September 22, 2003

NOTICE AO DRAFT COMMENT PROCEDURES

The Commission has approved a revision in its advisory opinion procedures that permits the submission of written public comments on draft advisory opinions when proposed by the Office of General Counsel and scheduled for a future Commission agenda.

Today, DRAFT ADVISORY OPINION 2003-21 is available for public comments under this procedure. It was requested by counsel Kenneth A. Gross and Ki P. Hong on behalf of Lehman Brothers, Inc. The draft may be obtained from the Public Disclosure Division of the Commission.

Proposed Advisory Opinion 2003-21 will be on the Commission's agenda for its public meeting of Thursday September 25, 2003.

Please note the following requirements for submitting comments:

1) Comments must be submitted in writing to the Commission Secretary with a duplicate copy to the Office of General Counsel. Comments in legible and complete form may be submitted by fax machine to the Secretary at (202) 208-3333 and to OGC at (202) 219-3923.

2) The deadline for the submission of comments is at the close of business on September 24, 2003.

3) No comments will be accepted or considered if received after the deadline. Late comments will be rejected and returned to the commenter. Requests to extend the comment period are discouraged and unwelcome. An extension request will be considered only if received before the comment deadline and then only on a case by case basis in special circumstances.

4) All comments timely received will be distributed to the Commission and the Office of General Counsel. They will also be made available to the public at the Commission's Public Disclosure Division.

CONTACTS

Press inquiries: Ron Harris (202) 694-1220

Acting Commission Secretary: Mary Dove (202) 694-1040

Other inquiries:

To obtain copy of draft AO 2003-21 contact Public Records Office-Public Disclosure Division (202) 694-1120, or 800-424-9530.

For questions about comment submission procedure contact Rosemary C. Smith, Acting Associate General Counsel, (202) 694-1650.

ADDRESSES

Submit single copy of written comments to:

Commission Secretary
Federal Election Commission
999 E Street NW
Washington, DC 20463

AGENDA DOCUMENT NO. 03-70

FEDERAL ELECTION COMMISSION
Washington, DC 20463

September 22, 2003

MEMORANDUM

AGENDA ITEM
For Meeting of: 9-25-03

TO: The Commission

THROUGH: James A. Pehrkon
Staff Director

FROM: Lawrence H. Norton
General Counsel

James A. Kahl
Deputy General Counsel

Rosemary C. Smith
Acting Associate General Counsel

John C. Vergelli
Acting Assistant General Counsel

Albert J. Kiss
Attorney

SUBJECT: Draft AO 2003-21

Attached is a proposed draft of the subject advisory opinion. We request that this draft be placed on the agenda for September 25, 2003.

Attachment

ADVISORY OPINION 2003-21

DRAFT

Kenneth A. Gross, Esq.
Ki P. Hong, Esq.
Skadden, Arps, Slate, Meagher & Flom LLP
1440 New York Avenue, N.W.
Washington, D.C. 20005-2111

Dear Messrs. Gross and Hong:

This responds to your letters dated May 16, 2003, June 17, 2003, July 17, 2003, and August 5, 2003, requesting an advisory opinion on behalf of Lehman Brothers Holdings Inc. and its subsidiaries ("Lehman"), concerning application of the Federal Election Campaign Act of 1971 ("the Act"), and Commission regulations, to the question of disaffiliation of Lehman's separate segregated fund ("SSF"), the Action Fund of Lehman Brothers Holdings Inc. ("Lehman PAC"), from Peabody Energy Corporation's ("Peabody's") SSF, the Peabody Energy Corporation Political Action Committee ("Peabody PAC").

Background

In May 1998, Lehman purchased 87.5 percent of the voting stock of Peabody, a Delaware corporation, in a leveraged buyout solely for investment purposes. You state that, subsequently, Lehman has not actively participated in the day-to-day operations of Peabody. In May 2001, Peabody completed an initial public offering of voting stock in which Lehman's interest was reduced to 59.3 percent. In April 2002, Lehman sold Peabody voting stock, reducing its holdings to 40.9 percent. In May and August 2003, Lehman sold additional voting stock, reducing its holdings to approximately 19 percent of

Peabody's voting stock (before the effect of dilution from stock options). The remainder of Peabody's shares of voting stock are publicly held. You assert that, with such holdings, Lehman may not act unilaterally with regard to Peabody's corporate activities.

You state that Lehman and Peabody are separate, publicly traded companies that engage in different, non-overlapping businesses, and that Lehman had no role in Peabody's formation. You state that Peabody was never a subsidiary of Lehman for either federal tax law or federal securities law purposes.

Question Presented

Is Peabody PAC no longer affiliated with Lehman PAC?

Legal Analysis and Conclusion

Peabody PAC is no longer affiliated with Lehman PAC.

