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To: Chair Ravel and Commissioners Eskovitz, Garrett, Montgomery and Rotunda

From: Zackery P. Morazzini, General Counsel

Subject: Legal Division Analysis of Contribution Limits and LDFs in Wake of Recent Accounts of Widespread Campaign Fraud and Pending Interpleader Action

Date: October 31, 2011

The Commission has asked that the Legal Division analyze the legal issues regarding application of campaign contribution limits for donors that have already contributed to state officers, candidates, or committees[1] given the alleged widespread fraud perpetrated by political treasurer Kindee Durkee and her firm Durkee & Associates. We have also been asked to discuss the scope of the proper use of contributions raised through Legal Defense Funds, and anticipate issuing an Advice Letter on this topic.

SUMMARY OF CONCLUSIONS

The Commission is bound by the Political Reform Act and does not have independent authority to waive contribution limits or the post-election fundraising prohibitions to allow candidates to raise replacement funds in the event of treasurer malfeasance. However, under the unique circumstances being faced by many candidates and committees that previously employed Durkee as their treasurer, the Act's contribution limits and implementing regulations can be interpreted to not apply where a contribution for an upcoming election was delivered to Durkee, but the contribution was never deposited into the intended candidate or committee account, and was instead misappropriated by Durkee. Under these facts, it appears to staff that, given the breadth of the alleged criminal conduct by Durkee, she was not acting as an agent for the candidate or committee when she received these contributions, but rather was acting with the intent to defraud her clients at the time of receipt. Therefore, these contributions were never accepted for purposes of the Act's contribution limits. However, once a contribution is deposited into the candidate or committee's account, the contribution is considered made and accepted and the Act's contribution limits apply, regardless of whether funds are thereafter misappropriated from the account. The Act provides no

[1] The Act's contribution limits apply per election, and do not apply to federal or local officers or candidates.

exception for the misappropriation of contributions once they are made and accepted. Any such exception would have to be enacted through legislation and further the purposes of the Act. There may, however, be instances where the evidence demonstrates that Durkee was in fact never acting as an agent for a candidate or committee, made no proper expenditures from their campaign accounts, and gave them no access to their accounts prior to misappropriating funds. Staff would consider such facts on a case-by-case basis to determine whether contributions were "accepted" for purposes of the Act's contribution limits.

Candidates and committees that have been named as defendants in the interpleader action filed by First California Bank may establish Legal Defense Funds to pay for attorneys' fees and legal costs related to their defense in that action. Candidates and committees interested in using these funds to pay for such costs in pursuing a cross-complaint against Durkee as part of their defense in the interpleader action are encouraged to request advice from Commission staff based upon the specific facts of their case.

However, a Legal Defense Fund cannot be used to pay attorneys' fees or costs incurred if a candidate or committee brings a separate plaintiff's action against Durkee seeking restitution of misappropriated contributions. The Act strictly limits the use of such funds to a candidate or officer's "legal defense" if they are "subject to one or more civil or criminal proceedings or administrative proceedings arising directly out of the conduct of an election campaign…." Any exception for a plaintiff's action filed by a candidate or committee against Durkee would have to be enacted through legislation and further the purposes of the Act.

FACTUAL ALLEGATIONS

As discovered during an audit by the Commission's Enforcement Division, and as alleged in the federal complaint against Durkee filed by the United States Attorney's Office, Durkee engaged in an illegal scheme whereby she transferred campaign funds from committee accounts for Assemblymember Jose Solorio to her firm's account without the knowledge or consent of her client. She also is alleged to have improperly transferred funds between accounts, sometime transferring funds from federal committee accounts to state committee accounts and vice versa, in an attempt to cover up her actions. It has also been reported that Durkee misappropriated contributions prior to depositing them into her clients' accounts.

Federal prosecutors accuse Durkee of misappropriating over $670,000 from Assemblymember Solorio alone. Representatives of Senator Diane Feinstein have reported that Durkee misappropriated approximately $4.7 million in federal contributions. Having signatory authority for nearly 400 committee accounts, some estimate that Durkee could have stolen as much as $25 million in campaign funds over the past few years.

