AGENDA DOCUMENT #96-112

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FEDERAL ELECTION COMMISSION

Washington, DC 20463

November 1, 1996

AGENDA ITEM

For Meeting of: NOV 1 4 1996

MEMORANDUM

TO: The Commission

THROUGH: John C. Surina
Staff Director

FROM: Lawrence M. Noble
General Counsel

N. Bradley Litchfield
Associate General Counsel

Jonathan M. Levin
Senior Attorney

SUBJECT: Revised Draft AO 1996-42

At the Open Session on October 31, 1996, the Commission considered Draft Advisory Opinion 1996-42 (Agenda Document #96-110). At that meeting, the Commission sent the agenda draft back to the Office of General Counsel with instructions to revise the paragraph appearing on p. 10, line 26 through p. 11, line 2. That paragraph required Lucent PAC to refund amounts contributed by way of payroll deduction since the disaffiliation. The revision, which appears on p. 10, line 26, through p. 11, line 14, provides a method by which the PAC can retain the funds from the October payroll deduction, the only deduction implemented thus far. However, an affirmative authorization from the eligible Lucent employee for any future payroll deductions is still required.

We request that the attached draft be circulated as a tally vote matter.

Attachment

DRAFT

ADVISORY OPINION 1996-42

Michael A. Nemeroff
Sidley & Austin
1722 Eye Street, N.W.
Washington, D.C. 20006

Dear Mr. Nemeroff:

This responds to your letter dated September 20, 1996, as supplemented by your letters dated October 11 and 22, 1996, requesting an advisory opinion on behalf of Lucent Technologies, Inc. ("Lucent") concerning the application of the Federal Election Campaign Act of 1971, as amended ("the Act"), and Commission regulations to the disaffiliation of political committees and the authorization of payroll deductions by Lucent employees.

Your request presents the situation of a spin-off of a corporate subsidiary and a consequent change in the relationship between the former parent and subsidiary. You ask about the effect of the new relationship on the respective separate segregated funds of the companies and on the previous payroll deduction authorizations granted by employees to the former parent.

In September 1995, AT&T Corp. ("AT&T") announced the creation of Lucent as a company composed of a number of AT&T businesses. (All dates hereinafter are in 1996, unless otherwise stated.) This was part of a broader announcement by AT&T that it intended to separate into three publicly held companies, i.e., AT&T, NCR Corporation (which is not a part of this request), and Lucent. AT&T incorporated Lucent in Delaware as a wholly-owned subsidiary, and beginning on February 1, AT&T began transferring to Lucent the assets and liabilities related to the businesses that are now part of Lucent. On April 3, 1996, AT&T offered over 112 million shares of Lucent common stock in an Initial Public Offering ("IPO"). After this offering, AT&T owned approximately 82.4 percent of Lucent's common stock which, pursuant to the separation plan, it distributed on September 30 to AT&T shareholders of record as of September 17. You state that this distribution ("the Distribution") completed the separation of the two companies.

You explain that, for many years, employees who now work for Lucent have been "active participants in AT&T PAC." Several thousand of these employees have authorized AT&T to deduct contributions to AT&T PAC from their salaries on a regular basis. When it became clear that Lucent would become a separate company, its management began planning for a new SSF to represent Lucent employees, and, on August 2, Lucent Technologies PAC ("Lucent PAC") filed a Statement of Organization which showed AT&T PAC as affiliated because the Distribution had not yet occurred. Prior to September 30, AT&T PAC transferred funds to Lucent PAC that had been contributed to AT&T PAC by Lucent employees. After September 30, Lucent PAC will solicit Lucent's employees directly and contributions will be deposited directly into Lucent PAC. In addition, subject to the Commission's approval, Lucent wishes to continue, without a new express authorization from each employee, the payroll deductions of its employees who have authorized AT&T to make payroll deductions; such deductions would go directly into Lucent PAC.

You describe the past and present relationships of the two companies and enclose the IPO Prospectus (from April) and an Information Statement from AT&T, (dated July 24) announcing the timetable and other circumstances of the Distribution to AT&T shareholders. You ask three questions pertaining to the circumstances of the relationship between AT&T and Lucent:

(1) Is Lucent PAC disaffiliated from AT&T PAC after the Distribution?

(2) Were Lucent PAC and AT&T affiliated prior to the Distribution and must the contributions made or received by each PAC prior to their disaffiliation be aggregated for the purposes of the contribution limits?

