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FEDERAL ELECTION COMMISSION
Washington, DC 20463

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March 8, 2001

AGENDA ITEM
For Meeting of: 3-15-01

MEMORANDUM

TO: The Commission

THROUGH: James A. Pehrkon *[Signature]*
Staff Director

FROM: Lois G. Lerner *[Signature]*
Acting General Counsel

N. Bradley Litchfield *[Signature]*
Associate General Counsel

Jonathan M. Levin *[Signature]*
Senior Attorney

Subject: Draft AO 2000-30

Attached is a proposed draft of the subject advisory opinion. We request that this draft be placed on the agenda for March 15, 2001.

Attachment

1 ADVISORY OPINION 2000-30

2
3 Ronald B. Turovsky
4 Manatt, Phelps & Phillips, LLP
5 11355 West Olympic Boulevard
6 Los Angeles, CA 90064-1614

DRAFT

7
8 Dear Mr. Turovsky:

9 This responds to your letters dated July 13, 2000, and January 23 and February
10 26, 2001, on behalf of pac.com, requesting an advisory opinion concerning the
11 application of the Federal Election Campaign Act of 1971, as amended (the Act”), and
12 Commission regulations to the receipt by a nonconnected political committee of
13 contributions from individuals in the form of stock, some of which is not publicly traded.

14 ***Background***

15 Pac.com is a nonconnected political committee which filed its statement of
16 organization with the Commission on June 16, 2000. Pac.com anticipates soliciting and
17 receiving contributions from individuals, who are otherwise lawfully permitted to make
18 contributions, in the form of stock owned by those individuals. The stock will be stock of
19 domestic corporations formed under the laws of the various states in the United States
20 and operating for profit in the United States. It is anticipated that, generally, these
21 companies will be “technology companies, broadly defined.”

22 Pac.com will maintain a securities account to hold all such stock received from
23 the individual contributions through a brokerage service that offers such accounts
24 generally to the public, and pac.com will pay the ordinary fee to the brokerage service for
25 such accounts. All contributions of stock received by pac.com will be deposited in that
26 securities account within ten days of receipt by the committee treasurer. Pac.com will use
27 the stocks in one of two ways: (1) It will hold the stocks in the securities account and sell
28 stocks on the open market at the times it deems appropriate in its discretion. When shares
29 are sold, the proceeds of the sale will be transferred to a checking account maintained by
30 pac.com at one of its depositories for the purpose of making disbursements. (2) It will
31 hold the stock in a securities account and contribute stock that it holds to the authorized

1 campaign committees of candidates. You state that pac.com will only contribute shares
2 that are publicly traded and have a specific price.

3 It is anticipated that some of the stock contributed to pac.com will be stock that is
4 publicly traded on markets such as the New York Stock Exchange ("NYSE"), the
5 American Stock Exchange ("AMEX"), or NASDAQ. Some of the stock contributed to
6 pac.com will be stock that is not publicly traded.

7 A significant number of persons who contribute the non-publicly traded stock will
8 be individuals who were founders, executives, or employees of the companies that issued
9 the stock. You state that the terms of investment of the individual investors who will
10 donate some of their stock "will be ordinary and customary as is practiced widely in the
11 industry."¹ Individuals who contribute to pac.com will become "members" of pac.com;
12 the members will be the individuals and not the companies whose stock has been
13 contributed.

14 Your request provides information as to the nature of the stock to be contributed
15 and the valuation of such stock. In order to make a determination of the fair market value
16 of publicly traded stock contributed to pac.com, it will use the published value of the
17 stock at the close of trading on the day of receipt. This information will be obtained from
18 publicly available publications or online listings for the NYSE, AMEX, or NASDAQ.
19 With respect to stock that is not publicly traded at the time pac.com receives the in-kind
20 contribution, pac.com will determine the fair market value of the stock by using the stock
21 share price for which it was purchased at the most recent round of outside investment.²
22 Shares will only be accepted if the share price has been set by such an external funding
23 event within a commercially reasonable time prior to the contribution, and no stock will
24 be accepted where such a funding event closed more than 120 days prior to the
25 contribution.³

¹ You state that each company will have a significant number of non-employee investors.