In September of 2011, First California Bank[2] filed an interpleader action in the Los Angeles County Superior Court, naming nearly 400 officers, candidates, and committees

[2] We are informed that Durkee maintained most or all of her clients' campaign accounts at First California Bank.

as defendants, and remitting the remaining balance of each account to the court. As discussed more fully below, should that action proceed as a proper interpleader action, the candidates and committees named as defendants will have an opportunity to establish their entitlement to the remaining funds.

CONTRIBUTION LIMITS UNDER THE POLITICAL REFORM ACT

The Supreme Court of the United States has recognized that limits on political contributions serve the government's important interest in preventing corruption because they reduce the risk of *quid pro quo* arrangements and mitigate "the appearance of corruption spawned by the real or imagined coercive influence of large financial contributions on candidates' positions and on their actions if elected to office." (*Buckley v. Valeo* (1976) 424 U.S. 1, 25.)

Most recently, in *Citizens United v. Federal Election Commission* (2010) 130 S.Ct. 876, the Supreme Court reaffirmed the *Buckley* Court's holding with regard to the corrupting potential of large direct contributions. (*Id*., at 908 ["The *Buckley* Court … sustained limits on direct contributions in order to ensure against the reality or appearance of corruption."].) It is the state's interest in preventing candidate corruption, or the appearance thereof, that supports the Act's limits on political contributions.

The Act imposes limits on direct contributions to state officers and candidates. These limits apply per election. Section 85301[3] provides:

> (a) A person, other than a small contributor committee or political party committee, **may not make** to any candidate for elective state office other than a candidate for statewide elective office, and a candidate for elective state office other than a candidate for statewide elective office **may not accept** from a person, any contribution totaling more than three thousand dollars ($3,000) **per election**.
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> (b) Except to a candidate for Governor, a person, other than a small contributor committee or political party committee, **may not make** to any candidate for statewide elective office, and except a candidate for Governor, a candidate for statewide elective office **may not accept** from a person other than a small contributor committee or a political party committee, any contribution totaling more than five thousand dollars ($5,000) **per election**.
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> (c) A person, other than a small contributor committee or political party committee, **may not make** to any candidate for Governor, and a candidate for governor **may not accept** from any person other than a small contributor committee or political party committee, any contribution totaling more than twenty thousand dollars ($20,000) **per election**.

[3] The limits set forth in this Section apply per election and are adjusted biennially by the Commission based upon changes to the Consumer Price Index. The limits applicable for the 2011 -12 election cycle are $3,900 for legislative candidates, $6,500 for statewide candidates except governor, and $26,000 for candidates for governor. (Section 83124; Regulation 18544.)

(d) The provisions of this section do not apply to a candidate's contributions of his or her personal funds to his or her own campaign.

Under Section 85302, "small contributor committees" are subject to separate contribution limits for various candidates, as are individual contributions to committees and political parties under Section 85303. This legal analysis applies equally to those provisions to the extent Durkee was the treasurer for the intended recipients of the contributions and the recipients were victims of the alleged fraud.

Under the relevant provisions of Regulation 18421.1, appearing within the campaign reporting provisions of the Commission's regulations, the following standards apply to the making and receipt of monetary contributions:

(a) A monetary contribution, including one made through wire transfer, credit card transaction, debit account transaction or similar electronic payment option (including one made via the Internet), **is "made" on the date that the contribution is mailed, delivered, or otherwise transmitted to the candidate or committee**. Alternatively, the date of the check or other negotiable instrument by which the contribution is made may be used in lieu of the date on which the contribution is mailed, delivered, or otherwise transmitted, provided it is no later than the date the contribution is mailed, delivered, or otherwise transmitted.

(b) Notwithstanding subdivision (a), for purposes of the disclosure of late contributions, as defined in Government Code section 82036 and pursuant to Government Code section 84203, a monetary contribution is "made" on the date the contribution is mailed, delivered, or otherwise transmitted to the candidate or committee. Consistent with 2 Cal. Code Regs. section 18401, the candidate or committee shall maintain documentation to support the date the contribution was made.