(3) After disaffiliation, may Lucent PAC continue the payroll deduction authorization that Lucent employees had granted to AT&T PAC if it sends each employee a letter, while it is affiliated with AT&T PAC, informing them of their right to withdraw their consent to continue payroll deduction?

The Commission's response to these questions is divided into three parts: (1) a discussion of the affiliation question as it pertains to the past and present relationships of the two companies; (2) the consequences of those relationships on the aggregation of contributions; and (3) the legal requirements for payroll deduction by Lucent employees.

Affiliation

The Act and Commission regulations provide that committees, including separate segregated funds, that are established, financed, maintained or controlled by the same corporation, person, or group of persons, including any parent, subsidiary, branch, division, department, or local unit thereof, are affiliated. Contributions made to or by such committees shall be considered to have been made to or by a single committee. 2 U.S.C. §441a(a)(5); 11 CFR 100.5(g)(2), 110.3(a)(1), and 110.3(a)(1)(ii). In addition, a corporation may make communications to and solicit the restricted class (i.e., executive and administrative personnel and stockholders, and the families thereof) of its subsidiaries for contributions to the corporation's separate segregated fund. 2 U.S.C. §441b(b)(2)(A) and (4)(A)(i); 11 CFR 114.3(a)(1) and 114.5(g)(1). Commission regulations further emphasize that committees established by a single corporation and its subsidiaries are affiliated *per se*. 11 CFR 110.3(a)(2)(i). Advisory Opinion 1990-10.

Where an entity is not an acknowledged subsidiary of another entity, as in 11 CFR 110.3(a)(2)(i), Commission regulations provide for an examination of various factors in the context of an overall relationship to determine whether one company is an affiliate of another and, hence, whether their respective SSFs are affiliated with each other. 11 CFR 100.5(g)(4)(i) and (ii)(A)-(J), and 110.3(a)(3)(i) and (ii)(A)-(J).[1] As discussed below, the relevant factors in the situation you have presented are as follows: (A) whether a sponsoring organization owns a controlling interest in the voting stock or securities of another sponsoring organization; (B) whether a sponsoring organization has the authority or ability to direct or participate in the governance of another sponsoring organization through provisions of constitutions, by-laws, contracts or other rules, or through formal or

[1] Specifically, the regulations, at 11 CFR 110.3(a)(3)(ii), state in part:

> The Commission will examine these factors in the context of the overall relationship between committees or sponsoring organizations to determine whether the presence of any factor or factors is evidence of one committee or organization having been established, financed, maintained or controlled by another committee or sponsoring organization.

informal practices or procedures; (C) whether a sponsoring organization has the authority or ability to hire, appoint, demote or otherwise control the officers, or other decisionmaking employees of another sponsoring organization; (E) whether a sponsoring organization has common or overlapping officers or employees with another sponsoring organization which indicates a formal or ongoing relationship between the organizations; (F) whether a sponsoring organization has any members, officers, or employees who were members, officers, or employees of another sponsoring organization which indicates a formal or ongoing relationship or the creation of a successor entity; (G) whether a sponsoring organization or committee provides goods in a significant amount or on an ongoing basis to another sponsoring organization or committee; (H) whether a sponsoring organization or committee causes or arranges for funds in a significant amount or on an ongoing basis to be provided to another sponsoring organization or committee; and (I) whether a sponsoring organization had an active or significant role in the formation of another sponsoring organization. 11 CFR 110.3(a)(3)(ii)(A), (B), (C), (E), (F), (G), (H), and (I). The list of ten circumstantial factors set out at 11 CFR 110.3(a)(3)(ii) is not an exclusive list, and other factors may be considered. See Advisory Opinion 1995-36.

Prior to the Distribution, AT&T owned approximately 82.4 percent of the common stock of Lucent and, hence, held an ownership interest sufficient to elect Lucent's Board of Directors and control the company. Since Lucent was, therefore, a subsidiary of AT&T, Lucent PAC was affiliated *per se* prior to the Distribution. 11 CFR 110.3(a)(2)(i).

After the Distribution on September 30, AT&T has no ownership interest in Lucent. See 11 CFR 110.3(a)(3)(ii)(A). You state that, after the Distribution, AT&T would have no power to participate in Lucent's governance. It would have no ability to vote in the selection of the Board of Directors which is responsible for the governance of the company, and would have no authority to hire, demote, or otherwise control Lucent's officers or directors. See 11 CFR 110.3(a)(3)(ii)(B) and (C).