² You state that it is not anticipated that discounts, premiums, or adjustments to the fair market value of the shares (e.g., with respect to voting rights, liquidation or dividend preferences, and controlling interests) would be applied or accepted by pac.com.

³ You state that pac.com devised this method based upon its attempt to determine what would be the most accurate way to ascertain fair market value.

1 Shares will only be accepted when the external funding event has occurred with
2 SEC qualified "Accredited Investors" as defined in Regulation D of the Security and
3 Exchange Commission's ("SEC") General Rules and Regulations for the Securities Act
4 of 1933. 17 CFR 230.501(a); *see also* 17 CFR 230.501-230.508.).⁴ Such investors are
5 persons who satisfy sophistication or wealth standards, such as banks, investment
6 companies, business development companies, charities, officers or directors of the issuer,
7 sophisticated individual investors (that is, persons of a certain wealth or income level), or
8 large trusts managed by sophisticated persons. You state that the funding event must
9 include sophisticated investors who are not employees, principals, or principal owners of
10 the companies, or family relatives of such persons. This is intended to address the
11 concern that the price set would be artificially low due to offers to relatives or other
12 individuals close to the company or its principals.⁵

13 You state that pac.com will not accept shares in companies whose private stock is
14 in SEC registration to make an initial public offering ("IPO") until the public offering is
15 concluded. You also state that pac.com will not accept or receive stock and then inform a
16 candidate that the particular stock will be contributed by pac.com to the candidate.

17 You ask whether pac.com may receive contributions of stock from individuals
18 valued in the manner described above. Your request also poses issues regarding the
19 disposition of such stock by pac.com.

20 *Analysis*

21 The Act and Commission regulations provide that no person may make
22 contributions to any political committee, other than an authorized committee or a political

⁴ These rules govern the limited offer or sale of securities without registration under the Securities Act of 1933. The securities regulations provide for exemptions from the provision of certain information to prospective investors or from SEC registration requirements. This may occur for offerings of a certain size where the number of unaccredited investors is limited and the rest of the offerees are accredited investors. *See* 17 CFR 230.504-506.

⁵ You state each company will have at least one round of outside investment known as a "Series A round." You explain that "in an emerging company's corporate life," this refers to the first round of financing in which the company issues preferred stock to investors, typically venture capitalists. You state that a Series A round is often preceded by an "angel" or "friends and family round," in which the company sells common stock or, sometimes, convertible debt to a close group of investors so that it has enough money to develop a business plan and attract investment in a Series A round. If the company is successful, the Series A round will be followed by successive rounds (B, C, and so on) of preferred stock financing, each

1 committee maintained by a national political party, that aggregate in excess of \$5,000 in
2 any calendar year. 2 U.S.C. §441a(a)(1)(C); 11 CFR 110.1(d). A committee that does
3 not qualify as a multicandidate committee may not make contributions to a candidate and
4 his authorized political committees, with respect to election to Federal office, that
5 aggregate in excess of \$1,000 per election.⁶ 2 U.S.C. 441a(a)(1)(a); 11 CFR 110.1(b)(1).
6 Contributions from a multicandidate committee may aggregate no more than \$5,000 to
7 any candidate and his authorized committees with respect to any election for Federal
8 office. 2 U.S.C. §441a(a)(2)(A); 11 CFR 110.2(b)(1).

