taxanalysts special report

California Fights to Unmask Donors

by Rose C. Chan

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The author thanks Craig A. Steele of Richards Watson & Gershon and William C. Choi of Rodriguez Horri Choi & Cafferata LLP for their review of this article.

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In California, a courtroom drama in the weeks leading up to Election Day 2012 highlighted the ongoing national controversy about whether and when section 501(c)(4) organizations engaged in political activity should be required to disclose the identity of their donors. Federal tax laws do not require tax-exempt organizations to make public the identity of their donors unless such organizations constitute political action committees. The California case illustrates that states are often more far-reaching than the federal government in requiring disclosure of donors by organizations that are politically active in their jurisdictions.

The state law at the center of the California dispute involves a new disclosure regulation that includes in its scope 501(c)(3), (c)(4), (c)(5), and (c)(6) organizations as well as state and federal PACs. Therefore, any nonprofit organization contemplating legislative or electioneering activity should review carefully the election laws of the states in which it wishes to be active.

The California case pitted the state's Fair Political Practices Commission (FPPC) against Americans for Responsible Leadership (ARL), an Arizona-based 501(c)(4) organization that had never made any contributions to California before its $11 million donation, just three weeks before Election Day, to the Small Business Action Committee PAC (SBA PAC), a California PAC. SBA PAC was organized to influence two high-profile initiatives on the California general election ballot: to oppose the passage of Proposition 30 (brought by Governor Jerry Brown to raise taxes) and to support the passage of Proposition 32 (to restrict the ability of unions and corporations to collect contributions from their members and employees).[1] ARL made the $11 million contribution to SBA PAC on October 15, and SBA PAC reported the contribution to the state's Secretary of State on October 16.

On October 18, Common Cause, a campaign reform organization, filed a complaint with the FPPC asking for an inquiry into the contribution, alleging that ARL had violated California's Political Reform Act (Act)[2] and the FPPC's regulation[3] thereunder requiring that donors of earmarked contributions be disclosed. On October 22, the FPCC advised ARL that it had 25 hours to produce documents regarding the sources of the contribution that it had made to SBA PAC. When ARL refused to comply with the FPCC's request to audit the group's records, the FPPC filed suit in California Superior Court seeking a preliminary injunction to compel compliance with an FPCC audit of ARL's campaign reports.[4] The FPCC argued that the audit was necessary to determine whether there had been a violation of the Act, and that time was of the essence:

> Unless and until this court compels Respondent to disclose as contributions the payments it received from donors that were used to make the $11,000,000 contribution to Small Business Action Committee PAC and compels Respondent to provide plaintiff with all records necessary to review its compliance with said disclosure requirements, Respondent's conduct will cause great and irreparable harm to the voters of California by potentially denying them vital information regarding the true source of large sums of money being spent to advocate for and against statewide initiatives.[5]

ARL did not dispute that the FPPC had the legal authority to conduct an audit, but argued that the FPPC did not have the authority to conduct an audit of ARL *before* the November 6 election. Citing *Citizens United v.*

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[1]Proposition 30 ultimately passed. Proposition 32 was defeated.

[2]The Political Reform Act of 1974 is found in California Government Code sections 81000 through 91014.

[3]The FPPC regulations are in Title 2 of the California Code of Regulations.

[4]Govt. Code Section 91003(a) provides:

> Any person residing in the jurisdiction may sue for injunctive relief to enjoin violations or to compel compliance with the provisions of this title. The court may in its discretion require any plaintiff other than the Commission to file a complaint with the Commission prior to seeking injunctive relief. The court may award to plaintiff or defendant who prevails his costs of litigation, including reasonable attorney's fees.

[5]Ex Parte Application for Preliminary Injunction and Order to Show Cause re Same, *Fair Political Practices Commission v. Americans for Responsible Leadership*, Case No. 34-2012-00131440, page 3.

Federal Election Commission (discussed further below),[6] ARL also noted generally that nonprofit corporations have constitutional rights, and citizens may associate together in nonprofit corporations to exercise their constitutional rights.

Superior Court Judge Shelleyanne Chang rejected ARL's procedural arguments that the audit could not be held before the election, finding the provisions cited by ARL to be inapplicable. Second, the judge concluded that the balancing of harms favored the FPPC, agreeing with the FPPC that the public had a right to know the identity of the donors before Election Day. Third, Chang rejected ARL's *Citizens United* argument, stating that the FPPC was not seeking to restrict expenditures by ARL and that nothing in *Citizens United* prohibits state-mandated disclosure of donors' identities.

Accordingly, on October 31, the Superior Court granted the FPPC's application for preliminary injunction and ordered ARL to produce documents within 25 hours. As requested by the FPPC, the order compelled ARL to produce (1) any and all records of communication between any donors and ARL, including written, e-mail, telephone, and fax communications; and (2) unredacted records of funds received by ARL, including checks, check registers, wire information, and any other financial or accounting record of such donations.

