commission and a settling party. Such statements reflect only what the parties can agree to say, which obviously differs from case to case and presents no single coherent picture of the law. Third, as this Court previously noted with regard to *Club for Growth*: "the Commission's complaint is based on facts specific to the activities and statements of that one group, and depends in no way on the group's status as a 'political organization' under section 527. Even if the Commission wins the case, it would likely have no bearing on any other group registered under section 527." 424 F. Supp. 2d at 116.

[21] The conciliation agreements that the FEC executed with 527 groups do not even include mutual agreements that the groups actually violated the law by failing to register as political committees. *See, e.g.* Conciliation Agreement at ¶ V, *Swift Boat Veterans and POWs for Truth* (FEC Dec. 8, 2006) (MUR 5511, 5525) (Ex. 42) ("Solely for the purpose of settling this matter expeditiously and avoiding litigation, without admission with respect to any other proceeding, and with no finding of probable cause by the Commission, SwiftVets agrees not to contest the Commission's conclusions [that SwiftVets wrongly failed to register as a political committee]."); Conciliation Agreement at ¶ V, *League of Conservation Voters et al.* (FEC Dec. 8, 2006) (MUR 5753) (Ex. 43) ("In order to settle this matter and avoid the cost and time of further proceedings, and without admitting or denying each specific basis for the findings, Respondents will no longer contest that [they should have registered as a political committee]."); Conciliation Agreement at ¶ V, *MoveOn org Voter Fund et al.* (FEC Dec. 8, 2006) (MUR 5754) (Ex. 44) (same); Conciliation Agreement at ¶ V, *Progress for America Voter Fund* (FEC Feb. 22, 2007) (MUR 5487) ("PFA-VF Conciliation Agreement") (Ex. 45) (same).

Indeed, E&J II is internally inconsistent on this point. While the Commission asserts that it does provide general guidance through the cases it prosecutes or settles, that proposition is entirely at odds with another assertion in E&J II: that a general rule is unworkable, because every case is so uniquely fact dependent that no meaningful rule can be written. *See* 72 Fed. Reg. at 5601 (Ex. 26) ("Applying the major purpose doctrine . . . requires the flexibility of a case-by-case analysis of an organization's conduct that is incompatible with a one-size-fits-all rule."). If, as the Commission contends, each case is so fact-specific that it is impossible to write a rule, then E&J II's suggestion that 527 groups should be able to rely on the idiosyncratic legal "precedents" created by individual negotiated settlements is irrational and absurd.

Notably, one of the settling 527 groups, PFA-VF stated at the time of its settlement that the Commission had "refused to . . . issue a rulemaking delineating permissible 527 activities" and thus "left all 527 groups, including PFA-VF, to their own interpretation of the law."[22] PFA-VF said, "The FEC subsequently announced a 'case by case' enforcement policy and opened investigations into violations of the very statutes for which the Commission had refused to provide guidance." *Id.* Although PFA-VF agreed to pay a civil penalty to conclude the matter, its statement asserts it "is not admitting to any wrong doing." *Id.*

The Commission also argues that, even if it had promulgated a regulation dealing with 527 groups, enforcement of that regulation would still have to take place through case-by-case adjudication. *See* 72 Fed. Reg. at 5602 (Ex. 26) ("Any revised rule adopted by the Commission would still have to be interpreted and applied through the very same statutory enforcement procedures as currently exist."). This truism misses the point. A rule -- particularly the type of rule proposed by Commissioners Toner and Thomas, and by the General Counsel -- would

[22] Progress for America Voter Fund, *Progress for America Voter Fund Statement on the Announced Settlement with the Federal Election Commission*, Feb. 28, 2007 *available at* http://pfavpterfund.com (Ex. 46).

provide clear, advance guidance to 527 groups, and that guidance in itself would have a significant educative and deterrent effect, thereby promoting compliance, even though the FEC might later have to pursue enforcement actions against groups that do not comply with the rule.

