FEDERAL ELECTION COMMISSION
Washington, DC 20463

July 24, 1987

CERTIFIED MAIL,
RETURN RECEIPT REQUESTED

ADVISORY OPINION 1987-21

Richard F. Smith
Gardere & Wynne
1500 Diamond Shamrock Tower
Dallas, Texas 75201

Dear Mr. Smith:

This responds to your letter of June 3, 1987, requesting an advisory opinion of behalf of MAXUS Energy Corporation and Diamond Shamrock R&M Inc., concerning application of the Federal Election Campaign Act of 1971, as amended ("the Act"), and Commission regulations to the treatment of two separate segregated funds after a corporate reorganization.

You state that on February 2, 1987, the Board of Directors of Diamond Shamrock Corporation ("DSC"), now known as MAXUS Energy Corporation, adopted a corporate reorganization plan. You indicate that this plan was adopted, at least in part, in response to several hostile take-over attempts by outside investors. DSC stated that the purpose of the corporate reorganization was to "(i) maximize the value of DSC stockholders' investment in DSC common stock, (ii) create two clearly focused entities, each concentrating its efforts on one of DSC's core businesses, and (iii) defeat an inadequate and coercive partial tender offer being made to DSC stockholders." Information Statement for the Stockholders of Diamond Shamrock Corporation at 1 (hereinafter "Information Statement"). The principal component of this reorganization was a tax-free spin-off to the holders of DSC common stock of all of the outstanding shares of common stock of Diamond Shamrock R&M, Inc. ("R&M"), a wholly owned subsidiary of DSC. R&M would retain the rights to the name "Diamond Shamrock" and the corporate logo. This action did not require approval of DSC shareholders. DSC stated that "R&M's businesses will continue to operate substantially in the manner in which they have been operated in the past and with substantially the same operating management as at present." Information Statement at 14. The distribution, to become effective April 30, 1987, was made in the form of a dividend to DSC shareholders of one share of R&M stock for every four shares of DSC common stock.

Prior to the spin-off of R&M, DSC, as the sole shareholder of R&M, elected all of the current nine members of R&M's board of directors. Four of those directors also serve as directors of DSC and constitute one-third of the membership of the DSC board. You state, however, that while no requirement exists prohibiting the individuals from serving on both boards until the expiration of their respective terms, it is anticipated that none of the directors will continue to serve as a director of both corporations for more than one year.

As the sole shareholder of R&M, DSC wrote R&M's certificate of incorporation, as well as its by-laws, and made both substantially identical to DSC's in order to "have the effect of making difficult an acquisition of control of R&M in a transaction not approved by R&M's Board Of Directors." Summary at iv; see also Information Statement at 47. These provisions include that: (i) the size of R&M Board will be fixed by directors of R&M; (ii) the R&M Board is classified in three groups, with staggered terms with each director serving for three years; (iii) a director may be removed only with the approval of 80% of R&M's shareholders; and (iv) any vacancy on the R&M Board may be filled only by the remaining directors then in office. These provisions also limit the voting rights of any shareholder beneficially owning more than 5% of the voting stock. Information Statement at 48. DSC acknowledges that "[t]hese provisions, individually or collectively, will make difficult and may discourage the initiation or completion of a merger, tender offer, proxy fight or other change of control transaction that a third party might desire to undertake, regardless of whether such a transaction or occurrence may be favorable or unfavorable to the interests of the stockholders." Information Statement at 49.

Since 1978, DSC has sponsored a separate segregated fund known as the Diamond Shamrock Voluntary Political Contribution Plan. This fund has been registered with the Commission and has qualified as a multicandidate political committee. On May 4, 1987, DSC, now MAXUS, changed the name of this fund to MAXUS Employees' Political Action Committee ("MAXUS PAC"). You state that R&M plans to form a separate segregated fund in the near future. In light of these developments, you ask the Commission:

(1) After R&M establishes the R&M PAC, will the R&M PAC be treated as not affiliated with the MAXUS PAC under 11 CFR 110.3?

(2) After its establishment, may the R&M PAC compute its contribution limitations under 11 CFR 110.3 without regard to contributions previously made by the MAXUS PAC?

(3) After its establishment, may the R&M PAC and the MAXUS PAC determine their contribution limits under 11 CFR 110.3 without regard to contributions by the other?

The Act and regulations provide that for purposes of the Act's contribution limitations, all contributions made to or by political committees established, financed, maintained, or controlled by any person or group of persons, or made to or by all separate segregated funds established, financed, maintained or controlled by any corporation including any parent, subsidiary, branch, division, department or local unit of such corporation, are considered to have been made to or by a single political committee, or made to or by a single separate segregated fund. 2 U.S.C. 441a(a)(5); 11 CFR 110.3(a)(1)(i), 110.3(a)(1)(ii)(A), and 110.3(a)(1)(ii)(E).