ARL refused to comply and filed an appeal with the Court of Appeal. On November 2, the Appeals Court judge issued a stay without comment in favor of ARL. The FPPC immediately filed a petition with the California Supreme Court asking the court to lift the stay pending appeal so that the FPCC could obtain the requested documents before the election. On November 4, at 3 p.m., the California Supreme Court vacated the stay pending appeal of the trial court's order and ordered ARL to comply with the FPCC's request for documents by 4 p.m. that day. ARL threatened to file a petition with the United States Supreme Court.

On November 5, however, just one day before Election Day, ARL agreed to produce the names of its donors in exchange for the FPPC forgoing a preelection audit. In disclosing its donors, ARL admitted that it had received the money from the Center to Protect Patient Rights,[7] which in turn reported that it had received the money from another nonprofit organization, Americans for Job Security (AJS).[8] The FPCC responded by calling it the biggest "campaign money laundering" scheme in California history.[9]

As of the publication of this article, the identities of the corporations and individuals who funded the contribution remain unknown, but the disclosure that AJS was the true donor gave voters some idea of who was behind the contribution. AJS, a 501(c)(6) organization based in Virginia, is a veteran in the political arena. It was founded in 1997 by Michael Dubke[10] and David Carney,[11] two Republican Party strategists. In 2008, the FEC's general counsel concluded that, regardless of AJS having been formed as a (c)(6), the trade group met the definition of a PAC under the federal election rules and therefore was required to report its donors. FEC counsel requested the FEC's approval to begin a formal investigation, but the FEC deadlocked and no action was taken.[12]

The final act of the California drama has yet to play out. On November 15, the FPCC opened an official investigation of the donation, the purpose of which is to determine the individual donors and the conditions of their donations; for example, whether the donors knew the donations would be used to influence political campaigns.[13] Many will be watching to see whether California's election laws, discussed in more detail below, will compel a disclosure of the underlying donors despite the multilayered structure of the contribution.

Background of the Disclosure Issue

Nonprofit organizations, in particular 501(c)(4)s, have become a popular mechanism for issue advocacy, legislative lobbying, and to some extent election campaigning. In contrast to a 501(c)(3) charitable organization, which may not carry on significant legislative lobbying and is

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[6]558 U.S. 310; 130 S. Ct. 876 (2010). *Citizens United* held that corporations have a right to engage in independent expenditures (expenditures that are not coordinated with a candidate, campaign, or party committee) and may use general treasury funds for such expenditures.

[7]The November 5, 2012, letter from Kirk Adams, president, Americans for Responsible Leadership to James V. Lacy, treasurer, Small Business Action Committee PAC, states:

> We are writing you that as a result of a settlement agreement with the Fair Political Practices Commission, we are reporting the donation made by Americans for Responsible Leadership on October 15, 2012 was an intermediary contribution. ARL received the $11,000,000 from the Center to Protect Patients Rights. Its mailing address is PO Box 72465, Phoenix, AZ 85050.

[8]The November 5, 2012, letter from Sean Noble (position not stated) of the Center to Protect Patient Rights to Kirk Adams, president, Americans for Responsible Leadership, states:

> We are writing as a result of a settlement agreement with the Fair Political Practices Commission that $11,000,000 of the donations made by Center to Protect Patient Rights on October 12, 2012 and October 15, 2012 was an intermediary contribution. Center to Protect Patient Rights received the $11,000,000 from Americans for Job Security, 107 South West Street, PM 551, Alexandria, VA 22314.

[9]Press release, California Fair Political Practices Commission, November 5, 2012, "Americans for Responsible Leadership Admits Campaign Money Laundering, Discloses $11 Million Donor."

[10]Michael Dubke is the founding partner of Black Rock Group, a strategic communications and public affairs firm, and the founder of Crossroads Media LLC.

[11]David Carney is a political adviser who headed the campaigns of Newt Gingrich, Bobby Jindal, and Rick Perry.

[12]Federal Election Commission, First General Counsel's Report, MURs 5694 and 5910, February 6, 2008, (*available at:* http://www.fec.gov/members/walther/sor/murs5910and5694.pdf.

[13]J. Small, "Elections Watchdog Launches Investigation into $11 Million Donation," 89.3 KPPC, http://www.scpr.org/blogs/politics/2012/11/15/11116/elections-watchdogs-investigation-11-million-campa/.

prohibited from doing any electioneering, 501(c)(4) organizations may conduct unlimited lobbying and may support or oppose candidates for public office as long as electioneering is not the organization's primary activity.[14] At the same time, 501(c)(4) entities in general have not been required to disclose the identities of their donors, as they clearly would be if they had been formed as PACs.

