FEDERAL ELECTION COMMISSION
Washington, DC 20463

September 3, 1998

CERITIFED MAIL
RETURN RECEIPT REQUESTED

ADVISORY OPINION 1998-11

John A. Ramirez
Nielsen, Merksamer, Parrinello, Mueller & Naylor, LLP
591 Redwood Highway #4000
Mill Valley, California, 94941

Dear Mr. Ramirez:

This refers to your letters dated July 2, and May 18, 1998, which request advice concerning the application of the Federal Election Campaign Act of 1971, as amended ("the Act"), and Commission regulations to the proposal by Patriot Holdings ("PH" or "the Firm") and two of its subsidiary limited liability companies to engage in political activity.

You state that PH is a limited liability company ("LLC") that has 90% ownership of two other limited liability companies. These two LLCs, American Ship Management ("ASM") and Patriot Contract Services ("PCS") are Federal Government contractors. PH, while owning both entities, also generates revenue from separate business ventures that are not related to either ASM or PCS.[1] You ask whether PH may make contributions to Federal candidates out of its general treasury account from this revenue. You also ask whether individuals from PH, ASM or PCS may establish a nonconnected PAC. In addition, assuming a nonconnected committee was established, you ask whether it would be required to pay all establishment, administration and solicitation expenses from the committee's own funds, and whether any funds given by PH for this purpose would be a contribution to the committee under the Act.

[1] This revenue is derived from ship management services and shore services provided by PH to other companies' container or commercial ships. You state that this produces approximately $175,000 per year in revenue.

ACT AND COMMISSION REGULATIONS

Under the Act, the term "person" includes an individual, partnership, committee, association, corporation, labor organization, or any other organization or group of persons. 2 U.S.C. §431(11); 11 CFR 100.10. The Act prohibits corporations from making any contribution or expenditure in connection with a Federal election. 2 U.S.C. §441b(a); 11 CFR 114.2(b). Contributions by persons whose contributions are not prohibited by the Act are subject to limits set out in 2 U.S.C. §441a.

Under 2 U.S.C. §441c, it is unlawful for a Federal contractor "directly or indirectly to make any contribution of money or other things of value, or to promise expressly or impliedly to make any such contribution to any political party, committee, or candidate for public office...". Commission regulations indicate that the prohibition bans contributions to Federal candidates and any political party or committee, but does not prohibit contributions (or expenditures) in connection with State or local elections. 11 CFR 115.2(a). This prohibition extends from the commencement of the contract negotiations until the completion of the contract performance or the termination of negotiations.
11 CFR 115.2(b) and 115.1(b).

In past advisory opinions, the Commission has concluded that a limited liability company is a "person" under the Act, instead of a corporation or a partnership, and thus is subject to the Act's contribution limitations and, in some circumstances, to the Act's prohibitions as well. See Advisory Opinions 1997-17, 1997-4, 1996-13, and 1995-11.

APPLICATION TO PH PROPOSAL

Patriot Holdings as limited liability company

In previous opinions, the Commission has addressed the ability of LLCs in Virginia, the District of Columbia, Pennsylvania, and Missouri to make contributions. Advisory Opinions 1997-17, 1997-4, 1996-13, and 1995-11. In those opinions, the Commission concluded that, in view of the fact that the LLC was a type of business entity that was not a corporation or partnership under the statutes of those jurisdictions, it fell instead within the language "any other organization or group of persons," which is part of the Act's definition of "person." Hence, as a person, but not a corporation, the LLC was subject to the Act's contribution limits rather than its prohibitions. In addition, contributions from the LLC's general operating accounts or treasury would not be attributed to any of its members. However, the Commission's allowance for contributions by LLCs has been premised on the assumption that none of the individual owners or members of the LLC are corporations, Federal contractors, or foreign nationals, i.e., entities prohibited by the Act from contributing. See 2 U.S.C. §§441b, 441c, and 441e. If any member of the contributing LLC falls within a category prohibited by the Act from contributing, the contribution by the LLC would be

impermissible. Advisory Opinion 1997-17; see also Advisory Opinions 1997-4, 1996-13, and 1995-11.

