February 24, 2017

To the Connecticut Legislature's Committee on Government Administration and Election:

I write in support of Proposed Bill No. 582. I am attaching my prior testimony to the St. Petersburg City Council supporting a proposed ordinance that was being discussed this past fall, regarding political spending by foreign-influenced corporations. I understand my testimony may be useful for a public hearing your committee has scheduled for this coming Monday regarding Proposed Bill No. 582.

If you have any further questions, please let me know. I can reached at 617-496-4420 or at jcoates@law.harvard.edu.

Very truly yours,

Professor John C. Coates IV

John F. Cogan, Jr. Professor of Law and Economics
Harvard Law School

October 27, 2016

To the Honorable City Council Chair Amy Foster and the Honorable City Council,

I am writing to express my support for the city's proposed ordinance regarding political spending by foreign-influenced corporations as a critical tool for uncovering foreign influences prohibited under federal law, as well as to explain how corporations can obtain responsive information about the foreign national status of shareholders, as mandated by the ordinance's certification requirement.

Background

I am the John F. Cogan, Jr. Professor of Law and Economics at Harvard Law School, and the Research Director of the Center on the Legal Profession. Before joining Harvard, I was a partner at Wachtell, Lipton, Rosen & Katz, specializing in financial institutions and mergers and acquisitions. I have testified before the United States Congress, am on the Investor Advisory Committee of the Securities and Exchange Commission (SEC), and have provided consulting services to the U.S. Department of Justice, the U.S. Department of Treasury, the New York Stock Exchange, and participants in the financial markets, including individuals, mutual funds, hedge funds, investment banks, commercial banks, and private equity funds. In June 2016, I testified by invitation at a forum on "Corporate Political Spending and Foreign Influence" at the Federal Election Commission.

Foreign corporate spending in American elections

Since the Supreme Court's 2010 *Citizens United* decision invalidated restrictions on corporate political spending,[1] the possibility that American elections could be influenced by foreign interests via corporations has attracted considerable public and policymaker interest. Foreign governments, foreign-based companies, and people who are neither U.S. citizens or permanent residents are currently barred by federal law from contributing or spending money in connection with federal, state, or local elections.[2] Unfortunately, *Citizens United* created a loophole to this ban: these foreign entities can invest money through U.S.-based corporations that can – as a result of the decision – then spend unlimited amounts of money in American elections.

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[1] *Citizens United v. FEC*, 558 U.S. 310 (2010).

[2] 52 U.S.C. § 30121(a). This prohibition was upheld by a unanimous U.S. Supreme Court in 2012. *See Bluman v. FEC*, 132 S. Ct. 1087 (2012).

The policy interest in regulating foreign influence need not rest on the idea that foreign investors are tied to hostile governments that are actively trying to undermine the democracy or economy of the United States. Rather, it may also or separately rest on the observation that foreign nationals (even those in countries that are staunch U.S. allies) are not part of the U.S. polity. Democratic self-governance presumes a coherent and defined population to engage in that activity. Foreign nationals have a different set of private interests than their U.S. counterparts, as regards a range of policies, such as defense, environmental regulation, and infrastructure. Few dispute the idea that a given government may properly seek to limit foreign influence over, in the words of the U.S. Supreme Court, "activities 'intimately related to the process of democratic self-government.'"[3] There is nothing particularly surprising or pernicious about this fact. Foreign and domestic interests predictably diverge.

Depending on the degree of their influence, foreign governments (or their agents, such as sovereign wealth funds), foreign corporations, or other foreign investors might be able to leverage ownership stakes in U.S. corporations to affect corporate governance. Through that channel, they could influence corporate political activity in a manner inconsistent with democratic self-government, or at least out of alignment with the interests of U.S. voters.

Every country regulates some types of foreign and domestic business activities differently. In many domains of the American economy, long-standing statutes, regulations, and legal traditions treat foreign companies or foreign-influenced companies differently than domestic companies. The United States has specific foreign restrictions across a number of different industries. In shipping, aircraft, telecom, and financial services, laws governing all of these industries limit or regulate foreign ownership or control. Some ban foreign ownership completely, and, for some, foreign ownership or control triggers special government approval procedures.