D. The FEC's Suggestion That its 2004 Rules Have Effectively Curtailed 527 Abuses Is Not Supported by Any Evidence.

The FEC's suggestion that it has dealt effectively with the 527 soft money problem by issuing two rules in the 2004 rulemaking -- on the definition of "contribution" and a revised formula for allocation -- has no support in the record or in experience. After it voted to issue those rules in August 2004 (and at the same time decided *not* to issue any rule focusing on 527 status), soft money spending by 527 groups continued unabated through the November 2004 election. The PFA-VF Conciliation Agreement, for instance, points to rampant soft money spending by that 527 group *after* the August 2004 vote to issue these rules (noting that in October 2004, PFA-VF spent $500,000 on Spanish-language TV ads praising George Bush and $900,000 on ads supporting the Republican Party and opposing the Democratic Party).[23] It further states that "[b]etween October 14 and the General Election on November 2, 2004, PFA-VF also spent $1.5 million on direct mail pieces, over $600,000 on email communications, and more than $170,000 on Internet banner advertisements. All of these materials supported George Bush and/or attacked John Kerry." *Id.* ¶16. Certainly, the over $200 million in soft money spending by 527 groups in the 2006 elections provides no support for the Commission's assertion that its 2004 rules curtailed the problem.

Nor is this surprising. The allocation rule issued in 2004, 11 C.F.R. § 106.6, addresses spending by groups that already have registered as political committees, but says nothing about when a group must register as a political committee -- the problem at hand. Moreover, the 2004

[23] PFA-VF Conciliation Agreement (Ex. 45) ¶15.

definition of "contribution," 11 C.F.R. § 100.57, is ineffectual. It provides that funds will be deemed "contributions" if they are raised in response to a solicitation that clearly indicates "any portion of the funds received will be used to support or oppose the election" of a candidate. 11 C.F.R. § 100.57. Thus, a solicitation that promotes or attacks a candidate by name, and solicits funds, will not result in a "contribution" unless the solicitation itself makes a clear reference to the use of those funds in connection with the candidate's election.[24] A 527 group can draft around the rule, and nothing from the experience in 2004 or 2006 indicates that this rule has acted as an effective brake on 527 abuses.

E. The Commission Errs in Asserting That a Baseline Rule on 527 Groups Would Ignore the Difference Between Section 527 " Political Organizations" and FECA "Political Committees."

The Commission argues that it cannot proceed by rule because taking 527 status alone as an indicator of a political committee's "major purpose" is necessarily overbroad. 72 Fed. Reg. at 5598 (Ex. 26) ("By definition, 527 organizations may engage in a host of State, local, and non-electoral activity well outside the Commission's jurisdiction.").

This argument knocks down the proverbial straw man, because no one has proposed, and the draft rules actually considered by the Commission did not suggest, that *all* 527 groups *per se* meet the "major purpose" test for political committee status. Rather, both the Toner-Thomas proposal and General Counsel's proposal excluded 527 groups engaged in purely non-federal or non-electoral activity. The Toner-Thomas rule deemed section 527 groups to meet the "major purpose" prong of the political committee test, but expressly *excluded* those 527 groups that,

[24] This distinction is made clear in the Commission's first E&J explaining this rule. 69 Fed. Reg. 68056, 68057 (Nov. 23, 2004) (A.R. 375) (noting that "the rule's focus on the planned use of funds leaves the group issuing the communication with complete control over whether its communications will trigger new section 100.57" and "[m]any groups' fundraising solicitations will say nothing of an electoral objective regarding the use of funds").

e.g., were organized solely to influence non-federal activities, or referenda and ballot measures, or the selection of individuals to non-elected positions, such as judgeships.[25] The General Counsel's proposed rule was structured the same way, to exclude from the special treatment accorded to 527 groups those 527 groups engaged in non-federal or non-electoral activities.[26]

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[25] The Toner-Thomas proposal stated:

> For purposes of [the "major purpose" test], a committee, club, association or group of persons that is organized under Section 527 . . . has the nomination or election of one or more Federal or non-Federal candidates as its major purpose, unless it is a type of organization described as follows:
>
> The campaign organization of an individual seeking nomination, election, appointment or selection to a non-Federal office;
>
> A committee, club, association or group of persons that is organized solely for the purpose of promoting the nomination or election of candidates to one or more non-Federal office;
>
> A committee, club, association or group of persons whose nomination or election activities relate solely to elections where no candidate for Federal office appears on the ballot;
>
> A committee, club, association or group of persons that is organized solely for the purpose of influencing state ballot initiatives or referenda; or
>
> A committee, club, association or group of persons that is organized solely for the purpose of influencing the nomination or appointment of individuals to one or more non-elected offices, or the nomination, election, or selection of individuals to leadership positions within a political party.

FEC Agenda Doc. 04-44 (A.R. 341) (Ex. 10) at 2-3 (proposed § 100.5(a)(2)).

[26] The General Counsel's proposal stated:

> Exceptions to 527 rules. Paragraphs (a)(3) and (a)(4) of this section do not apply where the committee, club, association or other group of persons is any of the following:
>
> (i) A campaign organization of an individual seeking nomination, election, appointment or selection to a non-Federal office;
>
> (ii) A committee, club, association or other group of persons whose election or nomination activities related solely to elections where no candidate for Federal office appears on the ballot; or
>
> (iii) A committee, club, association or other group of persons that is organized and operated exclusively for any of the following purposes:

The Commission also appears to argue that a group's 527 status proves nothing at all about its major purpose. But that is plainly wrong: a group's self-identification as a 527 "political organization" is indisputably relevant to whether it meets the "major purpose" prong of the political committee test, because that group is "*organized and operated primarily* for the purpose of directly or indirectly accepting contributions or making expenditures, or both, for an exempt function." 26 U.S.C. § 527(e)(1) (emphasis added). An "exempt function" is defined as the "function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice Presidential electors." 26 U.S.C. § 527(e)(2). Thus, unless a political organization is involved solely with the selection or appointment of individuals to non-electoral office, that group's primary purpose is to accept contributions and/or make expenditures in support of the election of individuals to office.

Indeed, in *McConnell v. FEC,* the Supreme Court specifically recognized the partisan electoral objectives of 527 groups, observing that "[s]ection 527 'political organizations' are, unlike § 501(c) groups, organized for the express purpose of engaging in partisan political activity." 540 U.S. 93, 174 n. 67 (2003). The Court also noted that 527 groups "by definition engage in partisan political activity . . . ." *Id.* at 177. This description in *McConnell*, and the

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(A) Influencing the nomination or election of one or more candidates to non-Federal offices;

(B) Influencing one or more state ballot initiatives, referenda, constitutional amendments, or bond issues; or

(C) Influencing the selection or appointment of one or more individuals to non-elected offices, or the nomination, election, selection, or appointment of one or more individuals to leadership positions within a political party.

FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 40-41 (proposed § 100.5(a)(5)).

rules proposed in the 2004 rulemaking, belie the irrational suggestion in E&J II (*see* 72 Fed. Reg. at 5598 (Ex. 26)) that 527 status is not a useful baseline indicator of an organization's major purpose.

The Commission itself has previously recognized this very point. In the "Factual and Legal Analysis" *adopted by the Commission* to support its "reason to believe" finding in the enforcement action against PFA-VF, the Commission described PFA-VF's status as a 527 group, noted the tax law definition of "exempt function," and said, "[a]s a factual matter, therefore, an organization that avails itself of 527 status has effectively declared that its primary purpose is influencing elections of one kind or another."[27] It repeated this same conclusion in the Swiftboat Veterans case.[28]