In reviewing the statutes of the four jurisdictions, the Commission noted how the statutes classified the entities in definitional terms and selection of business name. It also considered whether the statutes for LLCs and the rules of an entity itself broadly reflected characteristics that were different from those of a corporation in some instances, or a partnership in others. For example, the opinions reviewed statutory language defining LLCs or prohibiting the use of certain terms in an LLC name that might indicate another form of business entity. Moreover, the statutes reflected the corporate characteristic of limitation of liability for all the members of an LLC, along with the lack of other characteristics generally associated with corporations, i.e., free transferability of interest and continuity of life. The Commission has also noted how the statutes distinguished LLCs from partnerships, referring to the personal liability of general partners and the fact that the laws of the jurisdictions recognized the LLC as a business form distinct from partnerships. Advisory Opinions 1997-17, 1997-4, 1996-13, and 1995-11. In a recent opinion, the Commission stated that, even if flexibility in the particular State's law on LLCs and other business forms may allow LLCs to have more common attributes with the corporations or partnerships in that State, the LLC was still a separate type of business entity with its own comprehensive statutory framework. Advisory Opinion 1997-4.

Under California statutes, the LLC is a form of business organization that is distinct from corporations or partnerships. Like these other forms of organizations, the LLC is legally recognized pursuant to its own separate title of the California Corporate Code. The California statute states that the name must contain the term "company" or "limited" or "limited liability company" (or an abbreviation of any such term), and it is not permitted to use the words "corporation" or "corp." or "inc." or "incorporated" in its business name. Cal. Corp. Code §17002. California law requires that an LLC state in writing the last date on which the company will dissolve, and it also provides for dissolution upon events terminating a person's membership, e.g., that person's retirement, death, or expulsion (unless otherwise provided in the operating agreement or by consent of the members). Cal. Corp. Code §17350. Under the California statute, an LLC is given limited liability for all its members even if they are involved in management, as is generally the case with corporations and generally distinguishable from partnerships. Cal. Corp. Code §§17101(a) and 17158. Lastly, the statute provides for limitations on the transferability of interests. A member may not transfer the membership itself and the attendant management rights when transferring the right to receive distributions, unless the other members provide unanimous written consent or there is a provision for such transfer in the operating agreement. Cal. Corp. Code §§17301(a) and 17303(a).

The Firm's operating agreement, included with the request, corresponds to the above cited provisions. For example, the agreement explicitly provides for the termination of PH at a specific date in the future. PH agreement Article II, section 2.4. The agreement also provides for the termination of the Firm upon the occurrence of

events outlined in the California LLC statute. PH agreement Article III, section 7.1. It also explicitly prohibits the transfer of interests, except for a transfer back to the Firm, without the unanimous agreement of all the Firm members. PH agreement Article VI, section 6.1. Based on the foregoing analysis, the Commission concludes that Patriot Holdings is an LLC to the same extent as those LLC entities considered in Advisory Opinions 1997-17, 1997-4, 1996-13, and 1995-11.[2] However, given PH's status and relationships with two other LLC's that hold Federal contracts, PH is subject to certain restrictions on its Federal election activity. See discussion below.

PH and section 441c

As noted earlier, in past opinions the Commission concluded that an LLC may make contributions from its general treasury funds subject to the limits of 2 U.S.C. §441a(a) without attribution to any of the members who comprised the Firm. This conclusion was based on the assumption that neither the LLC itself nor any of its members were Federal contractors. 11 CFR 115.2. See the above cited opinions. Therefore, it is clear that both ASM and PCS, because they are Federal contractors, are prohibited from making contributions to Federal candidates or Federal political committees.

This request is the first time the Commission has been asked to address the situation of an LLC that owns other LLCs which are Federal contractors. However, several opinions dealing with bank holding companies and national banks are relevant to your situation. As you know, 2 U.S.C. §441b(a) prohibits the making of a contribution by national banks or Federally chartered corporations in any election to any political office in the United States. In past opinions, the Commission permitted a holding company of a national bank, a holding company of a Federally chartered savings and loan, and a wholly owned subsidiary of a Federally chartered savings and loan association, to make contributions in connection with State and local elections and to make donations to committees associated with national political party conventions. See Advisory Opinions 1995-32, 1995-31, 1981-61, 1981-49, and 1980-7. The Commission reasoned in these opinions that a holding company is considered a distinct legal entity in its own right, apart from its subsidiaries, and that there is no language in section 441b indicating that the prohibition (as to contributions in any election, including State or local elections) extends to parent holding companies which are not themselves national banks, or Federally chartered corporations or banks. See *id.*

[2] On September 2, 1998, the Commission voted to direct the Office of General Counsel to draft a notice of proposed rulemaking which may lead to regulations specifically addressing contributions by limited liability companies. The conclusion of this opinion could be modified or superseded by the adoption of any new regulations in this area, but the opinion may be relied upon until any change is made. If a change is made, it will become effective on a specific date announced in the Federal Register. In addition, the Commission's written explanation and justification for any new rules will identify each past advisory opinion that is modified or superseded.