(c) **A monetary contribution is "received" on the date that the candidate or committee, or the agent of the candidate or committee, obtains possession or control of the check or other negotiable instrument by which the contribution is made.** All contributions received by a person acting as an agent of a candidate or committee shall be reported to and disclosed by the candidate or committee, or by the committee's treasurer, no later than the closing date of the next campaign statement that the committee or candidate is required to file.

ANALYSIS

At the Commission's October 13, 2011 public hearing in Los Angeles, staff's earlier Interested Persons meeting in Sacramento, and through written correspondence, members of the regulated community, the public, and representatives of candidates and committees previously represented by Durkee provided comments regarding potential action or non-action by the Commission with regard to application of the Act's contribution limits and the use of Legal Defense Funds. Specifically, it has been suggested that the contribution limits should not be applied in instances where a contribution was delivered to Durkee but never deposited into the candidate's account, but was instead either stolen by Durkee

for her personal use or deposited into another client's account without the knowledge or consent of the candidate, or a contribution was delivered to Durkee and deposited into the candidate's account but thereafter transferred to Durkee's account, another client's account, or otherwise misappropriated. It has also been suggested that contribution limits should not be applied to those whose accounts are frozen and their assets have been remitted by the bank to the Superior Court as part of the interpleader action.

The question is whether under any of these scenarios the Commission has the authority to apply the Act and Regulations, or amend the Regulations, in a manner that permits contributors that have already "maxed out" to a candidate or committee to again contribute up to the contribution limit for the same election. Each scenario will be addressed below.

1) Contributions Delivered to Durkee But Never Deposited Into Candidate or Committee Account

The audit findings, criminal allegations, and resulting interpleader action all indicate that Durkee was not acting as an agent for a candidate or committee for purposes of receiving the contributions that were never deposited into the clients' accounts, but was instead acting with the intent to misappropriate the contributions for her personal benefit at the time she received them.

The Act's contribution limits prohibit the completion of a transaction: the making and accepting of a contribution above the set limit. It is upon completion of the transaction that the possibility of corruption, which the limits are intended to prevent, comes into being. When receiving campaign contributions, treasurers are acting as agents of the candidate or committee for purposes of this transaction. Thus, a contribution is considered "received" on the date that "the candidate or committee, or the agent of the candidate or committee, obtains possession or control of the check or other negotiable instrument by which the contribution is made…." (Regulation 18421.1, subd. (c).)

In California, "An agent is one who represents another, called the principal, in dealings with third persons. Such representation is called agency." (Civ. Code, § 2295.) However, an agent can never have authority to commit fraud upon the principal. (*Meyer v. Glenmoor Homes, Inc.* (1966) 246 Cal.App.2d 242, 264.) Those committing fraud against the principal are not acting as agents, as "an agency can be created only for the performance of lawful acts." (*Vaughan v. People's Mortg. Co.* (1933) 130 Cal.App. 632, 644 [internal citation omitted].)

The wide spread pattern and practice of fraud alleged to have been employed by Durkee indicates that, in instances where she never deposited the contributions into her clients' accounts, she was committing fraud at the outset and thus did not "receive" these contributions as an agent for the candidate or committee. Agents have no authority to defraud the principal. Therefore, under these specific circumstances, prior to deposit the candidate or committee had no possession or control of the contributions. As such, although those contributions that were given to Durkee were "made," they were never "accepted" or "received" as set forth in Section 85301 and Regulation 18421.1, subdivision (c), because neither the candidate, committee, nor proper agent "obtain[ed]

possession or control of the check or other negotiable instrument by which the contribution is made." Absent acceptance or receipt by the candidate, committee, or proper agent, the transaction has not been completed and there has been no contribution that would be subject to the contribution limit.

This analysis only applies to contributions to a candidate or committee being raised for the current election cycle. The Act's ban on post-election fundraising presents a barrier to applying this analysis to contributions received for prior elections, unless a committee had debt. The prohibition on post-election fundraising set forth in Section 85316, subdivision (a) states:

> [A] contribution for an election may be accepted by a candidate for elective state office after the date of the election only to the extent that the contribution does not exceed net debts outstanding from the election, and the contribution does not otherwise exceed the applicable contribution limit for that election.