The Act and Commission regulations provide that committees 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. 2 U.S.C. 441a(a)(5); 11 CFR 100.5(g)(2) and 110.3(a)(1)(ii). Contributions made to or by affiliated committees shall be considered to have been made to or by a single committee, and thus such committees share contribution limits. 11 CFR 110.3(a)(1).

11 CFR 110.3(a)(2)(i) provides that affiliated committees sharing a single contribution limit include, *per se*, all of the committees established, financed, maintained or controlled by a corporation and / or its subsidiaries. Lehman's current 19 percent voting stock interest does not create a parent / subsidiary relationship for purposes of the Act. Therefore, Lehman PAC and Peabody PAC are not *per se* affiliated.

In the absence of certain automatically affiliated relationships such as a parent corporation and its subsidiary, Commission regulations provide for an examination of certain circumstantial factors in the context of the 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); 11 CFR 110.3(a)(3). The list of ten factors set out at 11 CFR 110.3(a)(3)(ii) is not an exhaustive list, and other factors may be considered. *See, e.g.* Advisory Opinions 2000-28 (finding that an unincorporated association of businesses involved in the development and construction of multifamily housing for senior citizens and an incorporated trade association representing the interests of the multifamily housing industry were disaffiliated after a formal separation agreement was executed) and 1995-36 (finding that two formerly affiliated businesses were disaffiliated, in part because of the continuous separate operations of the businesses after an initial public offering of one entity's stock and direct competition between the businesses).

11 CFR 110.3(a)(3)(ii)(A) addresses whether a sponsoring organization of a committee owns a controlling interest in the voting stock or securities of the sponsoring organization of another committee. At present, Lehman owns approximately 19 percent of the voting shares in Peabody, down from 87.5 percent in May 1998 when Lehman acquired control of Peabody. You state that Lehman does not have any agreement with other shareholders of Peabody whereby its voting power or governance power regarding Peabody's affairs is enhanced or otherwise affected.

Peabody's bylaws provide that, except for a limited set of decisions, proposed

actions submitted to stockholders are decided by a majority of a quorum, except that elections for candidates for the board of directors are decided on the basis of which candidate receives the most shareholder votes, even if not a majority (sometimes called "plurality voting"). As most shareholder decisions are made on the basis of a majority affirmative vote, Lehman is unlikely to be able to control most shareholder decisions through ownership of 19 percent of Peabody voting stock. Further, cumulative voting cannot be used to enhance Lehman's voting power.[1] However, several important Peabody decisions are made on the basis of a 75 percent supermajority vote, which Lehman could block in some circumstances with its 19 percent voting stock ownership (*e.g.*, where only 60 percent of voting shares are present in a quorum.)[2]

Because approximately 5.8 million Peabody voting shares can be issued to Peabody employees upon the exercise of presently outstanding stock options under Peabody's 1998 Stock Purchase and Option Plan and Peabody's Long-Term Equity Incentive Plan, Lehman's voting stock interest in Peabody will likely represent a diminishing percentage

---

[1] Under Delaware law, cumulative voting is not a stockholder's right unless the certificate of incorporation expressly so provides. Peabody's certificate of incorporation does not provide for cumulative voting and as such shareholder voting is not cumulative in the situation you describe.

[2] The amount of voting stock that a shareholder needs to defeat a supermajority affirmative vote will vary with the percentage of Peabody's voting stock present in a quorum. For example, where only 60 percent of Peabody voting stock is present in a quorum, 75 percent of the voting stock present in that quorum (that is, 45 percent of Peabody's total voting stock) must vote for a supermajority proposition for that proposition to pass. In a quorum where 60 percent of Peabody voting stock is present, a single shareholder that controls more than 15 percent of Peabody's total stock would control more than 25 percent of the shares participating in the vote. Thus, for example, a 19 percent shareholder like Lehman could prevent a supermajority affirmative vote where 60 percent of Peabody voting stock is present in a quorum. Decisions which require a 75 percent vote (i.e., a supermajority vote) to be effective are: removal of directors for cause; an increase in the number of shares of authorized stock; altering, amending or repealing articles 5, 7, 9 or 9 of Peabody's certificate of incorporation (regarding rules for amending Peabody's bylaws, whether shareholders can fill a vacant directorship, and removing directors for cause); modifying or overriding the board's action on the bylaws; and amending or repealing the bylaws. Also, if Delaware law expressly confers power on the shareholders to fill a vacancy on the board of directors at a special meeting of the shareholders (e.g., if the Delaware Court of Chancery orders an election by the shareholders to fill either vacancies or newly created directorships), then the vacancy would be filled by a supermajority affirmative vote.

of Peabody's outstanding voting shares as the stock options are exercised. Based on the beneficial ownership tables published in Lehman and Peabody's 2003 proxy statements, which disclose the beneficial owners of more than five percent of the respective companies' voting shares (and ownership by directors and management in the case of Peabody), there is no overlap of shareholders owning more than five percent of both Lehman and Peabody, and no other shareholder overlap is evident. Under the facts you present, a significant separation has taken place and appears to be widening as stock options are exercised, diluting Lehman's stake. Thus, Lehman no longer has a controlling interest in Peabody, although in some limited circumstances where a supermajority affirmative vote is required Lehman could defeat such a vote. Further, no information presented indicates that a common shareholder base exists.