As of the Distribution, AT&T and Lucent have no overlapping directors, officers, or employees. All thirteen of the pre-Distribution Lucent directors were appointed by AT&T and had been officers or directors of AT&T. Seven of the directors on that Board who were officers or employees of AT&T (but not directors of AT&T) are still with AT&T. However, at or prior to the Distribution, those seven directors resigned from Lucent's Board, and Lucent expects to promptly replace those directors with individuals not chosen by AT&T. The six Lucent directors remaining after the Distribution had resigned from their AT&T positions (either on the AT&T Board or as an officer) by the time of the Closing Date of the IPO, i.e., several months before the Distribution. As of late October 1996, the six pre-Distribution Lucent directors remaining have elected three new directors who are not employed by AT&T and who are either employed by or retired from unrelated corporations. Moreover, at Lucent's annual shareholders meeting in February 1997, three of the directors (all of whom are remaining pre-Distribution directors) will be proposed to the Lucent shareholders for election. See 11 CFR 110.3(a)(3)(ii)(C), (E) and (F).

You state that most of the officers and employees of Lucent were officers or employees of AT&T. See 11 CFR 110.3(a)(3)(ii)(F). You assert, however, that this does not imply continuing control of Lucent by AT&T. You note that, according to the Prospectus, a principal reason for the separation of the companies is the competition between AT&T and many large present and future Lucent customers in the telecommunications service (such as the Regional Bell Operating Companies) and conclude that "it is likely that business realities will dominate over former professional ties and keep [Lucent] independent of [AT&T]."

There are a number of continuing agreements between the companies that are set out in the Prospectus. They relate to factors (B), (G), and (H), and to the overall concept of the continuing relationship between the companies. The Separation and Distribution Agreement sets forth the terms under which assets, liabilities, business opportunities, and other matters are divided between the companies. The agreement restricts the companies from taking any action that would jeopardize the intended tax consequences of the Distribution but you represent that, as with a similar provision referred to in Advisory Opinion 1996-23, this limitation will not inhibit the separate activities of the two companies.[2] Other agreements commit AT&T to purchase from Lucent at least $3 billion worth of products, licensed materials, and services cumulatively for the years 1996, 1997, and 1998, but you state that this amount has and will continue to represent only a small percentage of Lucent's revenues. There are other agreements covering areas such as employee benefits, intellectual property, tax matters, and real estate which are intended to apportion the rights and responsibilities of the companies. You state that none of these agreements permits one company to control the other in a way that is inconsistent with the objective of their status as separate, stand-alone companies.

Relevant to factor (G) is the pre-Distribution transfers of funds from AT&T PAC to Lucent PAC in amounts reflective of the contributions made by Lucent employees to AT&T PAC. You state that, after the Distribution, there will be no transfers and that Lucent will rely on contributions from its employees.

Another factor discussed in prior opinions addressing disaffiliation, but not specifically mentioned in the ten factors, is the common shareholder base. Immediately after the Distribution, AT&T shareholders will own 82.4 percent of Lucent common stock. Similar situations resulting from spin-offs were addressed in Advisory Opinions 1996-23 and 1993-23. This situation relates somewhat to factor (A) and also relates to the question of whether the companies are affiliated through control by a group of persons. See 11 CFR 110.3(a)(1)(ii) and (a)(2)(v). In Advisory Opinion 1996-23, the three disaffiliating companies shared a common pool of shareholders at the time of the spin-off but active trading led to a rapid diversification of the shareholder base within a period of months afterward, as evidenced by percentages set out in the opinion. In view of a number of factors occurring as a consequence of and after the spin-off, including the diversification of the shareholder base, the Commission concluded that the three companies were no longer affiliated at the time of the opinion. In Advisory Opinion 1993-23, the complete common identity had been broken by an IPO of 12-14 percent of

[2] The agreement generally does not preclude one company from engaging in the same or similar business activities, although certain intellectual property rights will be terminable if Lucent provides telecommunications services similar to those provided by AT&T before February 2001. You state that Lucent does not intend to provide such services because it would cause Lucent to compete with most of its major customers, including AT&T.

the spun-off company's common stock, and it was anticipated that, after the date of the distribution of the remaining shares to the parent's shareholders (which was to occur within six months of the IPO), the stock would be traded vigorously. In view of a number of factors (including the lack of board or personnel overlap), the Commission concluded that disaffiliation would occur at the time of the distribution. In this situation, you note that, after the Distribution, substantially all of the shares distributed at the Distribution "would be eligible for immediate resale in the public market." You further represent that "the IPO and public trading will ... cause distinctly different ownership of the two companies' common stock after the Distribution."

