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FAIR POLITICAL PRACTICES COMMISSION
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To: Chair Miadich, Commissioners Cardenas, Hatch, Hayward, and Wilson

From: Dave Bainbridge, General Counsel, Legal Division
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Subject: Adoption of Proposed Regulations 18402.2 and 18421.10 – Disclosure by Limited Liability Companies

Date: June 8, 2020

Requested Action and Summary of Proposed Action

Staff proposes adoption of proposed Regulation 18402.2 and proposed Regulation 18421.10, pre-notice discussion having occurred at the February Commission meeting.¹ These two proposed regulations will increase the information available about a limited liability company (LLC) participating in the political process. Proposed Regulation 18402.2 provides a definition for the “responsible officer” that is to be listed on campaign reports for LLCs that qualify as independent expenditure committees or major donors. “Responsible officer” is defined as “the individual primarily responsible for approving the political activity of the limited liability company.” Proposed Regulation 18421.10, meanwhile, details what information a committee that *receives* a contribution from an LLC must include as part of a contributor’s “name” on its campaign statements and reports. Together, these regulatory changes would allow the public to be informed of the actual individuals behind an LLC’s contribution to a committee, rather than simply the name of a corporate entity and its registered agent and/or professional manager.

Background

The Commission has expressed concern with the lack of meaningful disclosure of political activity by LLCs. The Enforcement Division has identified a pattern in which LLCs, often formed shortly before an election, make large contributions and expenditures in California elections without the sources of the money ever being disclosed to the public in any meaningful way. This lack of information about the individuals responsible for the political activity conducted through LLCs makes investigation of suspicious activity extremely challenging and burdensome and leaves no way for the public to determine the source of LLC political activity.

¹ The regulations of the FPPC are contained in sections 18110 through 18997 of Title 2 of the California Code of Regulations. All regulatory references are to this source. The Political Reform Act is contained in Government Code sections 81000 through 91014. All statutory references are to the Government Code.

LLCs as Business Entities

An LLC is a popular type of business structure that combines the benefits of a partnership and a corporation. LLCs, whose owners are referred to as members, may be formed to run a business, or simply to hold assets.² There are numerous legitimate business reasons why a business may incorporate as an LLC as opposed to a different corporate structure, such as: protecting the members from personal liability for business debts and claims; fewer formalities and less paperwork; avoiding double-taxation; no restrictions on the number and types of owners; and no specific required management structure.³ For these reasons, many different types of businesses, from small family businesses to some of the world's largest companies, choose to incorporate as LLCs.

In addition, LLCs generally can be formed quickly, easily, and anonymously—often in as little as two hours for only several hundred dollars.⁴ Corporate laws in most states, including California, require very little information from LLCs about their formation, funding, management, and operation.⁵ Indeed, the U.S. House of Representatives noted last year that “a person forming a corporation or limited liability company within the United States typically provides less information at the time of incorporation than is needed to obtain a bank account or driver’s license and typically does not name a single beneficial owner.”⁶

While California and most other states require the founders of an LLC to at least disclose the LLC’s (company) name, address, and registered agent, it is possible to form an LLC without ever having to name a single human being associated with the company. Even when an individual is listed as an LLC’s registered agent and/or manager, that person is usually not the true source of an LLC’s capital contributions (i.e. funding). Moreover, investors can use multiple layers of LLCs to obfuscate or completely hide their identities from public disclosure. For example, the California Corporations Code permits an LLC to list another corporate entity as its registered agent and/or manager; in such cases, no individual is identified in connection with the LLC.

² “Business Types: Limited Liability Company.” Franchise Tax Board. <https://www.ftb.ca.gov/file/business/types/limited-liability-company/index.html>. (Accessed May 13, 2020)

³ “Choose a business structure.” Small Business Authority. <https://www.sba.gov/business-guide/launch-your-business/choose-business-structure>. (Accessed May 13, 2020)

⁴ Carl Pacini & Nate Wadlinger, How Shell Entities and Lack of Ownership Transparency Facilitate Tax Evasion and Modern Policy Responses to These Problems, 102 Marquette L. Rev. 111, 119 (2018).