This entirely rational observation is consistent with the view espoused by the FEC's General Counsel who, during the 2004 rulemaking, noted that "there appears to be substantial congruence between, on the one hand, organizations that under section 527 are 'organized and operated primarily for the purpose of' influencing nominations or elections [to office], and on the other hand, groups 'the major purpose of which is the nomination or election of a candidate' *Buckley*, 424 U.S. at 79," FEC Agenda Doc. 04-48 (A.R. 343) (Ex. 9) at 9; and who later trenchantly observed that "an organization's decision to avail itself of 527 status is inherently

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[27] Factual and Legal Analysis at 4, *Progress for America Voter Fund* (MUR 5487) (Nov. 29, 2004) (Ex. 47). This Factual and Legal Analysis is adopted by the Commission itself, and thus is not just the expression of the views of the General Counsel.

[28] Factual and Legal Analysis at 6, *Swift Boat Vets and POWs for Truth* (MURs 5511 and 5525) (March 2, 2005) (Ex. 48). The Commission has used this same formulation in previous enforcement actions. *See* Factual and Legal Analysis at 10, *Council for Responsible Government, Inc.* (MUR 5024R) (Apr. 13, 2005) (Ex. 49). The Commission has also frequently cited the section 527 standard as equivalent to the "major purpose" prong of the test for political committee status in past advisory opinions. *See, e.g.,* FEC Advisory Opinion 1996-3 (Ex. 50); FEC Advisory Opinion 1996-11 (Ex. 51); and FEC Advisory Opinion 1996-13 (Ex. 52).

indicative of its choice to engage principally in electoral activity." FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 14.

E&J II is a complete about-face from the FEC's previously adopted view of the significance of 527 status. Accordingly, E&J II undermines the FEC's argument that clarity can be achieved through case-by-case adjudication. While the Commission found 527 group status significant in the PFA-VF and the Swiftboat Veterans cases, E&J II disavows the relevance of 527 status and leaves groups with no clear lines for when their activity will trigger FECA regulation.

Plaintiffs do not deny that some kind of factual examination would be necessary to determine whether a 527 group falls within one of the exceptions established under the proposed Toner-Thomas rule, or another comparable rule. However, such an analysis would be far simpler than the intensive, fact-based analysis that the FEC suggests is necessary in each case in the absence of a rule. Such a determination would also be easier for 527 groups themselves to understand, and accordingly would promote compliance.

F. The Commission's Argument That It Should Eschew Issuing a 527 Rule Because It Might Be Under-inclusive Is Irrational.

After first arguing, erroneously, that a 527 rule would be *over*-inclusive because it would sweep in too many 527 groups, the Commission then argues that such a rule would be *under*-inclusive because it would not apply to groups such as 501(c)(4) organizations. This argument, too, is beside the point. A rule that focused on 527 groups would not be the *exclusive* test for political committee status, nor would it in any way undermine the Commission's efforts to determine whether a non-527 group should register as a political committee. The Toner-Thomas proposed rule, for example, did not purport to be the only test for determining political committee status. Under Toner-Thomas, non-527 groups would still be subject to the current

law, which would be applied on a case-by-case basis to determine if such groups meet the major purpose standard and have made $1,000 in expenditures or contributions. The General Counsel's proposed rule took a different approach of setting forth a comprehensive test that would clarify the political committee standard for *all* groups, but within that rule, dealt separately with 527 groups as a special case. Both these proposals demonstrate the proposition that, even if a rule regulating 527 groups would not cover *all* groups that should register as political committees, that does not mean such a rule would be ineffectual in determining the status of a major subset of political committees that is responsible for the most widespread campaign finance abuses.