The U.S. Supreme Court's holding in *Citizens United* that corporations may use general treasury funds without restriction to engage in independent political expenditures[15] has increased the stakes in the disclosure controversy. The Court has indicated that it will not be changing its mind regarding *Citizens United*. In *American Traditional Partnership v. Bullock*,[16] the Court reversed a Montana Supreme Court ruling that had upheld a century-old Montana law prohibiting corporations from spending money on political campaigns, confirming that the holding of *Citizens United* applies at the state level and prevents states from limiting the independent expenditures of corporations. As nonprofit organizations have made increasingly significant donations to political causes, campaign reform groups have become increasingly concerned about the amount of secret money being funneled into elections and legislative campaigns through nonprofit organizations and have urged broader disclosure rules and more aggressive enforcement. A good number of states agree, and donor disclosure enforcement cases have been initiated in Arizona, Idaho, Maine, Minnesota, Montana, and Washington.[17] Conversely, state disclosure laws are being challenged in Wisconsin.[18]

Justice Anthony Kennedy's majority opinion in *Citizens United* strongly affirms the validity of disclosure laws:

> The First Amendment protects political speech; and disclosure permits citizens and shareholders to react to the speech of corporate entities in a proper way. This transparency enables the electorate to make informed decisions and give proper weight to different speakers and messages.[19]

Kennedy reasons that unlike spending restrictions, disclaimer and disclosure provisions, while they may burden the ability to speak, do not impose any ceiling on campaign-related activities and do not prevent anyone from speaking. Moreover, disclosure can be justified based on the governmental interest in providing the electorate with information about the sources of election-related spending.[20]

Overview of Federal Disclosure Requirements

A complete explanation of federal disclosure requirements is beyond the scope of this article. However, a brief summary provides helpful context to the discussion of California's disclosure controversy.

Two regimes are relevant to disclosure of donors under federal law: the tax laws and election laws. Under federal tax law, organizations that file a Form 990, Form 990-EZ, or Form 990-PF generally must identify to the IRS donors who have given $5,000 or more during the year. This information is provided on Schedule B of the organization's information return.

The federal tax disclosure rules provide, however, that only organizations formed under section 527 (PACs) and private foundations must provide such information to the public. Thus, most tax-exempt organizations may redact the names and addresses (and other information that could identify donors, such as amounts) from the copy of the Form 990 that they make available to the public. Indeed, the instructions to the Form 990 expressly advise filing organizations not to include Schedule B in filing a copy of their tax return with any state, unless a schedule of contributors is required by the state. "States that do not require the information might inadvertently make the schedule available for public inspection along with the rest of the Form 990 or 990-EZ," the instructions say. Federal tax laws applicable to section 501(c) entities generally focus on protecting the taxpayer's privacy rights. In contrast, a tax-exempt organization that organizes itself as a section 527 political organization must file Form 8872 to report contributions received and expenditures made, and the Form 8872s are made available for public inspection on the IRS's website.[21]

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[14]However, donations to a 501(c)(4) and a (c)(6) (including membership dues) are not deductible as charitable contributions. Contributions may be deductible as business expenses to the extent the nonprofits are not using such expenses for lobbying or electioneering.

[15]Independent expenditures are expenditures that are not coordinated with a candidate, campaign, or party committee.

[16]132 S. Ct. 2490 (2012).

[17]R. Cohen, "States Taking Political Donor Disclosure Into Their Own Hands," *The Los Angeles Times*, November 26, 2012; M. Gold and C. Megerian, "States Crack Down on Campaigning Nonprofits," *The Los Angeles Times*, November 26, 2012. *See also* September 24, 2012, letter from Eric T. Schneiderman, New York attorney general, to Senate Finance Committee ranking minority member Orrin G. Hatch, R-Utah, and House Ways and Means Committee Chair Dave Camp, R-Mich., confirming the right of state officials to obtain and utilize information that may appear on the tax returns in carrying out their law enforcement functions and noting that New York, like many other states, accepts or requires federal tax forms in lieu of state-specific filings, but also requires nonprofits to file state-specific forms. "The recent activities of some tax-exempt organizations and businesses have been of great concern to New Yorkers. While my office respects applicable federal requirements and restrictions, I will continue to perform my duties and enforce the laws of the State of New York."

[18]*Wisconsin Right to Life v. Deininger*, Case No. 10-C-0669, U.S. District Court, E.D., challenges several definitions in state law that implement Wisconsin's political disclosure system as well as Wisconsin's 24-hour reporting requirement for expenditures made close to an election and its requirement that a committee file an oath attesting that its disbursements are independent.

[19]*Citizens United*, *supra*, at 130 S.Ct. at 916.

[20]130 S.Ct. at 914.

[21]A qualified state or local political organization that functions solely to influence elections for state or local office does not have to file Form 8872 if it is subject to state law that requires it to report information similar to what is required by Form 8872.

