



FEDERAL ELECTION COMMISSION
WASHINGTON, D.C. 20463

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February 23, 1995

MEMORANDUM

TO: The Commission

THROUGH: John C. Surina
Staff Director

FROM: Lawrence M. Noble
General Counsel

N. Bradley Litchfield
Associate General Counsel

Michael G. Marinelli
Staff Attorney

SUBJECT: Draft AO 1994-36

Attached is a proposed draft of the subject advisory opinion.

We request that this draft be placed on the agenda for March 2, 1995.

Attachment

AGENDA ITEM
For Meeting of: MAR 2 1995

DRAFT

CERTIFIED MAIL
RETURN RECEIPT REQUESTED

ADVISORY OPINION 1994-36

Susan M. Frank, Corporate Counsel
Science Applications International Corporation
10260 Campus Point Drive
San Diego, California 92121-1578

Dear Ms. Frank:

This refers to your letters of February 13, January 23, and January 11, 1995, and November 17, 1994, on behalf of a separate segregated fund ("the Committee") to be established by Science Applications International Corporation ("SAIC"). Your request concerns the application of the Federal Election Campaign Act of 1971, as amended ("the Act"), to SAIC's proposed solicitation for political contributions on behalf of the Committee.

You state that SAIC is in the process of establishing the Committee and wishes to solicit contributions from employees who are direct or beneficial stockholders of SAIC. You note that Commission regulations permit a corporation to solicit its stockholders and their families on an unlimited basis, as well as its executive and administrative personnel, as further defined by Commission regulations. SAIC, which you describe as the largest U.S. employee-owned high technology company, has approximately 15,300 current employees (out of a total of 17,000) who are direct or

3 beneficial owners of SAIC stock.^{1/} You indicate that many of
4 these individuals would not qualify as executive or
5 administrative personnel under Commission regulations.
6 Therefore, SAIC seeks Commission guidance as to whether these
7 employees could be solicited for contributions to the
8 Committee in their capacity as stockholders.

9 THE PLANS

10 The materials included in your request detail various
11 methods by which SAIC employees can obtain SAIC stock.
12 As discussed more fully below, several plans allow for direct
13 purchase of stock, while others allow for beneficial
14 ownership through participation in SAIC retirement programs.

15 Direct purchase of SAIC stock

16 SAIC stock is not traded on any exchange, instead it is
17 formally traded four times a year in an internal market.^{2/}
18 Your materials indicate that the purchase price of SAIC stock
19 is calculated according to a formula that takes into account
20 various factors such as SAIC net income, objective market
21 factors and shareholder equity.

22 Employees can purchase stock during the time of the
23 internal market from approved sellers or other stockholders.
24 Employees can also receive invitations to purchase stock from

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26 _____
27 ^{1/} You state that as of October 1, 1994, 91% of SAIC's stock
28 was held directly or indirectly by the company's employees,
directors, officers and consultants, with the remainder held
by former affiliates of SAIC.

29 ^{2/} According to your February 13 submission, 10,626 employees
30 are direct SAIC stockholders.

3 the company. Employees can further acquire stock through
4 performance awards of stock or stock options. Your materials
5 indicate that the easiest way for an employee to purchase
6 stock is through SAIC's Employee Stock Purchase Plan
7 ("ESPP"). Under this plan, a portion of an employee's after
8 tax salary is held in an account by a trustee and used to
9 purchase stock during the four times a year that SAIC stock
10 is traded.

11 The employees who purchase SAIC stock directly may vote
12 the stock as they wish, have an immediate right of ownership,
13 and would have the right to receive dividends, if dividends
14 were declared. There are, however, certain restrictions on
15 SAIC stock which stem from its status as an employee-owned
16 corporation. The first is SAIC's right to repurchase its
17 stock. A stockholder who is no longer affiliated with SAIC
18 must give SAIC the opportunity to repurchase the stock at its
19 current valuation. A second restriction is SAIC's right of
20 first refusal. This applies if a stockholder wishes to sell
21 stock outside the internal market, in which case, the
22 stockholder must first give SAIC a chance to purchase the
23 stock at the current price. Even if SAIC chooses not to
24 exercise the right of first refusal, SAIC must give written
25 approval of any sale of stock outside the internal market and
26 may put restrictions on the sale.^{3/}

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28 3/ Your request materials state that SAIC's right of
29 repurchase does not apply to stock held beneficially through
30 participation in the various retirement plans discussed
below.

3 Beneficial ownership of SAIC stock

4 Beneficial ownership of SAIC stock is gained through
5 four basic retirement plans: the Cash or Deferred Account
6 ("CODA"), the Employee Stock Ownership Plan ("ESOP"), and the
7 Profit Sharing Retirement Plan I and II ("Profit Sharing
8 I and II").^{4/}

9 CODA

10 SAIC's CODA is a voluntary 401(k) retirement plan. It
11 is funded by an employee's contributions, the limit of which
12 is determined by IRS regulations, and a maximum 10% match by
13 SAIC. An employee's rights to a CODA account vest at 25% per
14 year starting with the third year of employment, with full
15 vestment after six years of service. At the employee's
16 option, employee contributions may be invested in several
17 different investment funds which include U.S. Government
18 bonds or non-SAIC corporate stock. The employee may also
19 chose to have the employee contribution placed in SAIC stock.
20 The company's contribution to CODA, however, is always
21 invested in SAIC stock. By directing the SAIC trustee of
22 CODA accounts, an employee owning stock through CODA may vote
23 the stock as that employee wishes.