The misappropriation of funds by the Durkee firm does not create a "debt" that a candidate or committee owes. Rather, those who had funds misappropriated by Durkee may be owed money by the firm. For purposes of the post-election fundraising ban, the Durkee firm's activities do not give rise to new debts for the affected candidates and committees.

Importantly, in the event a candidate or committee recovers from Durkee, through the interpleader action, or otherwise misappropriated funds that were never deposited into their account, any such recovery must be returned to the contributor if the contributor to which the amount of recovery can be attributed has contributed again and the combined total would violate the applicable contribution limit.

2) Contributions Delivered to Durkee and Deposited Into Candidate or Committee Accounts

Even under the unique facts presented, once a contribution is deposited into a candidate or committee account, it is considered "made" and "accepted" under the plain language of the Act and is therefore subject to contribution limits.[4] Once the contribution is deposited, the transaction is complete and the candidate or committee has actual possession and control of the contribution – even if only for a limited time. The Act's language appears to provide no exception for contributions that are misappropriated from the account prior to use by the candidate or committee. Any such exception would require a legislative amendment to the Act, and would have to further its purposes.

[4] There may be instances where the evidence demonstrates that Durkee accepted and deposited contributions into a candidate or committee account over which the client had no control or signatory authority, yet she made no expenditures from the account for campaign purposes but instead misappropriated all contributions for her own personal benefit. Staff would consider such facts on a case-by-case basis to determine whether the evidence is sufficient to demonstrate that Durkee was in fact at all relevant times acting with an intent to defraud the candidate or committee and not as an agent such that those deposited and then misappropriated contributions would not be considered "accepted" for purposes of the Act's contribution limits.

3) Candidate or Committee Accounts Frozen or Remitted to Court Due to Interpleader Action

Because a contribution remaining in a frozen account, or remitted to the court as part of the interpleader action, was necessarily deposited into the account, it would be considered "made" and "accepted" under the plain language of the Act and therefore subject to contribution limits. Once the contribution is deposited, the transaction is complete and the candidate or committee has actual possession and control of the contribution – even if only for a limited time before the account is frozen or the funds are remitted to the court. The Act's language appears to provide no exception for contributions that are frozen or remitted to a court prior to use by the candidate or committee. Any such exception would require a legislative amendment to the Act, and would have to further its purposes.

PROPER USE OF LEGAL DEFENSE FUNDS

Commission staff also anticipates receiving a request for an Advice Letter regarding the proper use of Legal Defense Funds (LDFs) under the circumstances described herein. Below is the analysis that will be employed in responding to any such request.

The Act permits candidates to establish LDFs for certain purposes. Contributions to LDFs are not subject to limits. Section 85304 states:

> (a) A candidate for elective state office or an elected state officer may establish a separate account to defray **attorney's fees and other related legal costs** incurred for the **candidate's or officer's legal defense if the candidate or officer is subject to one or more civil or criminal proceedings or administrative proceedings** arising directly out of the conduct of an election campaign, the electoral process, or the performance of the officer's governmental activities and duties. These funds may be used only to defray those attorney fees and other related legal costs.
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> (b) A candidate may receive contributions to this account that are not subject to the contribution limits set forth in this article. However, all contributions shall be reported in a manner prescribed by the commission.
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> (c) Once the legal dispute is resolved, the candidate shall dispose of any funds remaining after all expenses associated with the dispute are discharged for one or more of the purposes set forth in paragraphs (1) to (5), inclusive, of subdivision (b) of Section 89519.

(Emphasis added.) The Act was amended to provide for the establishment of LDFs by local candidates under the same terms as set forth in Section 85304 (see Section 85304.5). Regulation 18530.45 further identifies what procedures must be used in establishing an LDF at the local level.

Regulation 18530.4, in relevant part, implements Section 85304 for state candidates and officers and clarifies the proper uses of and limitations on LDFs:

(g) Limitations. For the purposes of Section 85304(a), the following limitations apply:

(1) Legal defense funds may only be raised in an amount reasonably calculated to pay, and may only be expended for, attorney's fees and other related legal costs.