The issue under federal tax law is whether these politically active 501(c)(4) organizations are overstepping the boundaries of their tax status and should be recharacterized as PACs under section 527 and required to comply with the disclosure rules of that section. Campaign reform groups are urging the IRS to examine the activities of 501(c)(4)s and other nonprofits to determine whether electioneering activity is in fact the primary activity of such groups.[22] The reform groups also are urging revisions to existing IRS regulations relating to the political activities of 501(c)(4)s.[23] In response, the IRS Exempt Organizations Division has told the reform groups that "[t]he IRS is aware of the current public interest in this issue" and that the Exempt Organizations Division will be working with IRS Office of Chief Counsel and the Treasury Department's Office of Tax Policy to identify tax issues that should be addressed through regulations and other published guidance.[24] Conversely, increased examination focus on political activities of exempt organizations has drawn criticism from some lawmakers, who object to what they consider the partisan selection of audit targets.[25]

On the election law side, the Federal Election Campaign Act (FECA) requires political organizations that are registered with the FEC as federal political committees to file reports disclosing the money they raise and spend. The reports filed by federal political committees, which include contributor information, are available for public inspection and copying. A group must register with the FEC as a federal political committee if: (1) it accepts contributions or makes expenditures above $1,000 in a calendar year and (2) has as its major purpose the nomination or election of one or more federal candidates.[26] Under FECA, a federal political committee is subject not only to disclosure requirements but also to contribution limits and source restrictions.[27] As illustrated by the FEC counsel's experience with AJS,[28] in which the counsel could not persuade enough members of the FEC to support his conclusion that AJS was a federal political committee under FECA, it has not been easy to challenge a nonprofit organization's representation that it is not a federal political committee subject to the FEC's reporting and disclosure regime.

Also, the Bipartisan Campaign Reform Act (BCRA) requires all groups and persons to file ad specific disclosure reports if they make expenditures for either (1) advertisements that expressly advocate the election or defeat of a federal candidate or (2) "electioneering communications," which are broadcast, cable, or satellite communications that refer to a clearly identified federal candidate, air within 60 days before an election or 30 days before a primary, and are targeted to the relevant electorate.[29]

The ad-specific disclosure rules of BCRA are not limited to PACs. The reports must disclose the identity of the person or group funding the ad, the recipients of disbursements for the ad, and contributors to the ad. Regarding electioneering communications, an FEC regulation limits disclosure to donors who made their contribution "for the purpose of furthering electioneering communications."[30] Since few donors earmark their donation for a specific electioneering expense, this regulation has limited the number of donors who are identified as contributors to electioneering communications.[31]

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[22]Note that a ballot measure committee cannot be a section 527 political organization, since such activity is considered to be lobbying rather than electioneering. J. Kindell and J. Reilly, 1993 EO CPE Text, "Election Year Issues," at 449, *citing* S. Rep. No.93, 1357, 93d Cong., 2d Sess. 27 (1974), 1975-1 C.B. 517, 532.

[23]July 27, 2010, "Petition for Rulemaking on Campaign Activities by Section 501(c)(4) Groups," submitted on July 27, 2010, by Democracy 21 and Campaign Legal Center; March 22, 2012, letter from Democracy 21 and Campaign Legal Center to IRS Commissioner Douglas Shulman and Lois Lerner, director of IRS Exempt Organizations Division; August 21, 2012, letter from Democracy 21 and Campaign Legal Center to Shulman and Lerner enclosing August 19, 2012, *ProPublica* article, "How Nonprofits Spend Millions on Elections and Call it Public Welfare."

[24]July 17, 2012, letter from Lois Lerner, director of IRS Exempt Organizations, to Fred Wertheimer, president of Democracy 21, and J. Gerald Hebert, executive director of the Campaign Legal Center. The groups have complained that the IRS is not acting quickly enough. July 23, 2012, letter from Democracy 21 and the Campaign Legal Center to IRS Commissioner Douglas Shulman and Lerner.

[25]March 14, 2012, letter to IRS Commissioner Douglas Shulman from 12 Republican senators urging that tax compliance be pursued in a fair, evenhanded manner and without reference to politics. Published on Senate Finance Committee website, http://www.finance.senate.gov/newsroom/ranking/release/?id=b49bd610-6a0f-4ea5-bea2-8ce37e2e5e04

[26]An organization that is formed as a PAC under section 527 is not necessarily a federal political committee under FECA. For example, a 527 committee focused only on state elections would not be subject to FECA. Note, however, that the federal tax rules require all 527 groups to disclose their donors. If a 527 does not disclose a contribution, it must pay tax on the amount of the contribution.

[27]The U.S. Supreme Court's holding in *Citizens United* that a corporation's independent expenditures eventually may cause more political organizations to register as federal political committees with the FEC. *See* Campaign Legal Center's "A Guide to the Current Rules for Federal Elections," note 1.

[28]Discussed *supra* at text accompanying note 12.

[29]2 U.S.C. section 434(f)(3).

[30]11 C.F.R. 104.20(c)(9). This regulation has been the subject of litigation. In *Van Hollen v. Federal Election Commission*, 851 F.Supp.2d 69 (D.D.C. 2012), the U.S. District Court for the District of Columbia ruled that the FEC regulation impermissibly narrowed BCRA's disclosure requirement, which specified that disclosure is required of all persons who contribute $1,000 or more to groups running electioneering communications and did not include an intent requirement. The FEC declined to appeal the ruling and announced that it would thereafter require all groups making electioneering communications to report all donors who contribute $1,000 or more to their group.