Although R&M was established by DSC as a wholly-owned subsidiary, R&M is no longer a subsidiary of DSC. Such a status would have resulted in automatic affiliation of R&M and DSC. See 2 U.S.C. 441a(a)(5); 11 CFR 110.3(a)(1)(ii)(A); and Advisory Opinion 1985-27. In order to determine whether R&M and DSC are currently affiliated entities, the Commission must look to the indicia set forth in the regulations.

Commission regulations explain that indicia of establishing, financing, maintaining, or controlling include: (1) ownership of a controlling interest in voting shares or securities; (2) provisions of by-laws, constitutions, or other documents by which one entity has the authority, power, or ability to direct another entity; and (3) the authority, power, or ability to hire, appoint, discipline, discharge, demote, remove or otherwise influence the decision of the officers of an entity. 11 CFR 110.3(a)(1)(iii)(A), (B), and (C). Commission regulations also provide that a corporation may exercise control over its separate segregated fund. 11 CFR 114.5(d). Thus, the Act and regulations provide for the affiliation of separate segregated funds based on the relationship of their respective connected organizations. See Advisory Opinions 1986-42 and 1985-27.

As previously discussed, R&M was originally established by DSC as a wholly-owned subsidiary. DSC spun-off R&M through a distribution of all of R&M's common stock to the stockholders of DSC, and, while R&M is no longer a subsidiary of DSC, immediately after the distribution both corporations had common ownership. All of the current members of the board of directors of R&M were appointed by DSC. Four of the current board members of R&M also serve on DSC's board of directors. While DSC states that it is not anticipated that these four will serve on both corporate boards for more than one year, there exists no prohibition on their doing so. Two of the concurrent directors' terms on the R&M board expire in 1988, while the remaining two may serve until 1990. As in Advisory Opinion 1986-42, the spun-off corporation's articles of incorporation and by-laws make it very difficult to wrest control of the new corporation from the control of the previously appointed board. In addition, in order to qualify as a tax-free spin-off, which DSC claims R&M is, there must be a "continuity of interest" between DSC and R&M under 26 U.S.C. 355 (the Federal tax code). According to DSC's Information Statement mailed to all DSC stockholders, "persons who are stockholders of DSC before the Distribution must have a substantial continuity of interest in DSC and R&M after the Distribution ... The continuity of interest requirement should be satisfied unless, pursuant to a pre-Distribution plan or intention, the stockholders of DSC sell or otherwise dispose of more than 50% of either of their DSC Common stock or their R&M Common Stock following the Distribution." Information Statement at 12. Thus, DSC originally established and appointed those who control R&M, DSC and R&M have common owners and there exists considerable overlap in the directors and interests of both corporations.

The facts presented in this request are substantially the same as those present in Advisory Opinion 1986-42 where the Commission concluded that the original corporation and the spun-off corporation were affiliated entities. In your request you claim that DSC, now MAXUS, and R&M are not affiliated because:

(a) MAXUS does not own any stock of R&M;

(b) while MAXUS organized R&M and elected its board, it has not established R&M in such a manner as to perpetuate its control;

(c) MAXUS and R&M will be in different segments of the oil and gas industry; and

(d) fewer than half of the R&M directors also serve on the MAXUS board.

None of these factors are sufficient to distinguish this request from the situation presented in Advisory Opinion 1986-42. While MAXUS does not currently own any stock in R&M, both corporations had, at least at the time of the spin-off, identical stockholder bases. While this factor may diminish over time, the request does not indicate that stock ownership has yet significantly diverged. The request does indicate that DSC has established R&M in such a manner that it is very difficult to replace the board appointed by DSC without the new board's permission. As in Advisory Opinion 1986-42, it is irrelevant that MAXUS and R&M will operate in different segments of the same industry. Finally, while the same majority may not necessarily control both corporations, there exists significant overlap in the personnel and organizational structures of both corporations that further supports the Commission's conclusion that MAXUS and R&M are affiliated corporations.

These facts demonstrate that, for purposes of the Act and Commission regulations, DSC established and continues to maintain an affiliated relationship with R&M. While the relationship between these two entities may change over time, because they are now affiliated, it follows that all separate segregated funds established by DSC (now MAXUS) or R&M will be treated as a single fund for purposes of the Act's contribution limitations. For the foregoing reasons all three questions set forth in the request are answered in the negative.

This response constitutes an advisory opinion concerning 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 yours,

(signed)

Scott E. Thomas
Chairman for the Federal Election Commission

Enclosures (AOs 1986-42 and 1985-27)