DEVELOPMENTS 2004-2005:
THE 2004 ELECTION CYCLE, SECTION 527 ORGANIZATIONS AND REVISIONS IN REGULATIONS

By Trevor Potter*

Introduction

The 2004 election cycle was the first election cycle under the Bipartisan Campaign Reform Act of 2002 (BCRA).[1] The Act constitutes a significant change in federal campaign finance law in at least two respects: first, BCRA prohibits national political party committees, as well as federal candidates and officeholders, from soliciting, receiving or directing *soft money* (*i.e.*, funds not in compliance with federal law contribution amount limitations, source prohibitions,[2] and reporting requirements);[3] and second, BCRA prohibits corporations, trade associations, and labor organizations from paying for "electioneering communication" (*i.e.*, any broadcast, cable or satellite communication referring to a clearly identified federal candidate and targeted to the candidate's state or district, sixty days before a general election and thirty days before a primary election).

The law was challenged in court and after nearly 20 months of legal battles (and one month before the election year began), the U.S. Supreme Court upheld almost entirely the constitutionality of the Act in its landmark *McConnell v. FEC* decision.[4]

This article will detail how the new law worked in the 2004 election cycle, and what enforcement issues the Federal Elections Commission has before it, as well as summarizing other related litigation filed and decided in 2004-2005.

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[1] Pub. L. No. 107-155, 116 Stat. 81 (2002).

[2] Federal law, for example, prohibits corporations and labor unions from using treasury funds to make political contributions or expenditures in connection with federal elections. *See* 2 U.S.C. § 441b.

[3] Further, BCRA prohibits state, district and local political party committees from spending soft money on "federal election activity."

[4] 540 U.S. 93 (2003).

I. BCRA in the 2004 Election Cycle

There was some apprehension of observers and actors alike over how the first federal election to be conducted under this new law would operate. The out come was that the parties thrived in their fundraising efforts, the small donor base expanded dramatically, and corporate and union money did not enter the party coffers. There was also a resulting increase in get-out-the-vote campaigns and television "issue ads" independent of candidate and party committees, conducted by "527" groups and funded primarily by wealthy individual supports of the parties and by Democratic-leaning labor unions.

One vocal pre-2004 election skeptic of campaign finance reform was David Broder, commentator and report for *The Washington Post*. In an article he wrote post-election, he stated:

> As one who has been skeptical of the claimed virtues of the McCain-Feingold campaign finance law, I am happy to concede that it has, in fact, passed its first test in the 2004 campaign with flying colors. The 2002 law…did not, as many of us critics feared, weaken political parties or stifle political debate. Instead it played at least a supportive role in the greatest upsurge ever recorded in the number of small contributors.[5]

Political Party Fundraising Success

The federal committees of the Republican and Democratic parties raised a total of $1.2 billion dollars in regulated hard money contributions in the 2004 election cycle—$140 million more than they had raised in unregulated soft money and regulated hard money contributions combined in 2000 (see Table 1). The gap in fundraising between the two national parties was the smallest it had been since 1978.

Table 1
National Party Committee Fundraising: 2000 and 2004 Cycles ($ millions).[6]

[5] David S. Broder, "A Win for Campaign Reform," The Washington Post, February 3, 2005, p. A27.
[6] Federal Election Commission data. These figures reflect unadjusted committee receipts, and may include transfers. Totals are adjusted for transfers, and thus may vary slightly from the sums reported individually by committees. The 2004 Democratic totals include $29.6 million in excess primary funds transferred from the Kerry for President committee ($23.6 million to the DNC, $3 million to the DSCC,

Committee	***Hard $***	***2000*** ***Soft $***	***Total $***	***2004*** ***Hard $***	***Total $***
DNC	124.0	136.6	260.6	402.3	402.3
DSCC	40.5	63.7	104.2	86.6	86.6
DCCC	48.4	56.7	105.1	91.9	91.9
Democrats	212.9	245.2	458.1	580.7	580.7
RNC	212.8	166.2	379.0	385.3	385.3
NRSC	51.5	47.3	96.2	74.9	74.9
NRCC	97.3	44.7	144.6	175.1	175.1
Republicans	361.6	249.9	611.5	632.5	632.5
TOTAL	**$ 574.5**	**$ 495.1**	**$ 1,069.6**	**$ 1,213.2**	**$ 1,213.2**