The same spirit of those bodies of law should inform regulation of election spending by foreign-influenced corporations. Since *Citizens United* opened the door for political activity by corporations, some corporations of which ownership or control is likely held in significant part by foreign entities have devoted considerable financial resources to influencing American elections.

[3] *Bluman v. FEC*, 800 F. Supp. 2d 281, 287 (D.D.C. 2011) (three-judge court) (quoting *Bernal v. Fainter,* 467 U.S. 216, 220 (1984)), *aff'd*, 132 S.Ct. 1087 (2012).

In practice, the policy preferences of foreign-influenced corporations are sometimes clear from public sources. This past May, Uber and Lyft spent over $9 million on a ballot initiative in Austin, Texas that would have overturned an ordinance passed by the Austin City Council requiring the companies' drivers to submit to fingerprint-based criminal background checks.[4] Weeks later, Uber disclosed that the Saudi Arabian government had invested $3.5 billion in the company, giving the Kingdom over five percent ownership and a seat on its board of directors.[5] Last month, the multinational "homestay" corporation Airbnb responded to the New York Legislature's growing interest in regulating the industry by arming a super PAC with $11 million to influence New York's legislative races.[6] Airbnb – a privately held company – is partly owned by Moscow-based DST Global.[7]

More strikingly, an investigation by *The Intercept* uncovered how APIC, a San Francisco-based company described as "controlled," "owned," and even "100 percent owned" by Gordon Tang and Huaidan Chen—two Chinese citizens with permanent residence in Singapore—gave $1.3 million to a super PAC that had supported Jeb Bush's run for president.[8] Though the story made headlines, it echoes similar, yet less publicized, efforts to influence high-profile state and national races. For example, in 2012, a Connecticut-based subsidiary of a

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[4] Nolan Hicks, "Prop 1 campaign crosses $9 million threshold," AUSTIN-AMERICAN STATESMAN, May 9, 2016, http://atxne.ws/29pbFBk.

[5] *See* Elliot Hannon, "Saudi Arabia Makes Record $3.5 Billion Investment in Uber," SLATE, June 1, 2016, http://slate.me/1UvvM3x. Uber also spent roughly $600,000 on a 2015 voter referendum in Seattle. *See* Karen Weise, "This is How Uber Takes Over a City," BLOOMBERG, June 23, 2015, http://bloom.bg/1Ln2MaN.

[6] Kenneth Lovett, "Airbnb to spend $10 on Super PAC to fund pre-Election day ads," N.Y. DAILY NEWS, Oct. 11, 2016, http://www.nydailynews.com/news/politics/airbnb-spend-10m-super-pac-fund-pre-election-day-ads-article-1.2825469.

[7] *See* Dan Primack, "Yuri Milner adds $1.7 billion to his VC war chest," FORTUNE, Aug. 3, 2015, http://fortune.com/2015/08/03/yuri-milner-adds-1-7-billion-to-his-vc-warchest/ (DST Global is Moscow based); Scott Austin, "Airbnb: From Y Combinator to $112M Funding in Three Years, The Wall Street Journal, July 25, 2011, http://blogs.wsj.com/venturecapital/2011/07/25/airbnb-from-y-combinator-to-112m-funding-in-three-years/ (DST Global is a major investor in Airbnb).

[8] Jon Schwartz & Lee Fang, "The Citizens United Playbook," THE INTERCEPT, Aug. 3, 2016, http://bit.ly/2auW75p.

Canadian insurance and investment corporation gave $1 million to the pro-Mitt Romney super PAC Restore Our Future.[9] In 2013, a New Jersey-based subsidiary of a Chinese-owned business contributed $120,000 directly to Terry McAuliffe's gubernatorial campaign in Virginia.[10]

Ballot initiatives have been particularly strong magnets for spending by multinational corporations. This past August, American Electric Power, Limited Brands, and Nationwide Insurance spent a combined $275,000 against a municipal initiative aimed at reconfiguring the Columbus City Council.[11] In 2012, a Los Angeles County ballot measure, the "Safer Sex in the Adult Film Industry Act," attracted over $325,000 from two companies tied to a Luxembourg corporation that ran adult webpages.[12] The company's then-CEO was a German national.[13] That same year, a statewide ballot initiative in California that would have required all foods containing genetically modified organisms to be labeled as such attracted $45 million in spending by multinationals such as Monsanto and DuPont.[14] Opponents of the measure spent five times more than its supporters, and ultimately defeated it by a 53-47 margin.[15]

Of course, not all politically active corporations are owned or controlled in significant part by foreign entities. Many privately held companies are owned directly by one or a small number of U.S. citizens. Among U.S. public companies, foreign ownership varies. I have recently completed research

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[9] Michael Beckel, "Foreign-Owned Firm Gives $1 Million to Romney Super-PAC," MOTHER JONES, Oct. 5, 2012, http://www.motherjones.com/politics/2012/10/canadian-foreign-donation-super-pac-restore-our-future.