9 The Act and regulations define a contribution as a gift, subscription, loan,
10 advance, or deposit of money or anything of value made by any person for the purpose of
11 influencing any election for Federal office. 2 U.S.C. §431(8)(a)(i); 11 CFR 100.7(a)(1).
12 The term “anything of value” includes all in-kind contributions, and the provision of any
13 goods or services without charge, or at a charge which is less than the usual and normal
14 charge for such goods or services, is a contribution. 11 CFR 100.7(a)(1)(iii)(A). The
15 regulations list specific examples of such goods or services, including “securities.” *Id.*

16 The Act and Commission regulations address the deposit and disbursement of
17 political committee receipts. All receipts by a political committee shall be deposited in
18 the committee’s depository bank accounts within ten days of the treasurer’s receipt unless
19 returned within that time to the contributor. 2 U.S.C. §432(h)(1); 11 CFR 103.3(a).⁷ All
20 disbursements by a political committee shall be made by check or similar draft drawn on
21 a committee depository account. 2 U.S.C. §432(h)(1); 11 CFR 102.10.⁸ Political
22 committee funds may be transferred from the depository for investment purposes, but

at higher per share valuations until an IPO or a sale to another company for cash or public securities of the acquiring entity.

⁶ A multicandidate committee is a political committee that has been registered with the Commission for six months, has received contributions from more than 50 persons, and has contributed to at least five candidates for Federal office. 2 U.S.C. §441a(a)(4); 11 CFR 100.5(e)(3). According to its filings with the Commission, pac.com has not qualified as a multicandidate committee.

⁷ A committee depository must be either a State bank, a Federally chartered depository institution, or a depository institution where the depositor accounts are insured by the Federal Deposit Insurance Corporation or the National Credit Union Administration. 2 U.S.C. §432(h)(1); 11 CFR 103.2.

⁸ These sections explicitly provide for one exception to this rule, which is disbursements from the petty cash fund established under 2 U.S.C. §432(h)(2)(i) and 11 CFR 102.11.

1 must be returned to the depository before they are used to make expenditures. 11 CFR
2 103.3(a).

3 Commission regulations explicitly address reporting of the receipt of in-kind
4 contributions. 11 CFR 104.13. The amount of the contribution is the usual and normal
5 value of the contribution on the date received. 11 CFR 104.13(a). Those regulations also
6 implicitly permit the donation of "stocks, bonds, art objects, and other similar items to be
7 liquidated," and, unlike other forms of in-kind contributions generally addressed in the
8 rule, those donations are not concurrently reported as disbursements. 11 CFR 104.13(b).
9 If the item has not been liquidated by the end of the reporting period, the committee
10 records, as a memo entry, the item's fair market value on the date received and donor
11 information. 11 CFR 104.13(b)(1). When the item is sold, the committee records the
12 proceeds and the identification of the purchaser if the item is purchased directly from the
13 committee (who would be considered a contributor to the committee), as well as the
14 identification of the original contributor.⁹ 11 CFR 104.13(b)(2).

15 The Commission applied its regulations to the receipt and subsequent disposition
16 sale of stock in Advisory Opinion 1989-6. In that situation, a principal campaign
17 committee received a contribution of 120 shares of stock valued at \$4.50 per share for a
18 total value of \$540. The committee had no advance notice that the stock would be
19 contributed. The opinion concluded that the committee could accept the contribution of
20 the stock as a contribution by the individual of his assets and advised as to the proposed
21 sale of the stock, including the reporting of its receipt and later sale.¹⁰ In pertinent part,
22 the Commission stated that, if the stock is subsequently purchased directly from the
23 committee so that the purchaser is known, the purchase is a contribution by the purchaser.
24 If, on the other hand, the committee sells the stock through an established market
25 mechanism whereby it does not know the identity of the purchaser, the purchaser will not
26 be purchasing the stock directly from the committee and, thus, will not be considered as

⁹ Commission regulations, at 11 CFR 100.7(a)(2), provide that the entire amount paid as the purchase price for a fundraising item sold by a political committee is a contribution.

¹⁰ The opinion clarified that when the identification of the original contributor is listed in connection with reporting the purchase from the committee, the amount of the original in-kind contribution is also listed as a memo entry.

1 making a contribution to the committee. The Commission did not require the liquidation
2 of the stock within any set time period after its receipt by the committee; nor did it
3 require the deposit of the proceeds in the committee's depository account within any
4 prescribed period.