The success of fundraising by both major national political parties was bolstered in part by a provision of BCRA that substantially increased the maximum permitted hard money contribution limit to national party committees (as well as to federal candidates).[7] Additional factors included a tremendous increase in the number of small donors. Republicans expanded their donor base in the 2004 election by 1.8 million and the Democrats, who faced a greater reliance on soft money in previous elections (see Table 1 2000 soft money data), expanded their small donor prospects via direct mail from 1 million to 100 million and small donor Internet contacts from 70,000 to 1 million.[8]

Section 527 Organizations Escape Regulation

Perhaps the most widely-discussed campaign finance development during the 2004 election cycle was the proliferation of unregulated 527 organizations—named after the section of the Internal Revenue Code establishing such organizations' tax-exempt status. This proliferation of 527 organizations was not the result of a loophole in BCRA but, instead, resulted from the FEC's refusal to enforce the definition of "political

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and $3 million to the DCCC). The Republican totals include $26 million in excess primary funds transferred from the Bush-Cheney '04 presidential committee ($24 million to the RNC, $1 million to the NRSC, and $1 million to the NRCC).

[7] BCRA also requires periodic adjustment of the new limits to reflect changes in the cost of living. *See* 2 U.S.C. § 441a(c).

[8] Broder, Washington Post, Feb. 3, 2005.

committee" contained in the 1974 amendments to the Federal Election Campaign Act (FECA).[9]

As noted in the Introduction, BCRA closed the soft money loophole that the FEC had created through a series of advisory opinions and rulemakings, dating back to 1978. BCRA did so by prohibiting "political committees" from receiving soft money. Following BCRA's closure of the soft money loophole, political party operatives sought a new means of maintaining soft money into the federal election process.

Despite nearly identical definitions of "political organization" in the tax code[10] and "political committee" in FECA,[11] a new generation of so-called 527 organizations claimed "political organization" tax-exempt status under section 527 of the tax code, while stating that they were not "political committees" for the purposes of federal campaign finance regulation. As this new soft money scheme was deployed, the FEC failed to act, declining to adopt regulations proposed by its general counsel clarifying that these new 527 organizations are required by federal law to register with the FEC as "political committees," and deadlocking on whether to pursue a rulemaking on the issue.

Despite widespread attention, the impact of 527 organizations on the 2004 federal election cycle was limited—$336 million was raised, 44% of which was raised by 25 wealthy donors; 14 democratic-leaning donors contributed $106 million and 11 republican-leaning donors contributed $40 million.

Not only did a substantial sum of money come from a handful of individuals, but most of the activity came from a very small number organizations—the top five democratic-leaning 527s active in the 2004 federal elections spent 77% of the money spent by all democratic-leaning 527s (not including labor unions). The top three 527s accounted for 73% of all republican-leaning money spent by the republican-leaning 527s in the 2004 election cycle (see Table 2).

Although unregulated 527 organizations were limited in number and most of their funding came from a very small pool of very wealthy individuals in this past election cycle, increased electoral activity by these groups in the 2004 election cycle strongly suggests that they could play an even larger and more influential role in future elections.

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[9] Pub. L. No. 93-443, § 201(A)(3), 88 Stat. 1263 (1974).
[10] 26 U.S.C. § 527(e).
[11] 2 U.S.C. §§ 431(4), (8)(A)(i) and (9)(A)(i).

Unless these 527 organizations are brought under regulation by the courts, the FEC or Congress, some fear that the previous abuses felt under the pre-BCRA soft money system will be reborn.

Table 2
Top Democratic and Republican-leaning 527s[12]

Democratic-leaning Organization	**Raised**	**Spent**
America Coming Together - Nonfederal Account	$78,652,163	$76,270,931
Media Fund	$59,394,183	$54,429,053
MoveOn.org Voter Fund	$12,517,365	$21,205,288
New Democrat Network - Non-Federal	$12,221,608	$12,194,451
Citizens for a Strong Senate	$10,848,730	$10,143,121
TOTAL	**$173,634,049**	**$174,242,844**

Republican-leaning Organization	**Raised**	**Spent**
Progress For America Voter Fund	$44,929,174	$35,437,204
Swift Boat Vets and POWs for Truth	$17,068,390	$22,424,420
Club for Growth (and Club for Growth.net)	$11,795,254	$13,322,704
TOTAL	**$73,792,818**	**$71,184,328**