[10] John Schwartz, "Va. Gov. Terry McAuliffe Took $120K from a Chinese Billionaire—but the Crime Is That It Was Legal," THE INTERCEPT, June 1, 2016, http://bit.ly/1XPvuXN.

[11] Lucas Sullivan, "Follow the money flowing to ward initiative campaigns in Columbus," THE COLUMBUS DISPATCH, July 22, 2016, http://bit.ly/2ahlSpq.

[12] *See* Ciara Torres-Spelliscy, "How a Foreign Pornographer Tried to Win a U.S. Election," THE BRENNAN CENTER FOR JUSTICE, Nov. 6, 2015, http://bit.ly/29pesu2.

[13] *Id.*

[14] Suzanne Goldenberg, "Prop 37: food companies spend $45m to defeat California GM label bill," THE GUARDIAN, Nov. 5, 2012, http://bit.ly/29I3SE7.

[15] *Id.*

(attached as an appendix to this letter) finding that, among publicly traded corporations in the Standard & Poor's (S&P) 500 index, only one in eleven (~9 percent) has a foreign institutional investor with more than five percent of the company's voting shares. (Five percent is the threshold at which federal securities law requires public disclosure of large stockholdings of US public companies.[16]) Other corporations may have foreign ownership at substantial levels (e.g., 20 percent or more) that would make unaffiliated foreign investors potentially capable of exerting influence on the corporate political spending, but lack any *single* foreign owner that holds at least five percent of total stock.

Regulating foreign corporate spending

Cities can simultaneously welcome foreign investment without exposing themselves to the risk of foreign money influencing their elections. The proposed ordinance addresses this issue through a requirement that a corporation spending money in city elections certify that it is not a "foreign-influenced corporation" – a definition based, in part, on the extent of foreign ownership of corporate stock. The proposed ordinance is a reasonable response to an increasingly localized problem, and is constitutional under the Court's decision in *Citizens United*. The remainder of this letter details how this certification requirement could operate.

The mechanics of the ordinance's certification requirement

1. Ownership of corporate stock

To begin, as a general matter, corporate stock may be "owned" in three different forms. First, many companies that have one or a relatively small number of shareholders hold paper stock certificates. Among larger, stock exchange listed companies, with numerous owners, such direct ownership is rare, and increasingly so. At such companies, shares are more commonly held in "street name" through a broker (e.g., Fidelity or Charles Schwab). In these instances, the name on the stock certificate is actually the broker, but the broker keeps track in a database of how many shares belong to each client. Clients who hold shares in street name are "beneficial owners" under SEC

[16] Under Section 13(d) of the Securities Exchange Act of 1934 (as amended by the Williams Act), any person or group of persons who acquire beneficial ownership of more than five percent of the voting class of the equity of a corporation that is listed or otherwise required to register as a "public" company under that law, must, within ten days, report that acquisition to the Securities and Exchange Commission (SEC) via Schedule 13D (or, in some cases, Schedule 13G). *See* 15 U.S.C. § 78m(d); 17 C.F.R. §§ 240.13d-1, 240.13d-101.

rules, can direct brokers how to vote or sell shares, and can participate in corporate governance.

Most shares of large, listed companies, however, are now held by separate legal entities, such as mutual funds, pension funds, insurance companies, and hedge funds. As an economic matter, these entities hold stock on behalf of their clients or beneficiaries. However, as a legal matter, the investment entities themselves are the owners of the stock, and they do not pass through to beneficiaries either the right to vote or the right to sell the shares of the stock that the entity purchases. Individuals whose wealth is invested through these types of institutional investments cannot exercise voting rights associated with the shares. Instead, those rights are exercised by the management of the institutions.