The Commission premised this position on the separate identity of a holding company from a subsidiary and the absence of facts which indicated the subsidiary was merely an agent, instrumentality, or alter ego of the holding company. See Advisory Opinions 1995-32, 1995-31 and 1980-7. The Commission has further required that the permitted political contributions of the holding company be funded only from revenue not derived from subsidiaries that are prohibited from the same activity by section 441b. See Advisory Opinions 1995-32, 1995-31, 1981-61 and 1981-49.

The Commission is of the opinion that this analysis should apply in PH's situation. The fact that PH and its subsidiaries are LLC's rather than corporations is not a significant distinction. As is the case with section 441b, the prohibitions of 2 U.S.C. §441c would not extend to an LLC holding company as long as it is, in fact, a separate and distinct legal entity from its Federal contractor subsidiaries. The facts in the request do not indicate that ASM or PCS are merely agents, instrumentalities, or alter egos of PH.[3] For example, you have stated that PH does not pay the salaries or expenses of either of its Federal contractor subsidiaries. More importantly, the Government contracts entered into by ASM and PCS do not contain clauses or terms which would hold PH liable for breaches by ASM and PCS. The same is true for all the other contracts of the PH subsidiaries.

Therefore, in response to your first question, the Commission concludes that the prohibitions of 2 U.S.C. §441c do not apply to PH which (unlike ASM and PCS) may make contributions to Federal candidates and committees. However, as in the holding company opinions cited above, the source for these Federal contributions must be revenue other than that resulting from the operations of ASM and PCS.[4] See footnote 1 and Advisory Opinions 1995-31, n.2 and 1995-32, n.4.

Establishment of nonconnected committees

Your second question concerns the establishment of nonconnected committees by individuals associated with PH, ASM and PCS. The Commission notes that 11 CFR 115.6 permits the employees, officers, or individual members of an unincorporated association, or other group or organization which is a Federal contractor, to make

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[3] The corporate concept of "alter ego" otherwise known as "piercing the corporate veil" has been held to apply to LLCs. See *Hollowell v. Orleans Regional Hospital*, No. Civ.A. 95-4029, 1998 U.S. Dist. WL 2832298 (E.D.La, May 29, 1998). See also J. Williams Callison and Maureen A. Sullivan, *Limited Liability Companies: A State by State Guide to Law and Practice* 44 (1994). For an outline of the factors that can lead to piercing the corporate veil, see *Hollowell* at 10 and 12. The fact that PH, ASM and PCS share common officers or directors, absent other factors, would be insufficient to establish that ASM and PCS were the alter egos of PH. See *United States v Bestfoods*, 1998 WL 292076, 15 (U.S., June 8, 1998).

[4] You state in your request that PH has a $10 million line of credit from a bank which is secured by the government contract account receivables held by ASM, and PCS. You state that the purpose of the credit line is to cover the cash flow needs arising from the ASM and PCS Government contracts. The Commission cautions you that use of the line of credit to fund PH's political activity is prohibited by section 441c, because the line of credit is underwritten and made possible by the Government contract activity of ASM and PCS. The use of the line of credit for PH's contributions would represent the making of an indirect contribution by ASM and PCS.

otherwise lawful contributions from their own personal assets, or to form a nonconnected political committee. See Advisory Opinions 1993-12, 1991-1 and 1990-20. However, while individuals employed by enterprises that are Federal contractors may establish these committees, such a committee would have to be independent of the Federal contractor and receive no support, direct or indirect, from the Federal contractor. See Advisory Opinion 1993-12 and 11 CFR 100.6. The Act does not extend to other forms of business organizations the ability granted to corporations to set up a separate segregated fund and conduct itself as a connected organization. Thus, payments for such costs would be contributions, rather than exempt costs. See Advisory Opinions 1991-1 and 1990-20; See also *California Medical Association v. Federal Election Commission*, 453 U.S. 182 (1981).

Therefore, individuals from PH, ASM and PCS could establish a nonconnected committee. However, any type of administrative support given to the committee would be a contribution subject to the prohibitions and limitations of the Act. See Advisory Opinion 1997-15. Consequently, ASM and PCS, as Federal contractors, would be prohibited from making any such contribution by section 441c, while PH could make the contributions if within the limitations of 2 U.S.C. §441a and if its contributions are made only from revenues generated by PH's separate business ventures, not those of ASM or PCS.

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,

(signed)

Joan D. Aikens
Chairman

Enclosures (AOs 1997-15, 1997-17, 1997-4, 1996-13, 1995-32, 1995-31, 1995-11, 1993-12, 1991-1, 1990-20, 1981-49, 1981-16 and 1980-7)