Based upon the application of the factors discussed above, the Commission concludes that Lucent PAC and AT&T PAC were disaffiliated as of September 30, the date of the Distribution. Factors indicating a continuity of the relationship between the two companies are substantially outweighed by the factors indicating separate control of the companies. The Commission notes AT&T's lack of ownership interest and its consequent inability to vote for directors. Although most of the officers and employees of Lucent had been officers and employees of AT&T and most of the directors were on the AT&T Board until several months before the Distribution, the former relationships to the parent of officers and employees is expected in a spun-off company, and the timing of the six remaining pre-Distribution director's resignations from AT&T is indicative of a break from the former parent. Moreover, the new competitive situation in which Lucent and AT&T operate will counteract somewhat the potential for any continuing controlling relationship. Most significant in negating such a relationship, however, is the lack of overlap of directors, officers, or employees that exists as of the Distribution (which resulted, in part, from steps to replace directors previously selected by AT&T). See Advisory Opinions 1996-23 and 1993-23.

As to the continuing agreements between the companies, previous opinions have addressed disaffiliation situations in which companies arrived at such agreements to sort out their obligations and liabilities that existed as an outgrowth of their previous relationship, including continuing tax, intellectual property, and other legal arrangements. See Advisory Opinions 1996-23 and 1993-23. Moreover, disaffiliated companies have still maintained some customer-supplier relationships with each other. See Advisory Opinions 1995-36, n.3, and 1993-23. These arrangements may have created certain obligations and restrictions on the companies, but did not appear to be aimed at continuing one company's control over another. Although the Commission cannot fully determine the effects of the Lucent-AT&T agreements, the Commission accepts your representations that these arrangements are not aimed at continuing AT&T's control over Lucent.

As to the transfers of funds from AT&T PAC to Lucent PAC, the Commission notes that such transfers were made only pre-Distribution and in anticipation of the end of AT&T's control of Lucent and, hence, the disaffiliation of their respective PACs. Such transfers were not intended for the continuance of the relationship between the PACs.

As to the common shareholder base, the Commission notes that this situation is similar to Advisory Opinion 1993-23. As in that opinion, the complete commonality was broken as a result of the IPO, and you anticipate that a distinct difference in ownership will result from the public trading of Lucent stock.[3]

Aggregation of Contributions

The Commission concludes that, after disaffiliation, the two SSFs may not disregard the other's pre-Distribution contributions for the purpose of complying with the Act's contribution limitations. Advisory Opinion 1993-23. As affiliated committees, they shared one set of contribution limits. In determining the amounts that each SSF may contribute to the same candidate after the Distribution, the committees must add the amounts given for a particular election by each of them before the disaffiliation and attribute that sum to the contribution limit. For example, if, before September 30, AT&T PAC gave $2,000 (whether before or after the formation of Lucent PAC) to Candidate X for the 1996 general election, and Lucent PAC gave $1,000 to X for the same election, it would follow that, after the disaffiliation, the two SSFs may each contribute $2,000 more to X for the same election, pursuant to 2 U.S.C. §441a(a)(2)(A).[4] The result stems from

[3] NCR's relationship to Lucent and to AT&T has not been presented. The Commission assumes, however, that, even if NCR is still affiliated with AT&T, Lucent is no longer affiliated with NCR.

[4] AT&T PAC was already a multicandidate committee at the time of Lucent PAC's formation. As a newly created committee that was affiliated with a multicandidate committee, Lucent PAC qualified for

the required attribution of a $3,000 contribution to each SSF as a consequence of their affiliated status when both contributions were made. However, contributions by each SSF to the same candidate after their disaffiliation would only be attributed to the SSF making the contribution.

The same principles would apply to contributions made by employees to the SSFs. If, before September 30, a Lucent employee gave $1,000 to AT&T PAC and $1,000 to Lucent PAC during 1996, he would be limited to giving no more than an additional $3,000 to Lucent PAC in 1996 after the disaffiliation. 2 U.S.C §441a(a)(1)(C).