2. Determining shareholders

Most corporate stock is not traded on public markets. As of 2012, more than five million corporations filed U.S. income tax returns. Only about 4,000 corporations were listed on a U.S. stock exchange – less than 0.1 percent of corporations that filed tax returns. Of the rest, many are owned by a single shareholder, or are beneficially owned by up to 500 individual owners. (SEC rules generally require public registration and disclosure for companies with more than 500 owners and $10 million in assets.) Companies without public markets are still large and have substantial numbers of shareholders. Examples include Cargill, with revenues exceeding $130 billion and over 200 shareholders, and Mars, with revenues exceeding $33 billion and over 45 shareholders. Because shares of such companies do not trade freely in the public markets, such companies generally can and do track the identity of their shareholders directly.

For corporations listed on public markets, shares trade in significant volume—thousands of shares per day. However, publicly traded corporations have the ability to ascertain the exact ownership of their shares as of any arbitrary "record date." In fact, this happens at least annually, because companies are required by corporate law to have annual shareholder meetings, for which they must set a record date to determine which shareholders are eligible to attend and vote at the meeting. In fact, record dates are set and shareholder lists are created more frequently than that at many public companies, to allow for votes on off-cycle events, such as a merger proposal or charter amendments, which are brought to a vote at special meetings. Consequently, the ability to determine record stock ownership as of a given date is essential to the basic governance of corporations.

Few if any publicly traded corporations engage in the process of determining their record shareholders for a given record date themselves. They use an intermediary – most commonly, American Stock Transfer (AST) – that is dedicated to this function. Under state law, shareholders seeking to file a derivative suit or solicit shareholder support for a shareholder resolution or proxy contest can also obtain the list of shares using the same method. A corporation that needs the list of shareholders as of a specific date would engage AST to produce the list of shareholders as of that date. Under SEC rules, public companies also reach out beyond their record holders to the beneficial owners of broker- or bank-owned stock, and engage AST to contact banks, brokers or other intermediaries that are nominally record owners. Those firms, in turn, provide information about non-objecting beneficial owners to AST, which then compiles it and provides it to the corporation. Typically, banks, brokers and other intermediaries provide AST (and the corporation) with non-objecting client names, addresses, shares held, and purchase dates (which could be multiple blocks if a given shareholder bought multiple blocks of shares over time).

In addition to these basic corporate and securities law mechanisms, Section 13 of the federal Securities Exchange Act of 1934 requires any person or group of persons who acquire beneficial ownership of more than five percent of the voting class of a listed corporation's equity to within ten days report that acquisition to the SEC on a Schedule 13D (or, in some cases, Schedule 13G).[17] These acquisitions are, in turn, made public by the SEC, and available through the SEC's EDGAR online database.

3. Determining whether shareholders are "foreign nationals"

As just described above, acquisitions of five percent or more of the stock of public U.S. companies must already be disclosed under SEC rules, including the identity of the purchaser's citizenship.[18] Thus, the information is already publicly available for five percent blockholders of public companies.

Outside of the blockholder context, for most purposes, corporations typically do not inquire into the citizenship or permanent residency status of shareholders. Many brokerage firms impose restrictions on non-citizens, or specifically limit their customers to citizens or permanent residents. A 2012

[17] *See* 15 U.S.C. § 78m(d); 17 C.F.R. §§ 240.13d-1, 240.13d-101.

[18] *See* 17 C.F.R. § 240.13d-101 (item #6, requiring reporting of "Citizenship or place of organization").

sampling of major brokers by financial markets reporter Matt Krantz found divergence in practices:

> For instance, at Fidelity, the company says only U.S. citizens may open an account. . . . Over at TD Ameritrade, investors do not need to be a U.S. citizen to open an account. With that said, the stipulations and requirements vary dramatically based on the country the resident lives in and the potential customers' nationality, the company says. . . . Similarly at E-Trade, the brokerage has different rules based on the country. . . . The rules vary widely based on the nationality of the person wanting the account . . . . TradeKing requires investors, including U.S. citizens, to be U.S. residents to establish the account. It makes an exception for customers who are living abroad and have a valid U.S. military or government address. Investors who are not U.S. citizens, yet reside legally in the U.S., may open an account if they have a Social Security number and aren't from 27 specific [prohibited] countries . . . .[19]

The process of ascertaining the foreign national status of shareholders could be simple in many cases. If a publicly traded corporation asks American Stock Transfer to produce its list of shareholders (or just those shareholders who are foreign nationals), and AST in turn asks Fidelity, Fidelity's citizens-only customer policy would enable it to truthfully and simply answer that zero percent of the company's shares held through Fidelity are held by foreign nationals.