However, the Center for Individual Freedom and the Hispanic Leadership Fund, which had appeared in support of the FEC before the District Court, filed a timely appeal seeking reversal of the District Court's judgment. On appeal, the D.C. Court of Appeals overturned the District Court's ruling and remanded the case with instructions to "refer the matter to the FEC for further consideration." *Center for Individual Freedom v.*

(Footnote continued on next page.)

Bills have been introduced in the House and Senate to expand the reach of federal disclosure requirements.[32] The proposed Disclose Act would require 501(c)(4)s, as well as corporations, super PACs, and other outside groups that spend $10,000 or more on campaign-related activity to report those expenditures to the FEC within 24 hours. It also would require those organizations to identify donors who contribute $10,000 or more to the organization. So far, the Disclose Act has failed to pass in either the House or the Senate.[33]

Federal lobbying rules also could require disclosure of donors to nonprofit organizations. The Lobbying Disclosure Act of 1995[34] requires lobbying firms and organizations to register and file periodic reports of their lobbying activities with the Secretary of State of the state where they are located and the Clerk of the House of Representatives.[35] A report is required for each client of the lobbyist. However, the reports do not require any information beyond the name and general description of the business of the client. The instructions for the reporting form state as an example of general description of business "social welfare organization." No disclosure of the donors to such an organization is requested.

In summary, federal disclosure laws depend largely on an organization's decision to be organized as a political organization under section 527 or as a PAC under FECA. Moreover, the disclosure laws' scope does not cover all seemingly "political" activities. FECA applies only to elections for federal office, and section 527 applies only to elections. Neither set of federal laws is applicable to the campaigning on state ballot initiatives at issue in the California case. However, the California case illustrates that any organization that is engaging in political activities at the state or local level needs to look at the relevant state disclosure laws.

Spotlight on California's Disclosure Laws

The provisions of California law that were at issue in California's case against ARL are found in the Political Reform Act of 1974 (Government Code sections 81000 through 91014) and its accompanying regulations (Title 2 of the California Code of Regulations).

In its petition to the California Superior Court, the FPCC contended that an injunction requiring ARL to submit to a preelection audit was proper because the audit would let the FPPC know whether ARL was required to disclose donors under section 18412 of the regulations and, if it was, the voters had a right to know who those donors were before going to the polls.

The specific FPPC regulation spotlighted by the case, Regulation 18412, had just taken effect in May of 2012. Regulation 18412 "establishes rules governing organizations that are formed and operate as tax exempt organizations under Internal Revenue Code sections 501(c)(3), 501(c)(4), 501(c)(5) and 501(c)(6), as well as federal or out of state political organizations, which make contributions or independent expenditures totaling $1,000 or more from their general treasuries to support or oppose a candidate or ballot measure in California, as required by Regulation 18215(b)(1)."[36] Via Regulation 18412, the Act now expressly encompasses exempt organizations that participate in political campaigns in California, whether they are elections for public office or ballot measures. The Act's disclosure requirements for exempt organizations are triggered in the following circumstance:

> If a donor to such an organization requests or knows that the payment will be used by the organization to make a contribution or an independent expenditure to support or oppose a candidate or ballot measure in California, the full amount of the donor's payment shall be disclosed by the organization as a contribution. For purposes of this regulation, a donor "knows" that a payment will be used to make a contribution or an independent expenditure if a donor makes a payment in response to a message or a solicitation indicating the organization's intent to make a contribution or independent expenditure. An organization that solicits and receives contributions totaling $1,000 or more becomes a committee under Section 82013(a).[37]

To paraphrase Regulation 18412(b), if a donor to ARL requested or knew that the payment would be used by ARL to make the contribution to SB PAC, ARL was required to disclose the donor's payment. The donor would be considered to "know" that a payment would be used for such if the donor made the donation in response to a solicitation by ARL indicating intent to make the contribution to SB PAC. If an organization solicits and receives contributions totaling $1,000 or more, it becomes a committee and is subject to provisions requiring the disclosure of its donors.

Thus, the FPPC argued: (1) if ARL had solicited the contribution from a donor or donors, ARL would become a recipient committee under section 82013 of the Act[38] and would be required to disclose these donor(s) *before*

Van Hollen, 694 F.3d 108 (D.C. Circ. 2012). The Court of Appeals concluded that BCRA was ambiguous in whether a purpose or intent element was intended; therefore, the FEC's original regulations were a reasonable approach at clarification and not clearly inconsistent with the statute.

On October 4, 2012, the FEC filed a status report informing the court of its decision not to initiate a rulemaking to amend its regulations governing the disclosure of electioneering communications but instead to continue to defend the current regulation.

[31]*See* Independent Sector article, "Political Activity of 501(c)(4) Tax-Exempt Organizations" at http://www.independentsector.org/501c4organizations, and September 18, 2012 press release by the Campaign Legal Center, which was part of the legal team representing Rep. Christopher Van Hollen, D-Md., in the case.