5 The Commission has also applied its regulations to permit political committees to
6 transfer monetary contributions, which it previously received, from the committee's
7 depository account to investment accounts maintained with securities investment firms.
8 Advisory Opinions 1999-8, 1997-6, 1986-18, and 1980-39. However, as made clear in
9 the regulations and applied in the opinions, such funds must be returned to a committee
10 depository account before the funds can be used to make expenditures or other
11 disbursements.¹¹

12 Your request entails the receipt of stocks in publicly traded and non-publicly
13 traded companies, the holding of some of those stocks for a period that may be longer
14 than the ten day period referred to in 11 CFR 103.3(a), the liquidation of such stocks, and
15 contributions to Federal candidates.

16 *Pac.com's Receipt of Stock*

17 The Commission concludes that pac.com may accept the contribution, by an
18 individual, of stocks that are publicly traded on an exchange, subject to the limit of 2
19 U.S.C. §441a(a)(1)(C). The contribution would be valued at the closing price of the stock
20 on the day of the committee's receipt. The price would be the price of that particular
21 class of corporate stock on the exchange on which the stock is principally dealt.¹²

¹¹ A relevant situation as to the deposit of investment items was addressed in Advisory Opinion 1980-125 where a political committee accepted a contribution of 100 silver dollars and asked how the contribution should be valued. The Commission provided the option of treating the contribution as the receipt of \$100 in money or as a commodity to be liquidated, citing 11 CFR 104.13(b). The Commission stated that if the committee does not deposit the coins but rather sells or exchanges the coins for goods or services, the coins are instead a commodity with a value other than \$100 potentially, i.e., the market value for silver coins on the day the contribution was received. If the committee treats the coins as a \$100 money contribution, they would have to be deposited in the committee's depository account.

¹² The concept of using the price on the exchange on which the stock is principally dealt is derived from Page 5 of *Publication 561: Determining the Value of Donated Property* (Rev. February 2000), issued by the Internal Revenue Service. The standard accounts for the possibility that the stock may be traded on more than one exchange.

1 The acceptance from an individual of stock that is not publicly traded, particularly
2 when the individual is a company insider, presents other difficulties. The stock price is
3 not readily determinable from an exchange price. The Commission is mindful of the
4 attempts at objectivity and market price certainty that you discuss. You refer to the
5 acceptance of stocks only where the external funding event involved Accredited Investors
6 who were not company employees, principals, or principal owners, or family relatives of
7 such persons, and the event was at least a "Series A" round. (See footnote 5). You also
8 state that the value of the stock at the point of donation would not be reduced by
9 discounts, premiums or other adjustments. These statements are intended to address the
10 concern that pac.com would benefit from the receipt and holding of stock whose price
11 was artificially low at the point of contribution. You also state that if the stock is in SEC
12 registration to make an IPO, the stock may not be donated until the IPO is concluded,
13 which the Commission assumes (and so conditions its conclusions) is the end of the first
14 day of public trading so that it has a closing price on an exchange. Most importantly, you
15 state that the price will have been set by the most recent round of outside investment, and
16 no stock will be accepted where the funding event closed more than 120 days prior to the
17 contribution.

18 Although these conditions are important for Commission approval of your
19 proposal, they may not fully provide a standard in accordance with the valuation
20 provisions of 11 CFR 104.13(b). For example, the assurance as to stocks in registration
21 for an IPO does not account for non-publicly traded stocks that have not registered for an
22 IPO. Moreover, the application of a price that was used as far back as 120 days before
23 the contribution may not comport with the fair market value of the contributed stock on
24 the date received.¹³ The use of a valuation date that is much closer to the date of receipt
25 would be more consistent with the regulation, and certain criteria may be needed to
26 accurately determine a stock's fair market value. Although the sale price in the described
27 round of investment might provide the fair market value of the stock at the time of the

¹³ Furthermore, although you point to the funding event involvement of accredited investors who are not employees or principal owners or their relatives, your description does not preclude the possibility that company insiders, or others related to company employees or insiders, might also be offerees.

