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**Hearing on H.R. 5175 - The DISCLOSE Act - Democracy is Strengthened by
Casting Light on Spending in Elections**

**Before the Committee on House Administration
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Good afternoon Chairman Brady, ranking Member Lungren and distinguished members of the Committee. Thank you for inviting me to testify. My name is Elizabeth Lynch and I am an attorney and an editor at *China Law & Policy*.

I am grateful for this Committee's work on the DISCLOSE Act: legislation necessary to deal with the practical problems arising from the Supreme Court's recent decision in *Citizens United v. FEC*. Of particular concern in our post-*Citizens United* world is the potential influence of foreign money and—given the structure of some multinational corporations—direct pressure from foreign governments in our elections.

To guarantee a functioning democracy and a government accountable to its people, our country has a long-standing history of limiting participation in the electoral process to U.S. citizens.¹ While foreigners, including foreign corporations and foreign governments, are able to participate in other parts of our political process (such as lobbying and public comment periods), elections have remained sacrosanct; foreigners, be they citizens, businesses or governments, have never been permitted to participate in our elections. Voting, campaign donations, and campaign expenditures remain the exclusive rights of U.S. citizens.

In 1938, because of the fear of increasing foreign influence in U.S. politics, Congress codified this long-standing practice and passed the Foreign Agents Registration Act (FARA). In the 1974 Federal Election Campaign Act (FECA), Congress included a section prohibiting foreign governments, foreign political parties, foreign corporations

¹ The sole exception is green card holders. Green card holders may make a contribution to a U.S. campaign. Federal Election Commission, "Foreign Nationals Brochure," July 2003, p. 2 at <http://www.fec.gov/pages/brochures/foreign.shtml>.

and individuals with foreign citizenship from contributing, donating or spending funds, either directly or indirectly, in any U.S. election.

After *Citizens United*, however, it is questionable whether these longstanding prohibitions are still the law of the land.

The Court, in *Citizens United*, Rendered Corporations the Equal of Persons

This change stems from *Citizen United*'s unprecedented elevation of corporations to equal status with individual citizens in the sphere of political speech. For convenience's sake, the common law has periodically described corporations as "legal persons" and "citizens" of the state in which they are incorporated. But in *Citizens United*, this legal short-hand is taken literally. According to *Citizens United*, when analyzing a corporation's right to political speech, courts are no longer permitted to take into consideration elements that make corporations inherently different from individual citizens, such as limited liability, perpetual life and preferential tax treatment. Nor are courts allowed to treat corporations differently from actual human persons (as they have been doing since the country's founding).

Instead, after *Citizens United*, the law can no longer look behind the curtain of the corporate form: *Citizens United* commands that the law pertaining to political speech treat corporations exactly as individual citizens. What goes on behind the curtain, such as limited liability and the like, is no longer pertinent. Simply put, distinctions between corporations and human beings are no longer permissible and limitations on corporations' political speech are considered unconstitutional.

U.S. Subsidiaries of Foreign Corporations Offer a Loophole for Foreign Influence in U.S. Elections

In treating corporations the same as individuals, *Citizens United* leaves the door open for foreign influence in our politics. Today's corporations are global in scope and complicated in structure. For foreign corporations doing business in the United States, it is common to establish a U.S. subsidiary corporation. These U.S. subsidiaries of a foreign parent corporation are incorporated under state law, most often that of Delaware, and for purposes of the law, are considered "citizens" of the state in which they are incorporated. While in the past the citizenship status of a corporation was merely a legal fiction, *Citizens United* makes it into a reality.

Under *Citizens United*, we are no longer permitted to look behind the corporate veil of a U.S. corporation to see its possible relationship to a foreign corporation. But make no mistake: these U.S. subsidiaries are heavily influenced—if not outright controlled—by their foreign parent corporations. In a parent-subsidiary relationship, especially for foreign corporations, there is a high degree of overlap between the parent and its U.S. subsidiary; the parent usually owns a majority, if not all, of the shares of the subsidiary; capital is often infused to the subsidiary from the parent; and directors from the parent's board usually sit on the subsidiary's board of directors. But with *Citizens United*, what's going on behind the corporate curtain, such as limited liability or foreign ownership, is irrelevant as long as the American corporation's political speech rights are equal to an ordinary citizen's.

Foreign Governments Could Also Use the U.S. Subsidiary Loophole to Influence U.S. Elections

Perhaps even more pernicious is the ability of foreign governments to take advantage of the U.S. subsidiary loophole created by *Citizens United*.