II. Litigation Post-Supreme Court Decision in *McConnell v. FEC*

"*Shays* I" Lawsuit

As detailed in the 2004 update, a suit against the FEC was brought by Congressmen Christopher Shays (R-CT) and Marty Meehan (D-MA), who asked the court to reverse portions of the FEC's soft money, electioneering communications and coordination provisions, arguing they depart significantly from the Reform Act's text and are "contrary to law." On September 18, 2004, Judge Colleen Kollar-Kotelly, a member of the three-judge panel who heard *McConnell*, issued her decision in *Shays v. FEC* [13],

[12] Data as of December 8, 2004 from IRS filings as compiled by Center for Responsive Politics and FECInfo. Amounts contributed include donations to federally oriented 527 organizations. Figures do not include any donations made to state or local 527 organizations. See: http://www.campaignlegalcenter.org/attachments/1297.pdf.
[13] *Shays v. FEC*, 251 F. Supp 2d 176 (2004).

and struck down 15 separate regulations[14] adopting BCRA and directed the FEC to rewrite them.

The FEC appealed five of the 15 stricken regulations and on July 15, 2005, the D.C. Circuit Court of Appeals affirmed "in all respects" Judge Kollar-Kotelley's decision striking down the 15 regulations.[15]

<u>"*Shays* II" Lawsuit</u>

As detailed in last year's update, two separate cases were filed against the FEC in the fall of 2004 challenging the agency's failure to promulgate rules to define the term "political committee," particularly as applied to 527 groups, *Shays et al v. FEC*[16] and *Bush-Cheney '04 Inc., v. FEC*,[17] The two suits, both filed with the federal district court in Washington, D.C., have been consolidated and are often referred to collectively as the "*Shays* II" suit. In *Shays* II, plaintiffs allege that the Commission's failure to adopt rules defining the term "political committee" was arbitrary and capricious, an abuse of discretion and contrary to law under the Administrative Procedures Act. Plaintiffs in the consolidated suit, Congressmen Shays (R-CT) and Meehan (D-MA), and the Bush-Cheney '04 political committee, seek to have the court instruct the agency to immediately issue appropriate regulations. In December, 2004, the court granted Senators John McCain (R-AZ) and Russ Feingold (D-WI) the right to file as an amicus brief in the case, which they did in July 2005. As of this writing, both plaintiffs and defendant have filed cross-motions for summary judgment, but the court has not yet issued any decision in the case. The decision by the D.C. Circuit Court of Appeals affirming the Congressional plaintiff's standing in Shays I may serve to move the Shays II case forward more

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[14] Regulations struck down by the court included: "coordination" definition; coordination regulations excluding the Internet from rules; "agent" definition for purposes of coordination rules; "solicit" definition; "direct" definition; "agent" definition for purposes of the soft money rules; state party fundraising rules; "voter registration" definition as applied to state party soft money rules; "get out the vote activity" definition as applied to state party soft money rules; "voter identification" definition as applied to state party soft money rules; "generic campaign activity" definition as applied to state party soft money rules; definition of state, district and local employees for state party soft money rules; *de minimis* exemption definition of the Levin Amendment rules; regulations excluding 501(c)(3) groups from the "electioneering communications" rules; and "electioneering communications" rules exempting broadcasts not "for a fee".

[15] Civil No. 04-5352, Appeal no. 02cv01984, decided July 15, 2005, U.S. Court of Appeals for the District of Columbia. Decision found at: http://www.campaignlegalcenter.org/attachments/1410.pdf.

[16] Civil No. 04-1597 (D.D.C. filed Sept. 14, 2004).

[17] Civil No. 04-1612 (D.D.C. filed Sept. 17, 2004).

expeditiously, as the same standing objections were made by the FEC in District Court pleadings in Shays II.

III. Administrative Developments at the FEC

The 2004 calendar year ended with a flurry of administrative rulemaking activity. Further, as a result of the September 2004 district court decision in the *Shays* I lawsuit—invalidating 15 FEC rules and ordering the Commission to rewrite them—the FEC's 2005 calendar is packed with rulemaking. This section provides a brief overview of these 2004-05 rulemakings, divided into two categories: rulemaking unrelated to the *Shays* I litigation, and rulemaking ordered by the district court in *Shays* I.

A. Administrative Rulemaking Unrelated to *Shays* I

FEC re-adopted pre-BCRA rule on contributions by minors.