24 An employee gains access to funds in a CODA account upon
25 reaching the age of 59 1/2 or upon termination of
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28 ^{4/} These plans together hold approximately 76% of SAIC's
29 Class A common stock. Your materials indicate that employees
30 can belong to more than one plan. As of November 30, 1994,
CODA had 16,522 participants; ESOP had 13,454; Profit Sharing
I had 11,618; and Profit Sharing II had 2,032.

3 employment with SAIC. Hardship withdrawals are also
4 permitted for situations involving emergency circumstances,
5 heavy financial need for medical reasons, purchase of a
6 residence, tuition needs or to prevent eviction from the
7 employee's residence. However, if hardship withdrawals are
8 made, SAIC would suspend the employee's right to make
9 contributions to the plan for one year. Payment from the
10 CODA account is made in cash.

11 ESOP

12 The terms of SAIC's ESOP plan are similar to the CODA
13 with the following differences. The company's ESOP
14 contributions are invested only in SAIC stock. Unlike CODA,
15 participating employees do not make contributions into
16 the plan. Finally, ESOP does not permit any withdrawals,
17 hardship or otherwise, prior to retirement or the ending of
18 the employee's association with the company. At the
19 employee's option, payment from an ESOP account can be either
20 in cash or in SAIC stock.

21 Profit Sharing I and II

22 Again, the terms of Profit Sharing I and II are similar
23 to CODA with regards to vesting and the choice of investments
24 available. In 1992, Profit Sharing II was developed as a
25 replacement to Profit Sharing I, as regards new employees.
26 However, a sizable number of SAIC employees are still
27 enrolled in the earlier plan. A major difference between the
28 two plans is that Profit Sharing I, until 1987, allowed for
29 employees to make voluntary contributions into voluntary
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3 profit sharing accounts. These funds could then be used to
4 invest in the various options available under both plans,
5 including the option to invest in SAIC stock. Funds invested
6 in the voluntary accounts of Profit Sharing I could be
7 withdrawn by employees at any time with no restrictions.^{5/} By
8 contrast, Profit Sharing II, like ESOP, is funded entirely by
9 SAIC contributions. No withdrawals are possible prior to the
10 employee's ending of employment with SAIC. Payments from
11 Profit Sharing I and Profit Sharing II account, as with CODA
12 account payments, are made in cash.

13 The Act and Commission Regulations

14 The Act permits a corporation or its separate segregated
15 fund to solicit its individual stockholders and their
16 families. 2 U.S.C. §441b(b)(4)(A)(i). Under the Commission
17 regulations, a stockholder is defined as a person who (i) has
18 a vested beneficial interest in stock; (ii) has the power to
19 direct how that stock shall be voted (if it is voting stock);
20 and (iii) has the right to receive dividends. 11 CFR
21 114.1(h); see also Advisory Opinions 1994-27, 1988-36,
22 1988-19, 1984-5, 1983-35 and 1983-17.

23
24 ^{5/} Profit Sharing I technically no longer holds any SAIC
25 stock. For tax purposes, the various accounts administered
26 by Profit Sharing I were combined with accounts held under
27 CODA. However, the funds originated from the prior voluntary
28 accounts of Profit Sharing I are subject to the liberal
29 withdrawal rules of Profit Sharing I rather than the more
30 restrictive rules of CODA. A significant fact is that the
transferred voluntary accounts held in CODA still currently
hold a small number of SAIC shares. In a phone conversation
with Commission staff, you have stated that the number of
employees participating in Profit Sharing I who have invested
in SAIC stock with their voluntary accounts is quite small.

The solicitation of SAIC stockholdersDirect stockholders

From the materials provided in your request, it appears that direct stockholders of SAIC would meet the requirements of section 114.1(h). Again, employees purchasing stock directly from SAIC would have an immediate ownership of and, hence, a vested interest in the stock. They also have the right to vote the stock they own. SAIC stock also carries the right to receive dividends. Therefore, the requirements of section 114.1(h) are met.^{6/}

The Commission notes the various restrictions such as the right of repurchase and first refusal regarding the purchase and selling of SAIC stock. As your request states, these restrictions arise from the need of an employee-owned company to maintain a closed internal market. The Commission has not previously addressed the solicitation of employee stockholders in employee-owned companies.^{7/} However, the Commission notes that none of the restrictions described in your request amount to a forfeiture of the stock since, when

^{6/} SAIC's past and current policy not to declare dividends is not relevant to the analysis of the cited regulation. It is not necessary that a corporation actually declare and pay out dividends to stockholders or makes it its policy to do so. Rather, what is required under section 114.1(h) is that the stock carry the right to receive dividends, if they were declared.