Past advisory opinions have found that a separation in ownership, control and personnel can lead to a finding of disaffiliation. *See, e.g.*, Advisory Opinion 2002-12 (after a significant restructuring of two connected organizations, the resulting separation in terms of ownership, control and personnel, as well as in terms of financial independence, separate staffs and contribution patterns of each, indicated that two SSFs were no longer affiliated). In Advisory Opinion 2002-12, one factor the Commission considered was a decrease in voting stock ownership of one company by another company from 45 percent to 12.3 percent. In finding the businesses to be disaffiliated the Commission considered several factors, and observed that it was highly unlikely that the 12.3 percent shareholder could elect an additional board member on its own. Although in the situation you describe there is no other shareholder with nearly the same voting power as Lehman, it is similarly

unlikely that a 19 percent shareholder could elect an additional board member on its own.

11 CFR 110.3(a)(3)(ii)(B) addresses whether a sponsoring organization or committee has the authority or ability to direct or participate in the governance of another sponsoring organization or committee through provisions of constitutions, bylaws, contracts, or other rules, or through formal or informal practices or procedures. Although Lehman's 19 percent voting stock interest in Peabody gives Lehman the ability to participate in the governance of Peabody, that interest, when considered in light of Peabody's articles of incorporation and bylaws, is not sufficient to give Lehman either direction over, or control of, the governance of Peabody. Rather, Lehman's ability to participate in the governance of Peabody is the ability of a minority shareholder. Furthermore, neither Lehman nor Lehman PAC directs or participates in any way in the governance of Peabody PAC. Rather, Peabody PAC is governed exclusively by Peabody's directors, officers and employees.

The factors discussed at sections 110.3(a)(3)(ii)(C), (E) and (F) are interrelated in the situation you ask about and are addressed together. 11 CFR 110.3(a)(3)(ii)(C) addresses whether a sponsoring organization or committee has the authority or ability to hire, appoint, demote or otherwise control the officers, or other decisionmaking employees or members of another sponsoring organization or committee. 11 CFR 110.3(a)(3)(ii)(E) addresses whether a sponsoring organization or committee has common or overlapping officers or employees with another sponsoring organization or committee which indicates a formal or ongoing relationship between the sponsoring organizations or committees. 11 CFR 110.3(a)(3)(ii)(F) addresses whether a sponsoring organization or committee has any

members, officers or employees who were members, officers or employees of another sponsoring organization or committee which indicates a formal or ongoing relationship between the sponsoring organizations or committees, or which indicates the creation of a successor entity. You state that there are no overlapping officers, directors or personnel between Lehman PAC and Peabody PAC, and you state that Lehman does not have authority regarding, nor is Lehman involved in, hiring, appointing, demoting or controlling any officer or director of Peabody PAC.[3] At present, one individual is both a director of Lehman and of Peabody. This individual has been a director of Peabody since 1998, and he is also a Managing Director of Lehman and the former head of Lehman's Merchant Banking Group, responsible for oversight of Lehman Brothers Merchant Banking Partners II L.P. Also, three other directors of Peabody have ties to Lehman. One who is also a Vice President, and who is the Assistant Secretary of Peabody, is an outside consultant to Lehman's Merchant Banking Group. Prior to becoming a consultant to Lehman in January 2003, this individual was a principal in Lehman's Merchant Banking Group. This individual is retained by Lehman on an annual basis and his consulting relationship with Lehman may be renegotiated at the end of this annual period. Another individual serves as Senior Advisor and consultant to Lehman. Finally, another individual serves as an outside consultant to Lehman. Prior to becoming a consultant to Lehman in May 2003, this individual was a Managing Director and then an Advisory Director at Lehman. This individual is in the process of concluding the investment banking projects on which he worked while he was a Lehman employee and is expected to retire from Lehman altogether

[3] No documents give Lehman the ability to hire, appoint, demote or otherwise control the officers, or other decisionmaking employees, of Peabody.

once those projects are concluded. The four Peabody board members who have ties to Lehman[4] constitute a minority of Peabody's eleven-person board of directors. In Advisory Opinion 1996-23, three previously affiliated SSFs were deemed no longer affiliated after a corporate reorganization, despite the fact that there was an overlap of three members on one company's eight-person board of directors, and four members on another company's eleven-person board.