The Supreme Court in *McConnell v. FEC* ruled the BCRA prohibition on contributions by minors (individuals 17 years old or younger) to be unconstitutional.[18] In April 2004 the FEC initiated a rulemaking to bring its regulations into conformity with this Supreme Court decision.[19] In February 2005, the Commission published a final rule essentially re-adopting its pre-BCRA rule on contributions by minors, with a single exception—the Commission has eliminated the pre-BCRA requirement that a minor *exclusively* own or control the funds contributed.[20]

Under the new rule, a minor can make contributions to federal political committees so long as: (1) the minor makes the decision to contribute knowingly and voluntarily; (2) the minor has ownership or control over the funds contributed; and (3) the contribution is not controlled by another individual and is not made from the proceeds of a gift, the purpose of which was to provide funds for the making of a political contribution.

B. *Shays* I Court-Ordered Administrative Rulemaking

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[18] 540 U.S. 93, 232 (2003).
[19] NPRM 2004-8, 69 Fed. Reg. 18841 (Apr. 9, 2004).
[20] *See* Final Rules and Explanation and Justification, 70 Fed. Reg. 5565 (Feb. 3, 2005).

Following the district court decision in *Shays* I, the FEC divided the 15 invalidated rule rewrites into nine rulemakings, with public notices of the rulemakings (NPRMs) scheduled to be published throughout the first half of 2005. The nine *Shays* I-related rulemakings, encompassing 15 separate invalidated rules, are as follows:

1. "Agent" definition (NPRM published Feb. 2, 2005);
2. $5,000 *de minimis* exception from Levin amendment (NPRM published Feb. 2, 2005);
3. Candidate fundraising at state party events (rulemaking concluded June 30, 2005);
4. Internet exclusion from coordination rules and definition of "public communication" (NPRM published April 4, 2005);
5. Federal election activity definitions, including "voter identification," "voter registration," and "get-out-the-vote" (NPRM published May 4, 2005);
6. State party payment of certain wages and salaries (NPRM published May 4, 2005);
7. Coordination rules (NPRM *scheduled* to be published in May, not yet published as of July 31);
8. Electioneering communications (NPRM *scheduled* to be published in June, not yet published as of July 31); and
9. Definitions of "solicit" and "direct" (NPRM *scheduled* to be published in July, not yet published as of July 31).

The lone *Shays*-related rulemaking completed at the time of this writing, as well as several important pending rulemakings, are detailed below.

FEC allows federal candidates and officeholders to speak at state party fundraising events "without restriction."

As of this writing, the FEC has completed only one of the *Shays* I-related rulemakings—the rulemaking on candidate fundraising at state party events. In the same section of BCRA prohibiting federal candidates and officeholders from soliciting, receiving, or directing soft money, the statute contains a provision that such candidates and officeholders may "may attend, speak, or be a featured guest at a fundraising event"

for a state political party committee.[21] Following the passage of BCRA, the FEC adopted a rule stating that federal candidates and officeholders may speak at such fundraising events "without restriction." Plaintiffs in *Shays* I argued that this rule constitutes an impermissible exception to BCRA's prohibition on federal candidate solicitation of soft money. The district court in *Shays* I ruled that the FEC's "Explanation and Justification" ("E&J") of the rule was "unreasonable" and in violation of the Administrative Procedures Act.[22] The court remanded the rule to the FEC for action consistent with its opinion.

The FEC opened a new rulemaking on this issue in February 2005 proposing two alternatives: (1) keep the rule as is and provide a more detailed E&J; or (2) adopt a new rule that would allow a federal candidates and officeholder to attend and speak at a fundraiser, but not to solicit soft money.[23] The FEC concluded the rulemaking by adopting a revised E&J for an unchanged rule, over the objections of the Congressional sponsors of BCRA.[24]

FEC commences rulemaking on the application of campaign finance laws to Internet activity.

Following the passage of BCRA, the FEC adopted a rule defining the term "public communication" nearly identically to the statutory definition of the term, with one exception—the FEC rule exempted "communications over the Internet" from the definition. This regulatory definition is incorporated into several important aspects of federal campaign finance regulation, including the "coordination" rules, advertising disclaimer requirements, and hard money requirements for "generic campaign activity" and public communications that support or oppose a clearly identified candidate.

The district court in *Shays* I ruled that the FEC's exclusion of Internet communications from its regulations was an "impermissible construction" of BCRA that "severely undermines" the law's purposes.[25] The court remanded the rule to the FEC for action consistent with the court's decision.

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[21] 2 U.S.C. § 441i(e)(3).
[22] *Shays*, 337 F. Supp. 2d at 92-93.
[23] NPRM 2005-6, 70 Fed. Reg. 9013 (Feb. 24, 2005).
[24] *See* Revised Explanation and Justification, 70 Fed. Reg. 37649 (June 30, 2005).
[25] *Shays*, 337 F. Supp. 2d at 70, 112.