Similarly, where stock is held by a non-human shareholder, such as another corporation, the "foreign national" status of that corporation can be ascertained readily by examining its place of incorporation and principal place of business.

The proposed ordinance counts stock owned by domestic subsidiaries of foreign parent corporations the same as stock owned by foreign corporations. (In the terms of the ordinance, either would be defined as a "foreign owner.") To the extent that a U.S. subsidiary of a foreign corporation has the potential to influence U.S. portfolio companies in which it invests, it has the potential to do so at the foreign parent's bidding or with the foreign parent's approval.

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[19] Matt Krantz, USA TODAY, "U.S. online brokerage options are limited for foreigners," http://usat.ly/KXpDan (May 16, 2012).

However, the ordinance does *not* require piercing through the beneficial ownership of institutional entities such as mutual funds. For the ordinance's purpose, corporate stock owned by a mutual fund is not corporate stock held by a foreign national, even if many of the mutual fund's customers are themselves foreign nationals, as long as the advisor to the fund is a U.S. entity (a fact that can be readily determined with public information). This is a reasonable approach, because customers of mutual funds cannot themselves directly participate in governance of the corporation actually spending money in a city election. Instead, it is the management of the advisory firm that plays that role.

4. "Due inquiry"

Importantly, the ordinance addresses any remaining possible difficulties that U.S. corporations might have in certifying as to whether they are foreign-influenced. As noted above, some brokerage firms allow foreign nationals to buy stock of U.S. companies through them, and they may not report citizenship information about such customers to the corporations in which they invest. Thus, it may not be possible for every corporation to verify the U.S. or foreign national status of all of its shareholders with complete confidence. (Note, however, that the ordinance does not actually require a corporation to verify *all* of its shareholders' statuses: Given the 20 percent, "aggregate" threshold, verifying that just over 80 percent of shareholders are not foreign owners would be sufficient.)

However, given this possibility, it is reasonable for the proposed ordinance to impose a certification requirement that specifies that the chief executive officer of the corporation certify that the information is provided after "due inquiry." The "due inquiry" standard is familiar from securities law,[20] as well as from other areas of law with which corporate executives are acquainted.[21] It imposes only the customary obligation to make such reasonable inquiry as the

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[20] *See, e.g.,* 17 C.F.R. § 275.206(4)-2(a)(3).

[21] *See, e.g., SRI Int'l, Inc. v. Advanced Tech. Labs., Inc.*, 127 F.3d 1462, 1464–65 (Fed. Cir. 1997) (in patent law, standard for whether infringement was "willful" is "whether the infringer, acting in good faith and upon due inquiry, had sound reason to believe that it had the right to act in the manner that was found to be infringing"); *Black Diamond Sportswear, Inc. v. Black Diamond Equip., Ltd.*, No. 06-3508-CV, 2007 WL 2914452, at *3 (2d Cir. Oct. 5, 2007) ("A trademark owner is '"chargeable with such knowledge as he might have obtained upon [due] inquiry."') (quoting *Polaroid Corp. v. Polarad Electronics Corp.,* 182 F. Supp. 350, 355 (E.D.N.Y. 1960)) (alteration in original).

corporation would do in any event. Thus, the ordinance does not impose a meaningful additional information-gathering cost beyond what it would already be required to do under existing law.

Conclusion

The ordinance is a reasonable solution to the risk of foreign influence in local elections through corporate political spending. The ordinance is constitutional under *Citizens United*, and reasonable from a corporate and securities law perspective. The ordinance would only apply to corporations that spend $5,000 or more on city elections. The ordinance imposes no obligations on corporations that spend less than that (or nothing at all) on city elections. For those corporations that do spend more than that, the certification required by the proposed ordinance is practicable and reasonable for both privately and publicly traded corporations, conditioned as it is on corporations engaging in "due inquiry," a standard that will not add material costs to the information-gathering and record-keeping corporations already engage.

If you have any further questions, please let me know.

Sincerely,

John C. Coates IV
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Harvard Law School