⁵ On an LLC’s Articles of Organization (Form LLC1), filed with the Secretary of State’s Office, an LLC must designate an agent and a manager, and list the name and address of both. An LLC must also indicate whether it is member-managed (i.e. managed by its investors) or manager-managed (i.e. professionally managed by an outsider). Many LLCs remain anonymous by appointing a professional agent and manager, such an attorney or accountant, thereby never having to reveal their members or the sources of capital contributions (i.e. funding).

⁶ H.R.2513, 116th Cong., §2 (2019).

Avenues for Abuse: “Shell Companies” and “Shelf Companies”

The same qualities that make LLCs popular among legitimate businesses make LLCs an ideal business structure for those seeking to conceal activities. Two common ways in which LLCs are often abused are through so-called “shell companies” and “aged shelf companies.” Shell companies are typically business entities that exist only on paper, have no office or employees, and are created only to hold assets or facilitate transactions. While shell companies can and do serve legitimate business purposes (such as facilitating corporate mergers), a 2006 report by the US Department of the Treasury’s Financial Crimes Enforcement Network (FinCEN) found that “the LLC [...] provides an attractive vehicle for a shell company because it can be owned or managed anonymously, and is inherently vulnerable to abuse.”⁷ The same report notes that domestic shell companies, including LLCs, “have become common tools for money laundering and other financial crime.”⁸

Similarly, various services sell so-called “aged *shelf* companies,” LLCs that do not engage in real business, but are instead formed and then “shelved” for the purpose of accumulating several years’ worth of tax and bank account history, in an effort to give the company a veneer of longevity and legitimacy. Years later, the aged company is sold, often for tens or even hundreds of thousands of dollars,⁹ bestowing upon the buyer an LLC with a seemingly established business history, complete with IRS employer identification number (EIN), credit rating, and seasoned tradelines. Again, like shell companies, aged shelf companies can serve legitimate purposes, such as facilitating certain types of business transactions. But also like shell companies, shelf companies are an attractive vehicle for illicit activities, such as fraud, money laundering, and tax evasion, and pose major obstacles to regulators and auditors seeking to determine the true owners behind LLCs.¹⁰ Providers of “aged shelf companies” are frequently based in states with lax LLC disclosure laws, such as Delaware, Nevada, or Wyoming.

LLCs and “Dark Money” in California Elections

The same attributes of LLCs discussed above make LLCs attractive vehicles for disguising the true source of political activity. An LLC can make campaign contributions or independent expenditures solely in the name of the LLC without disclosing any information about, or providing a way to determine, the source of the funds expended by the LLC and individuals responsible for operating the LLC. As the Center for Responsive Politics notes in the context of national elections, “This lack of accountability and transparency have helped disguise the source of millions of dollars in political spending each election cycle,” making LLCs “the darkest of the dark money groups.”¹¹

⁷ U.S. Department of the Treasury, Financial Crimes Enforcement Network: The Role of Domestic Shell Companies in Financial Crime and Money Laundering: Limited Liability Companies 3 (2006).

⁸ Id.

⁹ [Wyoming Corporate Services, Inc., Aged Shelf Companies, \[https://wyomingcompany.com/aged-corporation/?keyword=&gclid=EAIAIQobChM1InFkqHa6QIVjbLICh0zMQO7EAAYASAAEgJ7n_D_BwE\]\(https://wyomingcompany.com/aged-corporation/?keyword=&gclid=EAIAIQobChM1InFkqHa6QIVjbLICh0zMQO7EAAYASAAEgJ7n_D_BwE\)](https://wyomingcompany.com/aged-corporation/?keyword=&gclid=EAIAIQobChM1InFkqHa6QIVjbLICh0zMQO7EAAYASAAEgJ7n_D_BwE) (last visited May 29, 2020).