The FEC opened a new rulemaking on "Internet Communications" in April.[26] Whereas the *Shays* I court had ruled narrowly that the Commission's wholesale exclusion of Internet communications from its regulations was an impermissible construction of BCRA that must be remedied, the FEC took the opportunity to commence an extremely broad rulemaking to examine virtually all possible applications of campaign finance law to the Internet—including proposed alterations of the definitions of "contributions" and "expenditure," as well as proposed changes to the scope of the "media exemption." The FEC has received written public comment from hundreds of individuals and organizations and held a two-day public hearing on the rulemaking in June. As of this writing, the Commission has not adopted a final rule in the rulemaking.

FEC revisits rules defining terms "agent," "solicit," "direct," "voter identification," "voter registration," and "get-out-the-vote activity."

The court in *Shays* I invalidated the FEC's regulatory definitions of the terms "agent," "solicit," "direct," "voter identification," "voter registration," and "get-out-the-vote-activity" on a variety of legal grounds. The court found that the Commission's E&J for its definition of "agent" failed to adequately explain the Commission's decision to exclude "apparent authority" from the scope of its definition.[27] The court found the Commission's definitions of "solicit," "direct" and "voter identification" to be impermissible constructions of BCRA. Further, the court invalidated regulations defining "voter registration" and "get-out-the-vote-activity" on the ground that the Commission gave the public insufficient notice that it would construct the terms narrowly as to require more than encouragement of the given activity in order to meet the adopted definition. Rulemakings on the issues have been, or will soon be, commenced In order to comply with the *Shays* I court order.

[26] NPRM 2005-10, 70 Fed. Reg. 16967 (Apr. 4, 2005).
[27] *Shays*, 337 F. Supp. 2d at 72.

IV. Additional Proposed Campaign-Finance Legislation

527 Reform Legislation

Two competing measures have been introduced in Congress that address campaign finance laws. The first, "527 Reform Act,"[28], was introduced by Senators McCain and Feingold and Congressmen Shays and Meehan sought to regulate section 527 organizations that spend unlimited amounts from unlimited sources (corporations, unions and wealthy individuals) on federal elections. The would require all section 527 organizations to register as political committees with the Federal Elections Commission unless the organizations are solely raising and spending money for activities targeting non-federal elections, state or local ballot initiatives or state judicial elections.

The second legislation, an opposing measure called the "527 Fairness Act"[29] introduced by Congressmen Pence (R-IN) and Wynn (D-MD) would roll back many of the provisions of BCRA, including repealing the aggregate limit on the contributions individuals can give to party committees in an election. The bill would also make it possible for a federal officeholder to solicit, and a wealthy individual to contribute, up to $1,160,200 in a single cycle.

Both House bills have been voted out of committee and are awaiting votes on the floor. The Senate Governmental Oversight Committee conducted a mark up of the "527 Reform Act" but has not voted the bill out to the floor of the Senate.

FEC Reform Legislation

"The Federal Election Administration Act of 2003,"[30] was introduced a previous session of Congress and would replace the FEC with a new agency (the Federal Election Administration) structured to strengthen administration and enforcement of federal campaign finance law.

It would accomplish two main things: first, it would replace the six Commissioners with a Chair and two additional members, appointed by the President

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[28] H.R. 5127 and S. 2828 are available at: http://www.campaignlegalcenter.org/attachment.html/527+Reform+Act.pdf?id=1258 (Introduced September 22, 2004 – 108th Congress).
[29] H.R. 1316 (Introduced 2005 – 109th Congress).
[30] H.R. 2709 and S. 1388 (Introduced 2003 – 108th Congress)

with the advice and consent of the Senate. Second, the new Federal Election Administration would also have the power to impose civil monetary penalties or issue cease-and-desist orders in the event of violations. Enforcement proceedings would be conducted before impartial administrative law judges.

Hearings were held in October of 2003 in the U.S. House Committee on Administration and in July of 2004 in the U.S. Senate Governmental Oversight Committee on the FEC structure and on its handling of section 527 regulation. [31]

[31] See: http://rules.senate.gov/hearings/2004/071404_hearing.htm for agenda and links to testimonies by Senators McCain and Feingold, Trevor Potter, Benjamin Ginsberg, Bob Bauer and Chairman Smith and Commissioner Weintraub.