

DEC 06 2005

BEFORE THE FEDERAL ELECTION COMMISSION

**SENSITIVE**

2005 DEC -6 P 4: 25

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In the Matter of )  
John Kerry for President, Inc., and Robert Farmer, ) MUR 5421  
in his official capacity as treasurer )  
Mellon Trust of New England, N.A. )  
Teresa Heinz Kerry )

GENERAL COUNSEL'S REPORT #2

**I. ACTIONS RECOMMENDED**

Take no further action with regard to John Kerry for President, Inc., and Robert Farmer, in his official capacity as treasurer ("the Committee") and Mellon Trust of New England, N.A. ("Mellon Trust"); find no reason to believe that Teresa Heinz Kerry violated 2 U.S.C. § 441a(a)(1)(A); and close the file in this matter.

**II. BACKGROUND**

This matter involves a series of four loans Senator John Kerry made to his principal campaign committee, John Kerry for President, Inc., in December 2003, about a month before the first of the 2004 presidential primary elections. The loans were comprised of three relatively smaller loans, totaling \$1.1 million, that Senator Kerry obtained from draws on personal lines of credit while he sought a fourth, larger loan, a \$6.4 million mortgage from Mellon Trust of New England. Both the Mellon Trust loan and one of the three smaller loans, a \$350,000 draw made against a pre-existing \$450,000 home equity credit line at Citizen's Bank, were secured by Senator Kerry's Boston residence ("the collateral property"), a townhouse legally owned by a nominee trust of which Senator Kerry and his spouse, Teresa Heinz Kerry, are beneficiaries. An appraisal obtained by Mellon Trust in connection with the loan estimated the value of the

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1 collateral property to be \$12.8 million. Therefore, Senator Kerry was entitled to use as  
2 collateral for any loans benefiting his presidential campaign up to 50% of the value of the  
3 property, \$6.4 million.<sup>1</sup>

4 A review of publicly available information raised several concerns as to whether the  
5 Mellon Trust loan constituted an excessive or prohibited contribution and whether the loan was  
6 accurately reported. First, public records reflected a senior mortgage lien against the property in  
7 favor of Citizen's Bank that secured draws against the \$450,000 Citizen's Bank home equity  
8 credit line on the day Senator Kerry executed the \$6.4 million Mellon Trust loan and mortgage.

9 The Committee's disclosure reports reflected that the proceeds of the Mellon Trust loan were  
10 used to pay off the three smaller loans, including the \$350,000 Citizen's Bank draw, apparently  
11 sometime shortly after the loan documents were signed.<sup>2</sup> To the extent that Senator Kerry may  
12 have borrowed in excess of his interest in the collateral property for any period, an excessive  
13 contribution would have resulted from Teresa Heinz Kerry, the beneficial co-owner of the  
14 property.

<sup>1</sup> The complaint that generated this matter questioned the value of the collateral property based on a news article concerning the property's assessed value and alleged that the Committee may have accepted an unreported and excessive contribution from Mrs. Heinz Kerry to the extent that her interest in the Kerry family home or any other jointly-held property were pledged as collateral for any or all of the secured loans received by the Committee. Based on a review of the appraisal ordered by Mellon Trust in connection with its loan to Senator Kerry, the Commission concluded that the preponderance of available information supported a conclusion that the appraised value of the property reflected the property's fair market value for purposes of the Federal Election Campaign Act. In reviewing available information concerning the loans, however, other questions arose that could not be answered with available information as discussed further below.

<sup>2</sup> At the time the Commission made its reason to believe findings, we also did not know whether Senator Kerry had made other draws on the \$450,000 credit line that remained unpaid.