1 contribution, these concerns should be addressed by the contributor's use of the services
2 of a qualified appraiser who holds no employment or ownership interest with the
3 company, and is not an officer or member of pac.com. The contribution of non-publicly
4 traded stock to a political committee is analogous in some respects to the donation of
5 such stocks to charity, and the Commission derives this requirement, in part, from
6 instructions by the Internal Revenue Service in connection with the donation of stock to
7 charity in *Publication 561: Determining the Value of Donated Property* (Rev. February
8 2000), pp. 8-9.

9 The Commission recognizes that time may be needed, before an actual
10 contribution is made, to appraise the value of non-publicly traded stock because of
11 infrequent sales and because of the use of a number of factors in making an appraisal.
12 (See below as to the discussion of appraisals.) Thus, the Commission concludes that a
13 fair market value of such stock as of no more than 15 days prior to pac.com's receipt may
14 be used for determining the amount of a contribution. If the stock can be accurately
15 appraised as of a valuation date less than 15 days before the contribution is actually
16 received, then the valuation as of that date should be used.

17 In order to provide a valid basis upon which the non-publicly traded stock
18 contributed to pac.com can be valued, the Commission concludes that the factors
19 described by the IRS for determining the fair market value (on the date the stock is
20 deemed as contributed to the donee) of stock of a closely-held corporation, or where
21 selling prices are unavailable, should be applied. *Publication 561: Determining the*
22 *Value of Donated Property* (Rev. February 2000), p. 5.¹⁴ The factors considered are the
23 company's net worth, prospective earning power and dividend-paying capacity, and
24 "other relevant factors." These "other relevant factors" include "the goodwill of the

¹⁴ Although a selling price going back no more than 120 days may be available, the guidance given by the IRS with respect to the use of selling prices is instructive. The selling price of a stock is used to determine fair market value where there is an active market for the stocks on an exchange or elsewhere. The valuation is to be based on the average price quoted on the "valuation date" which is the date of the donation. If there were no sales on the valuation date, the average price within a "reasonable period" before and after the valuation date is used, i.e., the highest and lowest sales prices on the nearest date before and the nearest date after the valuation date (weighted by a described formula). Notably, the example given entails a sale two trading days before the valuation date and three trading days after the valuation date. *Publication 561: Determining the Value of Donated Property* (Rev. February 2000), p. 5.

1 business, the economic outlook in the particular industry, the company's position in the
2 industry and its management, and the value of securities of corporations engaged in the
3 same or similar business." For preferred stock, the most important of the other relevant
4 factors are its yield, dividend coverage, and protection of its liquidation preference.¹⁵

5 The fair market value of the stock contributed to pac.com would be the greater of:
6 (i) the selling price of the stock at the most recent outside funding event; and (ii) the fair
7 market value established by the appraisal under the standards set out above. Pac.com
8 may accept such contributions from individuals, subject to the limit of 2 U.S.C.
9 §441a(a)(1)(C). Upon contributing the stock, the contributor should also present a
10 statement from the independent qualified appraiser attesting to the value of the stock and
11 the criteria and bases she used to appraise the value, along with a statement of the event
12 selling price. The Commission acknowledges the importance of the restrictions you have
13 set out with respect to the stock that may be accepted by pac.com¹⁶ and also conditions
14 the permissibility of the contributions on these restrictions. Their absence would present
15 a different set of facts requiring a separate review by the Commission.

16 *Retention and Disposition of Stock*

17 Commission interpretations of its regulations indicate that a political committee
18 may receive certain kinds of items that it intends to liquidate at a later date to raise funds
19 (those listed in 11 CFR 104.13(b)) and hold those items without having to liquidate them
20 within ten days of receipt. See Advisory Opinions 1989-6 and 1980-125. Pac.com does
21 not have to liquidate the stock within ten days and deposit the proceeds into a committee
22 depository, but may hold the stocks in the securities account as an investment for
23 disposition at a later time.