(A) "Attorney's fees and other related legal costs" includes only the following:

(i) Attorney's fees and other legal costs **related to the defense of the candidate or officer**.

(ii) Administrative costs directly related to compliance with the requirements of subdivisions (b) and (d) and the recordkeeping requirements of subdivision (c) of this regulation.

(B) "Attorney's fees and other related legal costs" does not include for example expenses for fundraising, media or political consulting fees, mass mailing or other advertising, or a payment or reimbursement for a fine, penalty, judgment or settlement, or a payment to return or disgorge contributions made to any other committee controlled by the candidate or officer.

(2) A candidate or officer **may only raise funds under this regulation for defense against a civil or criminal proceeding, or for defense against a government agency's administrative enforcement proceeding** arising directly out of the conduct of an election campaign, the electoral process, or the performance of the officer's governmental activities and duties. […]

(3) **Legal defense funds may not be raised in connection with a proceeding until the following has occurred**:

(A) **In a proceeding brought by a government agency, when the candidate or officer reasonably concludes the agency has commenced an investigation or the agency formally commences the proceeding**, whichever is earlier.

(B) **In a civil proceeding brought by a private person, after the person files the civil action**.

The plain language of both the statute and the implementing regulation is clear that LDF funds may only be used in connection with a candidate or officer's "legal defense" if the

candidate or officer is "subject to" a "civil or criminal proceeding or administrative proceeding."

Use of LDFs to Pay for Attorneys' Fees and Legal Costs Related to the Interpleader Action

Soon after the federal complaint was filed against Durkee, First California Bank filed an interpleader action and remitted to the superior court all the remaining funds in the approximately 400 accounts managed by Durkee, totaling nearly $2.5 million. It is our understanding that all, or nearly all, alleged victims of Durkee are named as defendants in the action.

An interpleader action is a procedure whereby a person holding money or personal property to which conflicting claims are being made by others can join all claimants and force them to litigate their claims among themselves. Interpleader is proper whenever multiple claims are made by two or more persons such that they may expose the person against whom the claims are asserted to multiple liability. (*Id*.; see also Ca. Code Civ. Proc., § 386, subd. (b).)

Under such circumstances, it appears that the persons named in the interpleader action, including those named by reference to their candidate controlled committee, are defendants in a civil action directly related to the conduct of an election campaign for purposes of Section 85304, and may use funds raised through an LDF to pay attorneys' fees and legal costs related to the interpleader action. Such costs could include fees for auditors to examine bank records for purposes of establishing the amount of funds embezzled or otherwise misappropriated by Durkee or others, and other matters related to proving up the amount of money to which the defendant is entitled.

Additionally, because Durkee & Associates are also named as defendants in the interpleader action, we believe LDF funds may properly be used by candidates or committees that wish to file cross-complaints in that action against Durkee, to the extent appropriate or permitted in the interpleader action.[5] Defendants in an interpleader action may file claims against each other as part of the action. (Ca. Code. Civ. Proc., § 386.) In fact, those interpleader defendants having claims against each other may be required to assert such claims through a cross-complaint. (Compare *Cheiker v. Prudential Ins. Co. of America* (9th Cir. 1987) 820 F2d 334, 336 [cross-complaint compulsory in interpleader action] with *State Farm Fire & Cas. Co. v. Pietak* (2001) 90 Cal.App.4th 600, 615 [arguably not].) Under such circumstances, we believe LDF funds may be properly used for attorneys' fees and legal costs related to both the defense of the interpleader action and the directly related, and perhaps compulsory, cross-complaint to the extent necessary to defend one's rights. Establishing all claims against the other defendants in an interpleader action would appear to be part and parcel to one's legal defense in such an action. Therefore, such use would appear to be directly related to the legal defense of a candidate or officer subject to a civil proceeding in accordance with Section 85304. Candidates or committees interested in using LDF funds to pursue such a cross-complaint

[5] The extent to which a cross-complaint may be a legally or procedurally appropriate vehicle for seeking recovery or restitution from Durkee is beyond the scope of this memorandum.

are encouraged to seek advice from Commission staff based upon the individual facts of their case so staff can make a determination based upon concrete facts.