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1           Second, publicly available information raised questions as to whether the loan was  
2   made on a basis that assured repayment and whether it bore the usual and customary rate of  
3   interest for a loan of its type, two elements relevant in ascertaining that the loan was made  
4   within the ordinary course of business. A bank loan made outside the ordinary course of  
5   business is considered a prohibited contribution. The apparent temporary undercollateralization  
6   of Mellon Trust's loan together with the fact that the Committee's disclosure reports listed the  
7   value of the collateral property as only Senator Kerry's share of the property rather than the full  
8   value of the property, raised a question as to whether the loan was made on a basis that assured  
9   repayment since those facts suggested that the fair market value of the collateral was less than  
10   the loan amount and the senior lien on the date of the loan. Committee disclosure reports and  
11   other public information also reflected that the Mellon Trust loan carried a lower interest rate  
12   than those of the three smaller loans and included a favorable provision requiring interest-only  
13   payments for the first 10 years, thereby raising a question as to whether the loan bore Mellon  
14   Bank's usual and customary rate of interest.

15           Finally, publicly available information indicated that the Mellon Trust mortgage loan  
16   was a single loan of \$6.4 million made on December 19, 2003 and that the collateral was the  
17   entire property worth \$12.8 million. This raised raising questions as to whether the Committee  
18   accurately reported the loan since it reported the loan as if it were two separate loans and  
19   reported the collateral as only Senator Kerry's share of the property.

20           Consequently, to obtain the information necessary to resolve these questions, on June 23,  
21   2005 the Commission found reason to believe that the Committee may have violated 2 U.S.C.  
22   §§ 441a(f), 441b, 434(b) and 11 C.F.R. § 104.3(d) and that Mellon Bank may have violated

2 U.S.C. § 441b.<sup>3</sup> The Commission also decided to take no action as to Teresa Heinz Kerry pending receipt of further information concerning the structure and timing of the loans.

Information obtained from the Respondents establishes that Senator Kerry did not borrow in excess of his share of the collateral property since payoff of the prior loans, including the Citizen's Bank credit line secured by the senior lien against the collateral property, was a planned, integral part of the Mellon Trust loan transaction and the loan was structured so that the Citizen's Bank secured credit line was paid off before Senator Kerry obtained all of the loan proceeds; that the Mellon Trust loan was a standard loan product offered to a number of other Mellon Trust customers during the relevant time period; and that the Committee's reporting of the loan in most respects accurately reflected the flow of funds from Mellon Bank to Senator Kerry and from Senator Kerry to the Committee. See Responses of the Committee (Attachment 2) and Mellon Trust (Attachment 3). Accordingly, we recommend that the Commission take no further action against the Committee and Mellon Trust, find no reason to believe that Teresa Heinz Kerry violated 2 U.S.C. § 441(a)(1)(A), and close the file in this matter.

### III. DISCUSSION

#### No Excessive Contribution Resulted Because Senator Kerry Did Not Borrow in Excess of His Interest in the Collateral Property

The additional loan documentation provided by Respondents shows that the payoff of the three smaller loans, including the Citizen's Bank credit line draw secured by the senior lien

<sup>3</sup> The Commission also directed the Office of General Counsel to revise the Factual and Legal Analyses in accordance with its discussion at the June 21 and 23 Executive Sessions. The Commission approved the revised Analyses on August 2, 2005.

1 against the collateral property, was an integral part of the Mellon Trust loan transaction.<sup>4</sup> In  
2 preparation for paying off the Citizen's Bank credit line draws, Senator Kerry's legal  
3 representative signed a payoff letter dated December 17, 2003 that reflected the amount  
4 necessary to pay the credit line account in full. The letter also served as a request that Citizen's  
5 Bank permanently close the \$450,000 home equity credit line account so that Citizen's Bank  
6 could issue a mortgage discharge. Attachment 3 at 44; see also Attachment 2 at 4.

7 Additionally, documentation provided shows that although the Mellon Trust loan and  
8 mortgage documents were executed on December 19, 2003, Senator Kerry actually received the  
9 proceeds of the loan in two stages in accordance with a Staged Disbursement Amendment  
10 Agreement to the loan executed at the same time as the loan and mortgage documents.  
11 Attachment 3 at 25-26. Thus, he did not receive all of the Mellon Trust loan proceeds until the  
12 Citizen's Bank credit line draws had been paid off and the senior lien securing the collateral  
13 property had been discharged.