In any event, whether or not the FEC's case-by-case approach is appropriate for some or all non-527 groups has no bearing on the question posed by this Court -- whether the case-by-case only approach is better for dealing with 527 groups themselves. The record of the 2004 and 2006 cycles makes clear that 527 groups have perpetrated the largest abuses of unregulated soft money in federal elections. Further, the similarity between 527 tax status and the major purpose standard -- as the General Counsel says, the former is "inherently indicative" of the latter -- allows the use of tax status as a logical and fair baseline indicator for meeting the major purpose test in the case of 527 groups (with a limited number of clear exceptions that were detailed in the proposed rules from the 2004 rulemaking). This is exactly why it makes sense for the FEC to issue a rule that focuses on 527 groups in particular, while still allowing case-by-case enforcement actions against other groups that may also be required to register as political committees.

II. The E&J II Is Fatally Premised on a Fundamental Misinterpretation of Law.

Apart from failing to address the multiple questions and concerns this Court enumerated in its Memorandum Opinion, there is an entirely separate fatal defect at the heart of E&J II: it is premised on a misinterpretation of the FECA as construed in *Buckley* and *McConnell*. Because the FEC's interpretation of the FECA is contrary to law, E&J II must be set aside. *See* 5 U.S.C. § 706(2)(A).

A. Under Supreme Court Precedent, a Group Is a "Political Committee" Where Its Major Purpose Is the Nomination or Election of a Federal Candidate, and It Spends or Collects Money For the Purpose of Influencing a Federal Election.

The FECA defines a "political committee" as a group "which receives contributions aggregating in excess of $1,000 during a calendar year or which makes expenditures aggregating in excess of $1,000 during a calendar year . . ." 2 U.S.C. § 431(4)(A). The statute, in turn, defines "expenditure" and "contribution" to encompass any spending or fundraising, respectively, "for the purpose of influencing" an election. *Id.* at § 431(8)(A)(i) ("contribution"); *id.* at (9)(A)(i) ("expenditure").

In *Buckley*, the Supreme Court addressed constitutional concerns that the statutory definition of "political committee" was overbroad and, to the extent it incorporated the definition of "expenditure," vague as well. 424 U.S. at 78-79. The Supreme Court found the term "expenditure" caused "line drawing problems" by potentially "encompassing both issue discussion and advocacy of a political result," so that the "political committee" standard (which relied on the definition of "expenditure") might "reach groups engaged purely in issue discussion." *Id.* at 79.

The *Buckley* Court resolved these concerns by imposing two different limiting constructions. First, it narrowed the definition of "political committee" to encompass only

"organizations that are under the control of a candidate *or the major purpose of which is the nomination or election of a candidate*." *Id.* (emphasis added). For such "major purpose" groups, there was no vagueness concern about the statutory "for the purpose of influencing" definition of "expenditure" because, the Supreme Court held, disbursements by such groups "can be assumed to fall within the core area sought to be addressed by Congress. They are, *by definition, campaign related*." *Id.* (emphasis added). Second, "when the maker of the expenditure is *not* within these categories [--] when it is an individual other than a candidate or a group other than a 'political committee,'" the Court narrowly construed the term "expenditure" to reach "only funds used for communications that expressly advocate the election or defeat of a clearly identified candidate." *Id.* at 79-80.[29]

The importance of this distinction is the Supreme Court's recognition that the broader, statutory definition of "expenditure" as spending "for the purpose of influencing" an election is *not* vague when applied to groups "the major purpose of which is the nomination or election of a candidate," because spending by such groups is "by definition, campaign-related." *Id.* at 79. The Court imposed the narrowing gloss of express advocacy on the term "expenditure" *only* with regard to groups *other than* such "major purpose" groups. *Id.* at 80.