[32]*See* Independent Sector article, "Disclose Act" at http://www.independentsector.org/disclose_act.

[33]*Id.*

[34]2 U.S.C. 1601 et seq.

[35]Instructions for Form LD-1 (Lobbying Registration).

[36]Regulation 18412(a).

[37]Regulation 18412(b).

[38]Section 82013 provides:

(Footnote continued on next page.)

the election under section 84202.5[39] of the Act; and (2) if ARL had earmarked the contribution for SB PAC, ARL would have been required to inform SB PAC of the earmarking and SB PAC would be required to disclose the donor(s) before the election under section 84302 of the Act.[40] The FPPC argued that a preelection audit was necessary to know the circumstances of the donations and to determine whether ARL was encompassed by, and had complied with, the disclosure requirements of the Act and the regulations thereunder.[41]

ARL objected on the grounds that the FPCC did not have authority to conduct an audit or investigation before the election. ARL's main arguments against a preelection audit were: (1) Govt. Code section 90002 only authorizes an audit or investigation after an election; (2) the FPPC did not follow its own procedures for responding to a complaint filed with the FPPC in that the executive director was required by the FPPC's regulations to wait until 14 calendar days from the filing of the complaint to make a final determination, unless the final determination is to take no action; and (3) the FPPC did not follow its own procedures for initiating civil litigation in that the litigation against ARL had not been approved by the entire commission. ARL also contended that a preelection audit would violate ARL's due process rights and that the balance of harms favored ARL because associational rights are constitutionally protected, while the right to disclosure of donors was merely a statutory right.[42]

Judge Chang rejected ARL's procedural arguments against a preelection audit on the grounds that each "rule" cited by ARL was inapplicable to the circumstances:[43] (1) Government Code Section 90002, which ARL suggested precluded an audit until after the election, did not apply because ARL is not "a candidate, controlled committee, or committee primarily supporting or opposing a candidate or a measure." (Government Code Section 90002.) (The FPPC had argued that if ARL had been one of these entities, it would have been required to disclose its donors before the election.); (2) The 14-day period under FPPC regulations did not apply, because here the executive director had not made a final determination on the items listed in the cited regulation. The regulation does not prohibit the executive director from conducting an audit before the expiration of the 14 days; (3) The civil litigation contemplated by the Act is one for penalties and remedies under the Act. Here, the FPPC merely sought to audit ARL. There was no investigation to determine whether there was a violation of the Act and no decision to seek penalties against ARL. Therefore, Chang found that the FPPC had the general authority to audit ARL before the election to determine: (1) whether ARL is a committee under Government Code section 82013(a) or a major donor under Government Code section 82013(c); (2) if it is a committee under Government Code section 82013(a), whether ARL violated the preelection reporting requirements; and (3) whether any donations were earmarked for specific purposes.

Also, Judge Chang found that the balancing of harms favored FPPC in that the audit would not result in public disclosure of the donors' identities unless and until it was determined that disclosure was appropriate and lawful under the Act. Further, no penalties could be imposed on ARL until the FPPC followed additional procedures. Finally, Judge Chang noted that nothing in *Citizens United* prevented state-mandated disclosure of donors' identities.[44]

"Committee" means any person or combination of persons who directly or indirectly does any of the following:
(a) Receives contributions totaling one thousand dollars ($1,000) or more in a calendar year.
(b) Makes independent expenditures totaling one thousand dollars ($1,000) or more in a calendar year; or
(c) Makes contributions totaling ten thousand dollars ($10,000) or more in a calendar year to or at the behest of candidates or committees.
A person or combination of persons that becomes a committee shall retain its status as a committee until such time as that status is terminated pursuant to Section 84214.

[39]Section 84202.5 requires any candidate or committee under section 82013(a) that makes contributions totaling $10,000 or more in connection with an election to file a supplemental preelection statement no later than 12 days before the election for the period ending 17 days before the election, unless that candidate or committee had been required to file preelection statements under 84200.5.

[40]Memorandum of Points and Authorities In Support of Ex Parte Application for Preliminary Injunction, *Fair Political Practices Commission v. Americans for Responsible Leadership*, Case No. 34-2012-00131550, page 6.

[41]*Id.* Although the FPPC did not go further in its briefs, Regulation 18412(c)(1) provides an additional trigger for disclosure of donor identities:

If an organization makes a contribution or independent expenditure from its general treasury that is not fully paid from organizational income, it must identify additional donors if those described in subdivision (d) of this regulation did not provide the full balance of the contribution or independent expenditure. In such cases, the organization shall identify and report donors who pursuant to Regulation 18215(b)(1) are *presumed to have had reason to know* that all or part of their payments would be used to make expenditures or contributions, using a "last in, first out" accounting method, until a sufficient number of donors have been identified and reported to account for the full balance of the contribution or independent expenditure. An organization need not report a donor as a contributor if the organization has evidence clearly establishing specific circumstances that show the donor did not intend that its payment would be used to fund a contribution or independent expenditure. [Emphasis added.]