¹⁰ Pacini & Wadlinger, *supra* at 121.

¹¹ Center for Responsive Politics, Dark Money Basics, <https://www.opensecrets.org/darkmoney/dark-money-basics.php> (last visited May 29, 2020).

California's state and local elections are just as vulnerable to LLC dark money as our national elections. According to data from the California Secretary of State's Political Reform Division, LLCs accounted for eight percent of all major donors and independent expenditure committees in the 2017-18 election cycle. A 2019 Enforcement Division examination looked at a selection of such LLCs who were registered as major donors to determine what public information could be obtained for each without a subpoena. For each LLC, Enforcement was able to obtain information from the Secretary of State, Department of Business Oversight, Department of Real Estate, and other sources about the business entity type (i.e., LLC), jurisdiction, business address and agent for service of process. However, determining the identities of the LLC's owners or the true source of the LLC's political expenditures proved elusive. Moreover, the Enforcement Division has found that in addition to the lack of publicly available information about LLCs, LLC agents and managers often do not have, or are unwilling to share, basic information and records of the LLC that would facilitate an investigation.

Several recent examples further illustrate the lack of meaningful disclosure around LLC political activities in California elections. A 2017 KPBS San Diego investigation found that from Jan 1, 2017 through September 22 of that year, LLCs spent more than \$2.5 million in elections in San Diego City and County alone—79 percent of which was spent in support of one ballot measure.¹² The same KPBS report found that, in 2016, a single LLC, LHR Investment Group LLC, gave \$3.8 million to a different local ballot measure. Though LHR Investment Group, LLC filed a Form 461 Major Donor Report, because state law does not require major donors to list their funding sources, the public could not determine where the money actually came from. In addition, because the LLC's parent company was registered in Delaware, voters could not fully determine who operated the LLC.¹³

In another prominent Southern California case, an LLC that formed the month before the November 2018 election contributed nearly \$200,000 to a local campaign committee, which in turn produced mailers supporting and opposing candidates for city council. Since the California Corporations Code does not require any disclosure of an LLC's managers until 90 days after its formation,¹⁴ voters in that city had zero information as to where this money originated, or who authorized or directed these contributions, until after January 1st of the following year—well after the election was decided.

Discussion

Current Law

The Act requires the disclosure of a person who makes a campaign contribution but “person” is defined broadly to include “an individual, proprietorship, firm, partnership, joint venture, syndicate, business trust, company, corporation, limited liability company, association, committee, or any other organization or group of persons acting in concert.” (Section 82047.)

¹² Jill Castellano, *What You Need to Know About Dark Money in San Diego*, kpbs.org, <https://www.kpbs.org/news/2018/nov/01/what-you-need-know-about-dark-money-san-diego-you-/> (last visited May 29, 2020).

¹³ Id.

¹⁴ See, 17702.09(a) of the California Corporations Code (requiring an LLC to form a Statement of Information, Form LLC12, within 90 days of after filing its articles of incorporation).

Yet one impediment to truthful disclosure of LLC political activities is that recipient committees who receive contributions from an LLC generally list only the name of the LLC (e.g. “5th Street Development, LLC”), as opposed to the individual or individuals who funded or directed the LLC’s contributions or expenditures.

Under existing law, an LLC that makes independent expenditures totaling \$1,000 or more in a calendar year qualifies as an Independent Expenditure (“IE”) Committee, while an LLC that makes contributions totaling \$10,000 or more in a calendar year qualifies as a Major Donor Committee. (Section 82013(b) and (c).) IE Committees and Major Donors must complete Form 461 (Major Donor and Independent Expenditure Committee Campaign Statement), which provides a summary of all contributions and expenditures made, as well as information regarding the filer, such as the filer’s name and mailing address, responsible officer, and business interests. However, neither the Act nor the Commission Regulations define “responsible officer,” allowing an LLC filer to simply list its registered agent, attorney, or accountant on Form 461, as opposed to the individual(s) responsible for directing and controlling the LLC’s contributions and expenditures.