^{7/} In Advisory Opinion 1985-35, the Commission dealt with the solicitation of the non-shareholding directors of an employee-owned corporation. The Commission concluded that the employee-owned status of the company did not affect the solicitability of these directors. See Advisory Opinion 1985-35.

stock is resold to or repurchased by SAIC, the price obtained would be the current price available on the closed market to qualified buyers. Therefore, the Commission concludes that these restrictions do not interfere with the requirements of section 114.1(h) and direct SAIC stockholders are stockholders for purposes of the Act.

Beneficial Share Holders

The situation regarding employees holding SAIC stock as beneficial owners is more complex. Any employee enrolled for the third year in SAIC's CODA, ESOP or Profit Sharing I or II plan would meet the first requirement to the extent that the 25% vested value for that year would cover at least one share of stock beneficially held for that employee. The information contained in your request states that each employee who acquires SAIC stock through any of the four plans has the right to give voting instructions and that the trustee must comply with those instructions. Therefore, the second requirement of the regulations is met.

In past treatments of employee stock purchase plans, the third requirement--the right to receive dividends--is the element that has received the most intense scrutiny and analysis. Most of the plans discussed in the past have contained some limitations regarding the withdrawal of either the accumulated dividends or the underlying stock. See Advisory Opinion 1994-27 and the opinions cited therein. As stated in your request, SAIC policy is not to declare dividends. As noted in footnote 6, this policy does not, by

3 itself, interfere with the requirements of section 114.1(h).
4 A more important consideration are the limitations placed by
5 the various plans on the right to withdraw funds from plan
6 accounts, if dividends were declared. The test that the
7 Commission has used is whether "participants are able to
8 withdraw at least one share of stock purchased with employer
9 matching contributions without incurring a suspension
10 period..." to conclude that those participants had the right
11 to receive dividends and were stockholders under 11 CFR
12 114.1(h). See Advisory Opinion 1994-27 and the opinions
13 cited therein.

14 If an employee has already withdrawn stock which formed
15 part of an investment in the various retirement plans, that
16 employee would have the right to receive dividends in the
17 same manner as any other SAIC stockholder and so would be
18 considered as stockholder for purposes of the Act and the
19 Commission regulations. As in the past opinions, the
20 remaining issue is whether, absent any actual withdrawal of
21 stock, any vested plan participant may qualify as a
22 stockholder under section 114.1(h).

23 Participants in Profit Sharing II and ESOP may not
24 access their funds prior to leaving employment with SAIC or,
25 in the case of CODA, may not access their funds until they
26 reach retirement age. Prior to retirement, participants in
27 CODA may only withdraw funds from their accounts for hardship
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3 purposes.^{8/} Because of these restrictive withdrawal rights,
4 participants in CODA, Profit Sharing II and ESOP, prior to
5 retirement (or upon reaching retirement age, in the case of
6 CODA), would not qualify as stockholders under the Commission
7 regulations. For the same reason, most employee participants
8 in Profit Sharing I would also not qualify as stockholders.
9 However, a number of participants in the earlier profit
10 sharing plan would qualify. Those participants who, with
11 their remaining voluntary accounts, choose the option of
12 investing those funds in SAIC stock would qualify as
13 stockholders since they could access their funds without
14 restrictions.

15 Accordingly, with respect to stockholder solicitations
16 for contributions to SAIC's separate segregated fund, the
17 Commission concludes that the Committee (or SAIC) may solicit
18 political contributions from employees who are direct
19 stockholders. With regard to beneficial stockholders, SAIC
20 may solicit as stockholders only those plan participants who
21 have retired (or in the case of CODA, have reached retirement
22 age) or those who have have purchased SAIC stock through the
23 employee's voluntary contributions in SAIC's Profit Sharing I
24 plan. Of course, the solicitation by the Committee or SAIC
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27 ^{8/} In Advisory Opinion 1994-27, the Commission examined a
28 stock ownership plan that contained a provision for hardship
29 withdrawals identical to that permitted in SAIC's CODA plan.
30 The Commission concluded that this purpose based limitation
was at least as restrictive as limitations based on frequency
of permitted withdrawals, or those providing for suspension
as a penalty for withdrawals.

4 must otherwise meet the requirements for a proper
5 solicitation under the Act and regulations. 2 U.S.C.
6 §441b(b)(3)(A), (B) and (C); see 11 CFR 114.5(a).^{9/}

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

11 Sincerely,

12
13 Danny L. McDonald
14 Chairman

15 Enclosures (AOs 1994-27, 1988-36, 1988-19, 1985-35, 1984-5,
16 1983-35 and 1983-17.)
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25 ^{9/} For example, a corporation or separate segregated fund
26 that solicited contributions of a particular amount must
27 inform the person solicited that such amount is only a
28 suggestion and that the person is free to contribute more or
29 less than the suggested amount. 11 CFR 114.5(a)(2).
30 Moreover, any solicitation for a separate segregated fund
must describe the political purpose of the fund and specify
that persons have the right to refuse to contribute to the
fund without reprisal. 11 CFR 114.5(a)(3), (a)(4), and
(a)(5).