14 The Staged Disbursement Agreement contemplated that the loan principal would be  
15 drawn upon in stages and set forth the manner in which draws should be made and how interest  
16 would accrue. Pursuant to the December 19, 2003 HUD Settlement Statement, the proceeds of  
17 the initial \$2,996,768.21 loan disbursement were used to pay off the three smaller loans Senator  
18 Kerry obtained earlier in December 2003, including the outstanding Citizen's Bank credit line  
19 draws that were secured by a senior lien against the collateral property, and to pay the related  
20 loan costs. The remaining funds were distributed to Senator Kerry. Attachment 3 at 37-38.

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<sup>4</sup> The Factual and Legal Analyses in this matter also noted that the collateral property had been subject to an October 1996 \$820,000 mortgage lien in favor of Citizen's Bank that apparently had been discharged before Mellon Trust made its loan. Respondents confirm that when the October 1996 lien appeared on the title search of the property, Mellon's settlement attorney confirmed that it had been paid off and obtained a "confirmatory" discharge dated December 12, 2003 that he filed on December 23, 2003. Thus that lien is not at issue in this matter.

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1 Mellon Trust states that the Federal Truth in Lending Act prohibited it from disbursing  
2 any loan proceeds until a mandatory three business-day period expired during which Senator  
3 Kerry was permitted to rescind the contract. Attachment 3 at 2. Accordingly, on December 23,  
4 2003, Mellon wired the proceeds of the initial \$2,996,768 disbursement (the initial \$3 million  
5 draw minus loan costs) to the settlement attorney acting as its disbursement agent and recorded  
6 its mortgage securing the loan. Attachment 3 at 2-3, 28, and 42. On December 24, 2003, the  
7 settlement attorney sent a check to Citizen's Bank to pay off the outstanding credit line draws  
8 together with the payoff letter requesting that the account be closed, and requested that the  
9 mortgage discharge be forwarded to him for recording.<sup>5</sup> Attachment 3 at 43-46. The other non-  
10 secured credit line draws that Kerry had loaned to his Committee earlier in December were also  
11 paid, and the remainder of the initial disbursement \$1,787,965.80 was distributed to Senator  
12 Kerry who then loaned those funds to the Committee on the same day. Attachment 3 at 3 and  
13 37. Senator Kerry requested the second and final \$3.4 million disbursement on January 2, 2004  
14 which Mellon wired directly to a Committee bank account on January 5, 2004. Attachment 3 at  
15 39-40.

16 The loan documentation shows that Senator Kerry did not borrow in excess of his  
17 interest in the collateral property because payoff of the Citizen's Bank credit line secured by the  
18 senior lien was an integral part of Mellon Trust transaction and the loan was structured so that  
19 Senator Kerry did not receive all of the loan proceeds until the senior lien was effectively

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<sup>5</sup> The Committee states that Senator Kerry had made a \$95,129 draw against the \$450,000 Citizen's Bank credit line before he made the \$350,000 draw which he loaned to the Committee on December 15, 2003. Attachment 2 at 2, n. 2 and 4. Therefore, the payoff check sent to Citizen's Bank on December 24, 2003 totaled \$445,129.

discharged.<sup>6</sup>

Therefore, Teresa Heinz Kerry's interest in the collateral property at no time served as collateral for the Mellon Trust loan. Accordingly, we recommend that the Commission find no reason to believe that Teresa Heinz Kerry violated 2 U.S.C. § 441a(a)(1)(A) by making an excessive contribution to the Committee and take no further action with respect to the Committee on the issue of its acceptance of an unreported excessive contribution.

**The Mellon Trust Loan Was Made in the Ordinary Course of Business**

FECA prohibits national banks from making contributions in connection with election to any political office. *See* 2 U.S.C. § 441b. However, bank loans made in accordance with applicable law and in the ordinary business are not considered to be contributions. Commission regulations, in pertinent part, deem a loan to be made in the ordinary course of business when it is made on a basis that assures repayment and bears the usual and customary interest rate of the lending institution for the category of the loan involved. 11 C.F.R. § 100.82(a). Commission regulations also provide, in pertinent part, that a loan is made on a basis that assures repayment if the lending institution making the loan has a perfected security interest in collateral owned by the candidate receiving the loan, and the fair market value of the collateral is equal to or greater than the loan amount and any senior liens as determined on the date of the loan.