If an organization that had identified donors under subparagraphs (b) and (c)(1) did not provide the full amount of the contribution or independent expenditure, then the organization would allocate the remaining balance of the contribution or independent expenditure to itself.

[42]Respondent's Memorandum in Opposition to Ex Parte Application for Preliminary Injunction, *FPPC v. Americans for Responsible Leadership*, Case No. 34-2012-00131550.

[43]Minute Order Granting Application for Preliminary Injunction, October 31, 2012, 1:30PM, *FPPC v. Americans for Responsible Leadership*, Case No. 34-2012-00131550.

[44]*See* discussion, *supra*, at text accompanying notes 15-20.

As discussed above, the case wound its way up to the California Supreme Court. The Appeals Court reversed the District Court, and the Supreme Court reversed the Appeals Court, but neither court added to Judge Chang's discussion of the Act and the regulations.

In the end, the Supreme Court ordered ARL to comply with the preelection audit. However, the parties agreed that instead of a preelection audit, the FPPC would allow ARL to simply disclose the identity of its donors. What the FPPC got was an admission from ARL that it was an intermediary for another 501(c)(4) organization, which in turn admitted that it was an intermediary for a 501(c)(6) organization. The revelation by ARL that it was an intermediary changed the statutory focus of the case from Regulation 18412 to Section 84302 of the Act (Contributions by Intermediary or Agent) and its correlative Regulation 18432.5.

Under Section 84302,[45] no person can make a contribution on behalf of another without disclosing to the recipient of the contribution the identity of the donor and the identity of the other person. Further, the recipient is required to include in his or her campaign statement the full name and street address, occupation, and name of the employer, if any, or the principal place of business if self-employed, of both the intermediary and the contributor. Under section 84302, both ARL and SBC PAC filed new statements with California on November 5, 2012, identifying AJS and the Center for Patient Rights as donors.

Regulation 18432.5 reinforces section 84302. That regulation provides that a person is an intermediary for a contribution if either:

> (1) The recipient of the contribution would consider the person to be the contributor without the disclosure of the identity of the true source of the contribution; or
>
> (2) The person is a sponsored committee that must report its sponsor's identity under Regulation 18419.

Under Regulation 18419, a sponsored committee is a committee, other than a controlled committee, that has one or more sponsors. A sponsor is any person (except a candidate, proponent, or other individual) to whom any of the following applies:

> (A) The committee receives 80 percent or more of its contributions either from the person or from the person's members, officers, employees, or shareholders;
>
> (B) The person collects contributions for the committee by use of payroll deductions or dues from its members, officers, or employees;
>
> (C) The person provides, alone or in combination with other organizations, all or nearly all of the administrative services for the committee; or
>
> (D) The person sets, alone or in combination with other organizations, the policies for soliciting contributions or making expenditures of committee funds.

Consistent with Section 84302 of the Act, Regulation 18342.5 provides that any person who qualifies as an intermediary for making a contribution shall disclose to the recipient of the contribution both his or her full name and street address, occupation, and the name of his or her employer, if any, or his or her principal place of business if he or she is self-employed, and the full name and street address, occupation, and the name of employer, if any, or principal place of business if self-employed, of the contributor. Conversely, the recipient shall include the name of the intermediary and other information disclosed under section 84302 of the Act if the recipient knows or has reason to know that a contribution is made by an intermediary.

Despite their seemingly ineffective arguments before the Superior Court, AJS and the donors of the $11 million probably achieved their goal. By giving the contribution to SBA PAC, AJS could not argue that it was only engaging in and funding issue advocacy. Clearly, the $11 million was used for a ballot campaign. However, by structuring the donation as a series of contributions and timing the final contribution to SBA PAC to occur so close to the election, the donors and their advisers made it very difficult for public disclosure of their identities to occur before the election. Indeed, that level of disclosure did not occur before Election Day.

California Attorney General Kamala Harris and FPPC Director Ann Ravel both denounced the contribution to SBA PAC as "campaign money laundering." Section 84302 of the Act clearly prohibits making a contribution to a ballot campaign in someone else's name. Therefore, according to Harris and Ravel, it appeared that both ARL and the Center for Job Security had violated section 84302.

Because AJS is the true contributor of the $11 million, the next issue will be whether, under Regulation 18412, the state can require AJS to disclose the identity of its donors and their contribution amounts. Under the regulation, California will have to show either (1) that each individual requested that his or her contribution to AJS be used to oppose Proposition 30 and/or support Proposition 32; or (2) that each donor knew that AJS would use his or her donation to oppose Proposition 30 and/or support Proposition 32. For purposes of the regulation, donors know their contributions will be used if the donations were made in response to a message or solicitation indicating the intent of the recipients to make the contributions to the PAC.

[45]Section 84302 provides:
No person shall make a contribution on behalf of another, or while acting as the intermediary or agent of another, without disclosing to the recipient of the contribution both his own full name and street address, occupation, and the name of his employer, if any, or his principal place of business if he is self-employed, and the full name and street address, occupation, and the name of employer, if any, or principal place of business if self-employed, of the other person. The recipient of the contribution shall include in his campaign statement the full name and street address, occupation, and the name of the employer, if any, or the principal place of business if self-employed, of both the intermediary and the contributor.