In the situation you ask about, neither Lehman's 19 percent ownership of Peabody voting stock, nor the terms of Peabody's articles of incorporation and bylaws, provide Lehman the power to hire, appoint, demote or otherwise control the officers, or other decisionmaking employees, of Peabody. Further, while there is one Lehman director who also is a director of Peabody, and three Peabody directors work as consultants for Lehman, in the situation you ask about Lehman and Peabody do not have sufficient common or overlapping officers or employees to indicate a formal or ongoing relationship between Lehman and Peabody. Lastly, although one of the Peabody directors with ties to Lehman formerly was a Lehman director, one formerly was a Lehman officer, and one formerly was a Lehman employee, in the situation you ask about these overlaps do not indicate a formal or ongoing relationship between Lehman and Peabody.

11 CFR 110.3(a)(3)(ii)(G) addresses whether a sponsoring organization or committee provides funds or goods in a significant amount or on an ongoing basis to another sponsoring organization or committee, such as through direct or indirect payments for administrative, fundraising, or other costs. 11 CFR 110.3(a)(3)(ii)(H) addresses

[4] Three of these four individuals are neither directors, officers, or employees of Lehman, but rather are consultants to Lehman.

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. You state that Lehman does not provide funds or goods to Peabody in either a significant amount or on an ongoing basis. However, Lehman and its affiliates do provide financial advisory and investment banking services to Peabody, and may thus be viewed as causing or arranging funds for Peabody. In particular, a Peabody proxy statement dated March 31, 2003 indicates that Lehman and Peabody have engaged in several related party transactions involving investment banking and financial advisory services provided by Lehman. These related party transactions appear to be commercially reasonable transactions not made on terms any better than those offered by Lehman to other parties, but they nonetheless do evidence significant ongoing business activities between Lehman and Peabody in which the former arranges financing for the latter. Past advisory opinions, however, have found that disaffiliated companies may maintain some customer-supplier relationships. *See* Advisory Opinion 1996-42 (after a corporation was spun-off from its parent, the two companies were no longer affiliated because factors indicating a continuing relationship between the two companies were outweighed by factors indicating separate control), *citing* Advisory Opinion 1995-36, n.3 (noting that two formerly affiliated entities continued to do business on an arm's length basis). Lehman's investment banking relationship with Peabody is qualitatively different from an ordinary customer-supplier relationship because it, combined with Lehman's status as the majority owner of Peabody voting stock from May 1998 to April 2002, provides Lehman with nonpublic knowledge regarding Peabody that far exceeds the knowledge available to any

other investor. However, as part of the overall circumstances here, this consideration is not decisive.

11 CFR 110.3(a)(3)(ii)(I) addresses whether a sponsoring organization or a committee or its agent had an active or significant role in the formation of another sponsoring organization or committee. Lehman did not have any role in the formation of Peabody or Peabody's PAC.

11 CFR 110.3(a)(3)(ii)(J) addresses whether two SSFs have similar patterns of contributions or contributors, thereby indicating a formal or ongoing relationship between the two SSFs or their sponsoring organizations. Lehman PAC and Peabody PAC do not conduct any joint fundraising activities nor do they transfer any funds to each other. Rather, Lehman PAC and Peabody PAC have separate contributor bases, and each PAC only solicits contributions from its own respective executive and administrative personnel. Also, Lehman and Peabody are in different businesses and make contributions to a wide variety of candidates who support specific issues of concern to each company. Lehman PAC and Peabody PAC do not coordinate their contributions except for tracking contributions for purposes of complying with applicable Federal contribution limits. The facts you describe indicate a lack of either a formal or ongoing relationship between Lehman PAC and Peabody PAC.

Based on the foregoing, the Commission concludes that Peabody PAC and Lehman PAC are no longer affiliated for purposes of the Act. Thus, Peabody PAC and Lehman PAC no longer share limits on the receipt and making of contributions, and neither Peabody and Lehman may solicit the solicitable class of each other's organization for

contributions.

This response constitutes an advisory opinion concerning the application of the Act and Commission regulations to the specific transaction or activity set forth in your request. *See* 2 U.S.C. 437f. The Commission emphasizes that, if there is a change in any of the facts or assumptions presented, and such facts or assumptions are material to a conclusion presented in this advisory opinion, then the requestor may not rely on that conclusion as support for its proposed activity.

Sincerely,

Ellen L. Weintraub
Chair

Enclosures (AOs 2002-12, 2000-28, 1996-42, 1996-23, and 1995-36).