11 C.F.R. § 100.82(e)(1)(i).

The loan documentation provided by Respondents establishes that the loan was made on

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<sup>6</sup> The payoff check to Citizen's Bank along with instructions to close the Citizen's Bank home equity credit line account were sent on December 24, 2003, the receipt of which effectively discharged the senior lien despite the delay in Citizen's execution of a mortgage discharge on January 13, 2004 and the recording of that discharge on April 20, 2005.

1 a basis that assured repayment. The credit line draws secured by the senior mortgage lien in  
2 favor of Citizen's Bank were paid off as part of Mellon Trust's initial disbursement of the loan  
3 proceeds and Citizen's Bank was instructed to permanently close the home equity credit line  
4 account so there were effectively no liens against the collateral property that were senior to  
5 Mellon's.<sup>7</sup> Therefore, the fair market value of Senator Kerry's share of the collateral securing  
6 the loan was equal to the amount of Mellon Trust's loan.

7 Respondent Mellon Trust also provided sufficient information to conclude that the  
8 interest rate and interest-only terms of the \$6.4 million loan it made to Senator Kerry were usual  
9 and customary for a loan of its type. According to an affidavit submitted by a Mellon Trust  
10 Vice president, Mellon's loan to Kerry was a standard residential mortgage loan product offered  
11 to Mellon customers during the five month period beginning October 1, 2003 though  
12 February 24, 2004. See Attachment 3 at 47-48. The loan, made under Mellon's LIBOR One  
13 Month Adjustable Rate Mortgage Loan Program, provided for an adjustable rate mortgage tied  
14 to the One Month London Interbank Offered Rate (LIBOR) index plus a margin of percentage  
15 points added to the LIBOR rate, adjusted monthly, and interest only payments for first 10 years.  
16 *Id.* and Attachment 3 at 49-50. Senator Kerry's 30-year mortgage loan was one of 52 such loans  
17 made by Mellon Trust during the five-month period; 48 of those loans, including Senator  
18 Kerry's, carried an initial interest rate of 3.125%. Attachment 3 at 48.

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<sup>7</sup> Mellon Trust acknowledges the delays between payoff of the Citizen's Bank loan by its settlement attorney and the ultimate execution and recording of the Citizen Bank mortgage discharge. The delays in recording and executing the discharge did not impair Mellon's security interest for purposes of the FECA because a check paying off the Citizen's Bank credit line draws secured by the senior lien had, in fact, been transmitted as of December 24, 2003. Moreover, Mellon Trust notes that as a matter of property law, by paying of the Citizen's Bank credit line draw with the proceeds of its own secured loan, Mellon Trust's security interest became the first lien on the property, replacing the Citizen's Bank mortgage lien in the priority lien position through equitable subrogation. See Attachment 3 at 6, citing the Restatement Third of Property; Mortgages, § 7.6, cmt e (1997).



1 Because Mellon Trust's \$6.4 million loan to Senator Kerry was made on a basis that  
2 assured repayment and carried an interest rate that was usual and customary for a loan of its  
3 type, we conclude that the loan was made in the ordinary course of business. Therefore, we  
4 recommend that the Commission take no further action against the Committee and Mellon Trust  
5 on the prohibited contribution issue.

6 **The Reporting of the Mellon Trust Loan Was Substantially Correct**

7 Publicly available property records and the Committee reports also raised questions as to  
8 whether the Committee accurately reported on Schedules C and C-1 the terms of the Mellon  
9 Trust and the value of the collateral property. Based on the loan documentation, the  
10 Committee's reporting of the loan appears to have been accurate in most respects.

11 The loan documents provided by Respondents shed light on why the Committee reported  
12 the \$6.4 million Mellon Trust loan in its 2003 Year End and February 2004 disclosure reports as  
13 if it were two loans rather than one. The Committee's reporting of the loan tracked the amounts  
14 and dates of the staged disbursements rather than the total loan amount and the date it was  
15 signed.