The Supreme Court affirmed this approach in *McConnell*. In reviewing a BCRA requirement that state parties use hard money to pay for a public communication that "promotes

[29] The Court defined express advocacy to include phrases such as "vote for," "vote against," "elect," "support," "reject" or "defeat" a clearly identified candidate. *Id*. at 44 n. 52. In a subsequent case, the Ninth Circuit somewhat expanded the definition of express advocacy also to include speech which "when read as a whole, and with limited reference to external events, [is] susceptible of no other reasonable interpretation but as an exhortation to vote for or against a specific candidate." The message must be "unmistakable and unambiguous, suggestive of only one plausible meaning." *FEC v. Furgatch,* 807 F.2d 857, 864 (9th Cir. 1987). The Commission has codified the so-called "magic words" standard of *Buckley* at 11 C.F.R. § 100.22(a), and the *Furgatch* standard at §100.22(b). The *Furgatch* test is sometimes referred to as the "subpart (b)" standard.

or supports" or "attacks or opposes" a federal candidate, 2 U.S.C. §§ 431(20)(A)(iii); 441i(b)(1), the Court rejected a vagueness challenge because the words "clearly set forth the confines within which *potential party speakers* must act in order to avoid triggering the provision." *McConnell,* 540 U.S. at 169 n. 64 (emphasis added).[30] Quoting *Buckley*, the Court noted that "a general requirement that political committees disclose their expenditures raised no vagueness problems because the term 'political committee' 'need only encompass organizations that are under the control of a candidate or the major purpose of which is the nomination or election of a candidate' and thus a political committee's expenditures 'are, by definition, campaign related.'" *Id.* Thus, the Court in *McConnell* affirmed that the express advocacy test set forth in *Buckley* does not apply to groups whose major purpose is to influence federal elections.

B. The Supplemental E&J Posits a Test for "Political Committee" Status That Stands *Buckley* and *McConnell* on Their Heads.

The Supreme Court's analysis in *Buckley* and *McConnell* necessarily requires that the first step in determining whether an organization is a political committee is to assess whether it is a "major purpose" organization or not. The answer to that question determines what definition of "expenditure" to use (either "for the purpose of influencing" or "express advocacy").

But in E&J II, the FEC proceeds exactly backwards. Rather than *first* determine that a section 527 group has met the "major purpose" prong, and, if so, *then* assess whether the group has spent $1,000 "for the purpose of influencing" a federal election, E&J II's explanation of why the FEC has not promulgated a 527 rule posits that the FEC must *first* determine whether a section 527 group has made "expenditures" or received "contributions" of $1,000. 72 Fed. Reg. at 5603-04 (Ex. 26). For the former purpose, the Commission looks *only to whether a group's expenditures fund express advocacy*. *Id.* at 5605. Under the FEC's faulty legal analysis, if (and

[30] The "promotes, attacks, supports or opposes" test of BCRA is colloquially known as the "PASO" test.

only if) a section 527 group has spent $1,000 on express advocacy expenditures will the FEC proceed to determine whether the organization has as its "major purpose" the nomination or election of a candidate. *Id.* If a section 527 group is not found to have spent at least $1,000 on "express advocacy," the FEC never reaches the question whether the group has a "major purpose" to influence elections, and the group will not be deemed a "political committee."

The FEC's interpretation of the FECA, which undergirds its reasons for not promulgating a 527 rule, directly contradicts *Buckley* and *McConnell* and is irrational as applied to 527 groups, because (absent an applicable exception) such groups meet the "major purpose" test and are thereby subject to the broader "for the purpose of influencing" definition of "expenditure," not the more restricted, "express advocacy" test. By registering with the IRS as a 527 group, an organization identifies itself as a "political organization" that is "organized and operated *primarily* for the purpose" of accepting contributions or making expenditures for an "exempt function," *i.e.*, for electoral activity. 26 U.S.C. § 527(e)(1) (emphasis added). As the General Counsel previously told the Commission, section 527 status "is inherently indicative" of a group's "choice to engage principally in electoral activity." FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 14.