The FPPC undoubtedly will be challenged in proving its case against AJS. It would not be surprising to discover that AJS's donors agree with the organization's pro-business goals and made the contributions to AJS without any specific earmarking for the California ballots. According to AJS's Form 990, AJS's program service revenue comes from membership dues and voluntary assessments paid by its more than 100 members, and the payments are deposited into the general fund to support the broad mission and efforts of the organization. The allocation of the dues to the various activities of the organization is determined by the professional staff and the board of directors of AJS.[46]

The Act provides for a range of enforcement tools. More commonly, the FPPC enforces the Act through Government Code Section 83116, which provides that the FPPC may issue an order that the violator cease and desist violation under the Act; file any reports, statements or other documents or information required by the Act; and pay a monetary penalty of up to $5,000 per violation to the state. If, however, the state can show a "knowing and willful" violation of the Act, Government Code Section 91000 provides for a fine of up to the greater of $10,000 or three times the amount the person failed to report properly or unlawfully contributed, expended, gave, or received, "in addition to other penalties provided by law." Since Section 91000 classifies a knowing and willful violation of the Act as a misdemeanor, such other penalties could include up to a year in jail.[47]

Regardless of the eventual outcome, watching the FPPC try to pull back the curtain on AJS will make for more interesting drama.

Proposals for Legislative Change

Since Election Day, various proposals have been introduced in the California Legislature to strengthen the Political Reform Act of 1974. The bills range from general proposals to "close the loophole associated with campaign contributions from multi-purpose groups and nonprofit organizations"[48]to more specific proposals to require the disclosure of the three largest funders of political advertisements[49] and to modify the formatting requirements of notices to voters.[50]

The most comprehensive bill, A.B. 45,[51] contains 13 sections. The two most significant proposals clearly respond to the FPPC's case against ARL. Section 3 of AB 45 would revise the definition of "contribution" in Government Code section 82015 to include a payment made to a "multipurpose organization" if the donor knows or has reason to know that the payment, or part of the payment, will be used to make a contribution or an independent expenditure. A "multipurpose organization" means a nonprofit organization, a federal or out-of-state PAC, or a local club focusing on educational or social activities.

For purposes of the revised provision, a donor knows a payment to a multipurpose organization will be used to make a contribution or an independent expenditure if the donor specifies that to be the purpose for which the payment must be used or if the donor makes the payment in response to a message or solicitation indicating the multipurpose organization's intent to make a contribution or an independent expenditure. Further, a donor is presumed to have reason to know that a payment to a multipurpose organization will be used to make a contribution or an independent expenditure if the multipurpose organization has made aggregate contributions or independent expenditures of $2,000 or more during the calendar year in which the payment is made or during any of the four preceding calendar years. Moreover, a donor who makes an aggregate payment of $50,000 or more to a multipurpose organization within the six months before an election is presumed to have reason to know that the aggregate payments will be used by the multipurpose organization to make a contribution or an independent expenditure if the multipurpose organization makes an aggregate contribution or independent expenditure of $50,000 or more to support or oppose a candidate or ballot measure within the six months before the election. Finally, a donor who makes a contribution as described above shall be identified and reported by the multipurpose organization receiving the contribution.

Section 13 of A.B. 45 relates to procedures for audit and litigation, amending Government Code section 90003. The proposed revision provides that the FPPC may audit an organization before the election or before the date on which a report or statement must be filed. A person may contest the performance of the audit by seeking a writ of mandate, and the venue for the proceeding shall be exclusively in the county of Sacramento, with the action to be given priority over all other civil matters. Finally, an appeal of an injunction issued in favor of the FPPC shall not result in a mandatory stay pending the resolution of the appeal, and a stay of an injunction pending resolution of the appeal may be ordered at the discretion of the court issuing the injunction.

Conclusion

The battle between California's FPPC and the nonprofit ARL illustrates the nationwide controversy about whether 501(c)(4)s and other nonprofit organizations engaged in political activity should be required to disclose the identity of their donors. The case also spotlighted perceived weaknesses in California's Political Reform Act and triggered proposals for additional laws to protect the public's right to know. Similar activities are going on in other states. Thus, nonprofits active in the political arena, as well as donors to such nonprofits, need to know that despite federal laws protecting donor identity, the states in which they are active may require disclosure of their donors' identities.

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[46]AJS 2009 Form 990 at Part VIII, Line 2a and Schedule O.

[47]Section 91000.

[48]S.B.No. 3, introduced by Sens. Yee and Lieu, December 3, 2012.

[49]S.B. No. 52, introduced by Sens. Leno and Hill, December 20, 2012.

[50]S.B. No. 26, introduced by Sen. Correa, December 3, 2012.

[51]A.B. No. 45, introduced by Assembly member Dickinson, December 19, 2012.