Proposed Regulations for Adoption

Regulation 18402.2: Limited Liability Companies, Responsible Officer.

Campaign statements that are filed by LLCs that are major donors or independent expenditure committees are signed by a responsible officer. (Section 81004; *see also*, FPPC Form 461.) Subdivision (a) of proposed Regulation 18402.2 defines “responsible officer” for LLCs that qualify as IE Committees or Major Donors as “the individual primarily responsible for approving the political activity of the limited liability company.” This change would provide the public with information regarding who is directing an LLC’s expenditures and contributions, rather than just a registered agent or professional manager with no actual authority or control of the LLC. Subdivision (b) provides that if one or more individuals share this primary responsibility, at least one such individual must be listed the LLC’s responsible officer.

Subdivision (c) clarifies that a responsible officer may be held liable not only for violations of the Act he or she caused, but also those violations which he or she “purposefully or negligently” caused another to commit, as well as for violations he or she aided or abetted, as provided under Section 83116.5.¹⁵

Subdivision (d) makes clear that an LLC qualifies as a recipient committee if it receives payments totaling \$2,000 or more in a calendar year for the purpose of making contributions or expenditures in California, as specified under Section 82013(a) of the Act. Unlike a major donor or independent expenditure committee, a recipient committee must report all contributions received and expenditures made.

¹⁵ Section 83116.5 provides that any person who purposefully or negligently causes any other person to violate any provision of the Act is liable if the person causing the violation has filing obligations under the Act, or is compensated for services related to activities regulated under the Act.

Finally, subdivision (e) specifies that any LLC that makes a contribution on behalf of another, or while acting as the intermediary or agent of another, must disclose to the recipient of the contribution both the identity of the LLC and the original contributor, as required by Section 84302.

Subdivisions (c)(d) and (e) are intended to restate the application of existing law to LLCs.

Regulation 18421.10: Reporting Contributions from Limited Liability Companies.

Proposed Regulation 18421.10, meanwhile, details the information a committee that receives a contribution from an LLC must include as part of a contributor's "name" on its campaign statements and reports. The committee receiving the contribution would be required to provide the name of the individual responsible for the LLC's political activity in addition to reporting the name of the LLC. That individual will vary slightly depending on the whether the LLC is a committee under the Act and what type of committee.

Subdivision (a) of proposed Regulation 18421.10 requires committees who receive a contribution of \$100 or more from an LLC that has qualified as an IE Committee or Major Donor Committee under the Act to include the name of the LLC's responsible officer, as defined in proposed Regulation 18402.2. Subdivision (b) addresses contributions of \$100 or more from LLCs that have not qualified as committees under Section 82013, requiring the "name" of such contributors to include the individual primarily responsible for approving the contribution. In addition, subdivision (b) provides that if more than one individual shares in the primary responsibility for approving a contribution, a committee must report at least one such individual. Subdivision (c) makes clear that, for contributions of \$100 or more received from an LLC that has qualified as a recipient committee under the Act, the "name" must include the LLC's principal officer as defined in Section 82047.6. Finally, as discussed at the April 20, 2020 Law and Policy Committee meeting, staff has added subdivision (d) to clarify that a contribution lacking the "name" information required by subdivisions (a) through (c) shall be returned within 60 days of receipt under Section 85700 and Regulation 18570, which generally require the return of contributions that lack the requisite donor information.

Summary

Proposed Regulation 18402.2 and adoption of Regulation 18421.10 define "responsible officer" for limited liability companies (LLCs) that qualify as independent expenditure committees or major donors and specify what information a committee that receives a contribution from an LLC must include as part of a contributor's "name" on its campaign statements and reports. These changes would provide the public with more information about the natural persons behind an LLCs that make contributions and expenditures in California elections, rather than simply the name of a corporate entity and its registered agent and/or professional manager.

Attachments:

- Proposed Regulations 18402.2 and 18421.10