Because section 527 groups generally meet the "major purpose" test, the reasoning of *Buckley* and *McConnell* dictates that the FEC should not employ the express advocacy test in determining whether such groups have made an "expenditure" of $1,000 and thus trigger political committee status. This was precisely the conclusion of the Commission's General Counsel who, in his August 2004 recommendation to the Commission, clearly stated that a "for the purpose of influencing" test, not an express advocacy test, should apply to "nascent political committees" that "meet *Buckley's* 'major purpose' test":

> If a Federal political committee – whose major purpose, by definition, is influencing elections – pays for a communication that PASOs a clearly identified Federal candidate, then it is logical to conclude that the payments for that communication were made for the purpose of influencing the election of that candidate, and therefore are "expenditures." *In order for this conclusion to apply to Federal political committees' first $1,000 of expenditures, draft section 100.115 would also apply to nascent political committees, which are unregistered groups that meet Buckley's "major purpose" test* as incorporated into draft 11 CFR 100.5(a)(1)(ii).

FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 20 (emphasis added). The General Counsel consequently adopted the distinction made in *Buckley*:

> Confining the PASO standard to Federal political committees and *unregistered groups with the major purpose of nominating or electing Federal candidates* would address concerns about the clarity of the PASO standard . . . . Draft section 100.115 . . . appl[ies] the standard to both Federal political committees *and to unregistered organizations so long as they satisfy the major purpose test*. In both cases, the organizations – the registered political committee and the group that satisfies the "major purpose" test proposed here – are "in the business" of influencing Federal elections and their communications demonstrably have that purpose or effect."

Id. at 21-22 (emphasis added).

The Commission in 2004 had before it illustrations of how to craft a rule for 527 organizations grounded on a proper interpretation of the FECA as construed in *Buckley* and *McConnell*. The Toner-Thomas proposal stated that a 527 "political organization" would be deemed to meet the "major purpose" test, unless it fell into one of several exceptions that demonstrate the group is involved solely in non-federal (or non-electoral) activity. FEC Agenda Doc. 04-75-A (A.R. 355) (Ex. 12) at 2 (proposed § 100.5(a)(2)). The proposed rule then defined "expenditure" to include any public communication by a 527 group that "promotes, supports, attacks or opposes" a federal candidate or political party. *Id.* at 4 (proposed § 100.116). Thus,

for purposes of the political committee test, a PASO communication by a section 527 group would count as an "expenditure."[31]

Thus, for groups that meet the "major purpose" test, including such 527 groups, the "expenditure" standard for political committee status should be a PASO test, not an express advocacy test. The contrary approach in E&J II is not only inconsistent with *Buckley* and *McConnell*, but also sets forth a clear path for 527 groups to spend millions of dollars on campaign related issues, yet avoid "political committee" status. Under the FEC's framework, a 527 group that spends millions of dollars on ads that promote or attack federal candidates will not be considered a "political committee" so long as its ads fall one step short of "express advocacy." For example, consider an advertisement run two months before an election that states: "Senator X has voted for bills that would destroy America's security from terrorist attacks. Call him to tell him that we need someone to start voting for America's security, not against it." Here, the classic "sham issue ad" avoids words of express advocacy. Even though it may be sponsored by a 527 "political organization" which has identified itself as "organized and operated primarily" to influence the selection of an individual to public office, the Commission would not treat this spending as relevant to the group's status as a political committee -- even if the 527 group spends tens of millions of dollars on such ads, and even if it is all the group does.

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[31] The General Counsel's proposed rule reached the same conclusion as the Toner-Thomas proposal by a different route. It would have first made a "major purpose" determination based, *inter alia,* on whether more than 50 percent of a group's disbursements in a year were for contributions or election-related disbursements. FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 38-39 (proposed § 100.5(a)(2)(ii)). For all groups, such disbursements would include contributions, independent expenditures (which require express advocacy, 2 U.S.C. § 431(17)), and "electioneering communications" (broadcast ads aired in the period 30 days before a primary or 60 days before a general election, 2 U.S.C. § 434(f)(3)). But the General Counsel proposed an "additional rule for 527 organizations" that would also have counted payments for any communications "that clearly identify one or more candidates for Federal office." FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 39 (proposed § 100.5(a)(3)(iv)). The General Counsel's proposal also specified that spending by a group "for which the nomination or election of one or more Federal candidates is its major purpose" is deemed an "expenditure" if the communication promotes, supports, attacks, or opposes a candidate. *Id.* at 42 (proposed § 100.115).