Use of LDFs to Pay for Attorneys' Fees and Legal Costs Related to Defending the Victim's Federal Rights During the Course of a Federal Prosecution of Durkee in Which the Candidate or Committee is a Victim in the Specific Case

Federal law (18 U.S.C. § 3771) provides enumerated rights for crime victims. Specifically, this law states, in relevant part:

> (a) Rights of crime victims. -- A crime victim has the following rights: [¶¶]
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> > (3) The right not to be excluded from any such public court proceeding, unless the court, after receiving clear and convincing evidence, determines that testimony by the victim would be materially altered if the victim heard other testimony at that proceeding.
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> > (4) The right to be reasonably heard at any public proceeding in the district court involving release, plea, sentencing, or any parole proceeding.
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> > (5) The reasonable right to confer with the attorney for the Government in the case.
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> > (6) The right to full and timely restitution as provided in law. [¶¶]
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> (c) … (2) Advice of attorney. -- The prosecutor shall advise the crime victim that the crime victim can seek the advice of an attorney with respect to the rights described in subsection (a).
>
> (d) … (1) Rights. -- The crime victim or the crime victim's lawful representative, and the attorney for the Government may assert the rights described in subsection (a).

Section 3771, subdivision (e) defines "crime victim" as "a person directly and proximately harmed as a result of the commission of a Federal offense…."

The language of Section 3771 contemplates the existence of formal charges pending against the accused (see § 3771, subd. (a)(2) [right to timely notice of public court proceeding]; (a)(3) [right not to be excluded from public court proceedings]) and for purposes of Section 85304, formal charges are necessary to qualify the candidate or committee as being subject to a criminal proceeding. Thus, under federal law, crime victims may defend their rights with the assistance of an attorney, including the right to restitution, in the course of a federal prosecution. We believe that LDF funds may properly be used by a candidate or officer that meets the definition of "crime victim" to cover attorneys' fees and related legal costs in a federal criminal action against Durkee under the facts described herein, because such use is directly related to the legal defense of a candidate or officer's rights, and the candidate or officer is subject to the criminal proceeding, in accordance with Section 85304.

Use of LDFs to Pay for Attorneys' Fees and Costs Related to a Separate Civil Action to Recover Contributions

It has also been asked whether LDF funds could be used by a candidate or officer to institute a separate civil action against Durkee for purposes of pursuing recovery of misappropriated contributions. The answer appears to be no.

Under the Section 85304, as discussed above, use of such funds is strictly limited to a candidate or officer's "legal defense" if the candidate or officer is "subject to" a "civil or criminal proceeding or administrative proceeding." Given the strict language of the statute and implementing regulations, the Commission receives very few requests for legal opinions on the proper use of LDFs. Therefore, we find no guidance in our prior opinions. However, under these facts, we do not see how instituting a plaintiff's action against Durkee to recover misappropriated contributions would meet the plain terms of the Act. Unlike an interpleader action where a candidate or officer is named as a defendant, a plaintiff's suit is not a "legal defense," nor does it make the candidate or officer "subject to" a civil action. To the contrary; the candidate or officer would be the prosecutor of, rather than subject to, the civil suit. Therefore, we do not believe LDF funds may be used for such purposes under the present statutory language. We believe a legislative amendment to Section 85304 would be necessary in order to authorize such use.

Potential LDF Legislation

The Commission may wish to support legislation to amend Section 85304 to authorize the use of LDF funds to pursue civil restitution actions against treasurers or others accused of misappropriating contributions. A narrowly-drawn amendment could be put forth that would authorize such use. We believe such an amendment would further the purposes of the Act in that candidates or officers would be using such funds to recover contributions. Pursuant to Section 89510, contributions are deemed to be held in "trust for expenses associated with the election of the candidate or for expenses associated with holding office." Permitting LDF funds to be used to recover misappropriated contributions that were held in trust would fit within the intent expressed in Section 85304, because the recovery of contributions "aris[es] directly out of the conduct of an election campaign" and serves the purpose of ensuring that elections are conducted more fairly by not disadvantaging a candidate or officer by requiring either personal or campaign funds to be used to recover funds held in trust. (Section 81002, subd. (e).)