¹⁵ The Commission does not intend to deprecate the use by an independent qualified appraiser of a price set at the most recent outside funding event, if the stock was purchased in an arms-length transaction, as a significant factor in the valuation. This is most particularly true if the event occurred much more recently than 120 days prior to the receipt of the contribution.

¹⁶ Briefly stated, these are the use of only those stocks where there has been an outside funding event (at least a "Series A round") within the previous 120 days that included Accredited Investors who are not employees, principals, or principal owners or relatives of such persons, the use of stocks in registration for an IPO only after the IPO has ended, and not reducing the contribution value of the stock by discounts, premiums, or other adjustments.

1 As indicated above, the Commission has applied the regulations to permit
2 political committees to invest committee receipts in securities accounts, but does not
3 permit committee expenditures from those accounts. As committee investments, the
4 stocks received as contributions are in essentially the same position as those securities.
5 The Commission concludes that pac.com cannot contribute stocks (regardless of whether
6 they are publicly traded) directly from the securities account to the authorized committees
7 of candidates or other political committees. Instead, pac.com must sell the stocks and
8 deposit the proceeds into committee depository accounts, and then it may contribute the
9 funds to the authorized or other political committees within the applicable limits of 2
10 U.S.C. §441a(a).

11 If stock is purchased directly from pac.com so that the purchaser is known, the
12 entire purchase price is a contribution by the purchaser, and the purchase (aggregated
13 with other contributions by the purchaser to pac.com) is subject to the limits of 2 U.S.C.
14 §441a(a)(1)C). If the committee sells the stock through an established market mechanism
15 whereby it does not know the identity of the purchaser, the purchaser will not be
16 considered a contributor. If a broker arranges the sale of stock in the ordinary course of
17 her business, the Commission also assumes that the purchaser would not know that the
18 purchased stock is owned by pac.com. If these conditions are not met, and depending on
19 all other facts and circumstances in a stock sale arranged by a broker on behalf of
20 pac.com, the purchase may result in a contribution to pac.com by the purchaser.

21 *Reporting*

22 When pac.com receives a contribution of stock and liquidates the stock at a later
23 date, it should follow the procedures set out above at 11 CFR 104.13(b) as further
24 explained in Advisory Opinion 1989-6. It should report the receipt of the stock as a
25 contribution, including the contributor's name and address (and other identification
26 information if the \$200 threshold is exceeded¹⁷) and the fair market value of the
27 contribution. The amount would be a memo entry and not cash. If the stock is purchased
28 directly from pac.com so that the purchaser is known, the dollar total of the purchase (a

¹⁷ See 2 U.S.C. §431(13)(A) and 11 CFR 100.12.

1 contribution) along with his name and address (and other identification information)
2 should be reported as a cash contribution and, below that, the identification of the original
3 contributor (or contributors) of the stock being sold, and the fair market value of each of
4 their contributions at the time received should be listed as a memo entry. If the stock is
5 sold through a broker in an established market mechanism where the purchaser is not
6 known, the dollar total of the purchase should be reported as an "other receipt" listing the
7 broker and explaining that the amount is the proceeds from the sale to an unknown
8 purchaser. Below that, pac.com should report the same information as to the original
9 contributors that it would report for the subsequent sale of stock directly to a known
10 purchaser.¹⁸

11 The Commission expresses no opinion regarding the application of any rules of
12 the Securities and Exchange Commission or any tax ramifications of the proposed
13 activity, other than as stated above, because those issues are not within its jurisdiction.

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

17 Sincerely,

18

19 Danny L. McDonald
20 Chairman

21

22 Enclosures (AOs 1999-8, 1997-6, 1989-6, 1986-18, 1980-125, and 1980-39)

¹⁸ See Attachments A, B, and C to Advisory Opinion 1989-6 for guidance as to the reporting of number of shares and name of the company whose stock is being contributed to, or purchased from, pac.com.