Requirements for Payroll Deduction

Prior to, and in anticipation of the Distribution, Lucent sent letters to its eligible employees[5] informing them that Lucent PAC has been established and that it is making arrangements to "transfer" the employee's AT&T PAC payroll deduction to Lucent PAC.[6] The letter states that the employee has the right to terminate the Lucent PAC payroll deduction without reprisal, and that, if he wished to terminate the deduction, he should complete and mail an enclosed form. According to the letter, no action was required from the employee if he wished to continue the deduction.

In situations where a company merged with an acquiring company and there was a planned merger of the SSFs of the two companies, the Commission approved a plan in which a newly merged corporation notified its eligible employees in writing of the PAC merger plan and their right to cancel their payroll deduction authorization. If the employees did not cancel their payroll deductions, the proceeds resulting from such deductions would be automatically contributed to the surviving PAC, and resolicitation by the surviving PAC of a separate payroll deduction authorization would not be required. Advisory Opinions 1994-23 and 1991-19.

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treatment as a multicandidate committee. Having already so qualified, Lucent PAC will continue to be a multicandidate committee after the Distribution. Advisory Opinion 1993-23.

[5] The Commission assumes that the Lucent employees who will participate in any payroll deduction will be the executive and administrative employees as defined in 11 CFR 114.1(c) or those employees who are also stockholders as defined in 11 CFR 114.1(h). Advisory Opinion 1994-23, n.1. Other classes of personnel are not eligible for participation in payroll deduction plans for SSFs. 11 CFR 114.6(e)(1).

[6] You have enclosed a copy of a letter dated September 18, 1996.

The situation you have presented, however, entails the breakup of two corporations and resembles a quite different situation considered by the Commission. Advisory Opinion 1989-16 addressed a situation involving employees of a bank corporation who had been in the payroll deduction plan for contributions to that company's SSF, but who became employees of a new corporation consisting of banks that had been severed from the first company. The Commission concluded that, in order for the new company to obtain participation of those employees in a payroll deduction plan for contributions to the new company's SSF, those employees would have to execute new authorizations.

You believe that Lucent's situation differs because the SSF of the new company in Advisory Opinion 1989-16 was created after disaffiliation and was therefore never affiliated with the SSF of the former parent; in this case, Lucent formed its PAC when it was still affiliated with AT&T PAC, and Lucent's letter informing its employees of their right to terminate the payroll deduction was sent before disaffiliation. Nevertheless, Lucent is attempting to retain the use of deduction authorizations made for AT&T PAC in contemplation of the impending separation of the two companies and the disaffiliation of the PACs. The applicability of Advisory Opinion 1989-16 is not negated merely because a letter was sent a number of weeks prior to the actual breakup and the employee ostensibly had an opportunity during that period of time to send in an explicit revocation. The tacit authorizations sought by Lucent were primarily for the operation of a PAC that would become disaffiliated from AT&T PAC. The Commission concludes, therefore, that Lucent PAC must obtain express and separate payroll deduction authorizations from its eligible employees in order to implement payroll deductions for their contributions to Lucent PAC. In soliciting these authorizations, Lucent and its PAC must follow the regulations on voluntariness set out at 11 CFR 114.5(a)(1)-(5).

The Commission understands that Lucent PAC has already received contributions from one monthly payroll deduction, implemented in October, whereby amounts were deducted from the salary of those who did not send in termination forms. As indicated above, a letter still needs to be sent to those contributors, asking for their signature on a form that authorizes a payroll deduction for voluntary contributions to

Lucent PAC. The signed form must be received by Lucent, in order for any further deductions to be implemented. In view of the fact that Lucent's request for advice was made before the first deduction, Lucent PAC may retain the funds from that deduction under the following circumstances.

In the deduction authorization form to be signed by the contributing employee, the employee should also be given an option to state (such as by marking a box) that he or she approves the deduction made in October. In order for Lucent to be able to retain an October deduction, it must receive the employee's affirmative response within sixty days of your receipt of this opinion. After that, Lucent PAC must refund the deduction amount. Until Lucent receives such a reply, the PAC should place the October deduction made for the employee in a separate bank account (holding all those deductions) from which it will not make disbursements, or it should maintain sufficient funds to make the refunds without using those amounts for other disbursements. See, by analogy, 11 CFR 103.3(b)(4).

This response constitutes an advisory opinion concerning the application of the Act, or regulations prescribed by the Commission, to the specific transaction or activity set forth in your request. See 2 U.S.C. §437f.

Sincerely,

Lee Ann Elliott
Chairman

Enclosures (AOs 1996-23, 1995-36, 1994-23, 1993-23, 1991-19, 1990-10, and 1989-16)