16 Generally, in the case of a bank loan obtained by a candidate where the candidate loans  
17 some or all of the proceeds to the Committee, Schedule C of the Committee's disclosure reports  
18 should reflect the terms of the loan between the candidate and the Committee and Schedule C-1  
19 should reflect the terms of loan made between the candidate and the lending institution. In this  
20 matter, Schedule C of the Committee's reports accurately reflects the dates Senator Kerry  
21 received the staged loan disbursements and the amount of each disbursement he directly loaned  
22 to the Committee. Because Senator Kerry did not receive all of the loan proceeds at one time

1 and some of the proceeds of the initial disbursement were used to repay a previous credit line  
2 draw used for purposes unrelated to the campaign, the amount of the loan shown on  
3 Schedule C-1 in the 2003 Year End and the 2004 February Reports accurately reflects the  
4 portion of proceeds from each staged disbursement that was used for the campaign. Although  
5 the \$6.4 million note was signed on December 19, 2003 suggesting that date should have been  
6 reported as the date the loan was incurred, we conclude that it was reasonable for the Committee  
7 to report the date the loan was incurred as the dates Senator Kerry received each staged  
8 disbursement since he incurred no obligation to repay loan proceeds until he accessed them.

9 The Committee's reporting of the Mellon Trust loan appears to have been inaccurate in  
10 reporting on Schedule C-1 the value of the collateral as Senator Kerry's \$6.4 million share of  
11 the property rather than the \$12.8 million fair market value of the entire property. Commission  
12 regulations require a Committee to report the "types and value of collateral" the loan secured.  
13 11 C.F.R. § 104.3(d)(4)(iii). The more detailed instructions for Schedule C-P-1 instruct the  
14 committee to "enter the total fair market value of the collateral as of the date of the loan  
15 agreement." Though Senator Kerry could draw only half of the property's value to loan his  
16 campaign without triggering an excessive contribution from the co-owner, the total fair market  
17 of the property used as collateral was \$12.8 million.<sup>8</sup>

18 The Committee observes that nothing in FECA or the regulations explicitly addresses  
19 whether the value of the collateral should be the entire amount of the jointly-owned property or  
20 the candidate's share of the property, and it maintains that reporting anything other than the

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<sup>8</sup> The General Counsel's Report also raised a question as to whether Mrs. Heinz Kerry was a co-endorser of the loan. A copy of the loan shows that she was not. See Attachment 3 at 18. According to the Committee, Mrs. Heinz Kerry's signature on the loan documents was unnecessary because the property was legally owned by a nominee trust; all that was required was that the trust permit Mellon Trust to encumber the property, which it did. Attachment 2 at 8.

1 value of Senator Kerry's share of the property would have sowed confusion on the public  
2 record. Attachment 2 at 8. To the extent that the Committee was concerned that listing the  
3 value of the collateral property as \$12.8 million would have caused confusion, it could have  
4 noted parenthetically on Schedule C-1 that the value of the candidate's share was 50% or \$6.4  
5 million. However, in light of the fact the overall reporting of the loan otherwise accurately  
6 disclosed the precise flow of money from the Mellon Trust to Senator Kerry, we do not believe  
7 it would be an efficient use of the Commission's resource to pursue this issue further.  
8 Accordingly, we recommend that the Commission take no further action with respect to the  
9 reporting issues and close the file in this matter.

10 **IV. RECOMMENDATIONS**

- 11 1. Take no further action with respect to John Kerry for President, Inc.,  
12 and Robert Farmer, in his official capacity as treasurer, and Mellon Trust of New  
13 England, N.A.  
14  
15 2. Find no reason to believe that Teresa Heinz Kerry violated 2 U.S.C. § 441a(a)(1)(A).  
16  
17 3. Approve the appropriate letters.  
18  
19 4. Close the file in this matter.  
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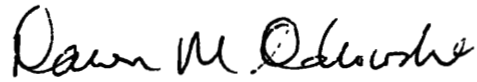
21 Lawrence H. Norton  
22 General Counsel

23  
24  
25 Date: 12/6/05

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29 Associate General Counsel  
30 for Enforcement

31 Sidney Rocke  
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Dawn M. Odrowski  
Attorney

Attachments:

- 1.
2. Response of John Kerry for President, Inc.
3. Response of Mellon Trust of New England, N.A.
- 4.

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