By contrast, both the Toner-Thomas and General Counsel proposals would treat this ad as an "expenditure" for political committee purposes.[32]

C. The FEC's Decision Not To Issue a Rule Focused on 527 Groups Is Dependent On Its Misconstruction of FECA.

The FEC's erroneous interpretation of the FECA is at the heart of its decision not to promulgate a rule addressing the applicability of FECA's requirements for political committees to 527 organizations.

The representations a 527 group makes by choosing to register with the IRS as a "political organization" -- that its "primary purpose" is to influence elections -- are directly relevant to the "major purpose" test for political committee status under the FECA. That is why, under a correct interpretation of the statute, a 527 rule that recognizes this fact -- as the Thomas-Toner and General Counsel proposals effectively did -- would significantly deter violations and facilitate enforcement. But the FEC's interpretative sleight-of-hand, *i.e.*, its misconstruction of the FECA, marginalizes, if not eliminates, the relevance of the major purpose test. As shown in the recent conciliation agreements, the FEC relies on the very same activities used to establish "expenditures" and "contributions" (one prong of the political committee test) to support its

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[32] E&J II argues that the Commission does not apply only a "magic words" definition of express advocacy, but also the somewhat broader definition under its subpart (b) rule, *see* n. 30, *supra*, that includes ads which have an "electoral portion" that is "'unmistakable, unambiguous, and suggestive of only one meaning' and about which 'reasonable minds could not differ as to whether it encourages actions to elect or defeat' a candidate . . . ." E&J II at 5604 (Ex. 26) (*citing* 11 C.F.R. § 100.22(b)). This definition, although broader than a bare "magic words" test, is still a very narrow standard, and considerably narrower than a PASO standard. It is easy to imagine advertisements, such as the example, which attack a candidate but which do not "encourage actions" to defeat the candidate or which do in text not have an "electoral portion" (much less one that is "unmistakable" and "unambiguous"), and thus would not constitute subpart (b) express advocacy.

Moreover, although this subpart (b) definition of "expenditure" was promulgated over 10 years ago, it has rarely (if ever) been applied by the Commission until the recent round of enforcement decisions. Further, this definition has been struck down by two Circuits. *See Virginia Society for Human Life v. FEC*, 263 F.3d 379, 392 (4th Cir. 2001); *Maine Right to Life Comm., Inc. v. FEC*, 98 F.3d 1(1st Cir. 1996). Given that, it is far from clear that the FEC will, or even can, continue to rely on this test, at least in the two Circuits in which it has been invalidated.

finding of "major purpose" (the other prong of the test). By effectively collapsing the two determinations into one, E&J II's framework makes the "major purpose" inquiry a hollow shell. But if the statute is interpreted correctly, with the major purpose analysis coming first, not last, the relevance of a group's 527 status to its "major purpose" is plain, and the irrationality of the Commission's "no rule" position becomes manifest.

The FEC cannot persuasively deny what its General Counsel admitted in 2004: "an organization's decision to avail itself of 527 status is *inherently indicative* of its choice principally to engage in electoral activity." FEC Agenda Doc. 04-75 (A.R. 354) (Ex. 11) at 20 (emphasis added). As the FEC's misconstruction of the FECA is the very basis for E&J II, its decision not to promulgate a rule directed to 527 groups is both arbitrary and capricious and contrary to law.

CONCLUSION

For these reasons, this Court should declare that the Commission's failure to issue an appropriate regulation focusing on when a section 527 group must register as a political committee is arbitrary and capricious and otherwise not in accordance with law. Since this is now the second time that the Commission has been unable to explain its position in a manner that complies with the APA, we urge the Court to remand this case to the Commission with a direction to promulgate an appropriate rule within ninety days.

Respectfully submitted,

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