Not all countries operate with the same business philosophy of the United States or Western Europe, where most corporations function independently of government. In socialist and post-socialist countries – like Russia, Vietnam and China – ties between business and government are particularly strong. Indeed, many of these countries' most successful corporations are controlled outright by the government. For example, in the case of China, three of its most profitable global corporations – Haier, China Telecom and China State Construction Engineering Corporation (CSCE) – all of which have U.S. subsidiaries incorporated in Delaware, are officially government-run. While the Chinese government does not meddle in the corporation's daily affairs, it will exert its influence if it suits the government's self-interest. For example, in 1994, Haier, a manufacturer of home appliances and one of China's most successful brands, was pressured by the Chinese government into acquiring a pharmaceutical company, a venture that ended badly.

Corporations in other countries, particularly oil-rich ones like Saudi Arabia and Venezuela, are often government-run and also own U.S. subsidiaries. CITGO is directly owned by Petroleos de Venezuela, Venezuela's state-owned oil company. Houston's Aramco Services Company is a wholly-owned subsidiary of Saudi Arabian Oil Company, the national oil company of Saudi Arabia.

In addition to ownership of U.S. subsidiaries by government-run foreign corporations, foreign governments can also influence U.S. elections through sovereign wealth funds: state-owned and managed investment funds. In the past five years, the world has seen an explosion of sovereign wealth funds, as commodity-rich and foreign reserve heavy nations, such as the United Arab Emirates and China, seek to invest their holdings abroad. In 2007, China's sovereign wealth fund, China Investment Corporation (CIC), bought a 9.9% stake in Morgan Stanley. The United Arab Emirates sovereign wealth fund, Abu Dhabi Investment Authority (ADIA), purchased a 4.9% stake in Citigroup in 2007. Interestingly, a member of the Saudi royal family, Prince Alwaleed Bin Talal Al Saud, owns a 4.3% stake in Citigroup through his company, Kingdom Holding.

It is the logic underlying *Citizens United's* literal definition of the corporation as citizen that enables these foreign governments—through both subsidiaries of government-controlled corporations and through direct investment in state-run sovereign wealth funds—to potentially influence our elections. After *Citizens United*, courts are no longer allowed to look behind the curtain of the corporate form to the realities of the situation or to distinguish between corporate citizens and individuals; the majority opinion allows no leeway to examine the foreign origins of the shareholders. For the purposes of political speech, one person's U.S. citizenship, be it from a passport or from the documents of incorporation, is just as good as another's; to draw distinctions would be discriminatory.

The Threat of Foreign Government Involvement in U.S. Elections is Real

As the world becomes more interconnected and brands in other countries become more global, the number of U.S. subsidiaries with a foreign parent corporation will only increase. Noted international lawyer Dan Harris, of Harris & Moure in Seattle, believes that the current number is substantial. In just looking at China he remarked, "My small firm represents a number of U.S. companies that are wholly-owned by Chinese companies or by Chinese citizens and that convinces me there must be thousands of such companies in the U.S." And that is just in terms of China. Russia, Vietnam, Saudi Arabia, the United Arab Emirates, and Venezuela likely follow suit. In fact, from 1996 to 2005, foreign ownership of U.S. companies more than doubled.²

While certainly not all of these foreign companies are directly owned by foreign governments, the ones that are will have the greatest incentives to use the *Citizens United*

² "Foreign Ownership of U.S. Companies Jumps," [Reuters](http://www.reuters.com/article/idUSN2744743020080827), August 27, 2008 at <http://www.reuters.com/article/idUSN2744743020080827>.

loophole to influence U.S. elections and flood money into our electoral process. Foreign governments are motivated by more than just corporate profits; global influence, power and advantage are also a major part of their calculation. Even if involvement in U.S. elections might harm profits of the state-controlled foreign corporation, if the investment is ultimately beneficial to the foreign government for other purposes, it will seek to take advantage of the loophole. In extending a corporation's political speech rights, *Citizens United* hinges on the belief that groups of people organize themselves into corporations solely to make a profit. But in the case of government-run foreign corporations with U.S. subsidiaries, this is not necessarily the case.

Unlike before, many of these foreign governments now have the money to spend on U.S. elections. It's only been within the past five years that there has been an explosion in sovereign wealth funds and other countries' holdings of vast amounts of foreign currency reserves. China's foreign currency reserves have recently hit \$2.4 trillion³ and the United Arab Emirates' sovereign wealth fund, ADIA, has an estimated \$450 billion in assets.⁴ In analyzing investment possibilities, a foreign government might determine that a better return than holding cash would be to use its money to run advertising campaigns against a member of Congress who has voted against that country's interest.

Section 102 of the DISCLOSE Act is Necessary to Protect U.S. Elections from Foreign Influence

While some may argue that the current version of the FECA can close *Citizens United's* U.S. subsidiary loophole, this is simply not true. In a post-*Citizens United* world, the current version of the FECA is glaringly ill-equipped to prevent foreign influence in our elections. Today, under the FECA, U.S. subsidiaries of a foreign corporation are only prevented from forming a political action committee (PAC) if either "the foreign parent corporation finances the PAC's establishment, administration, or solicitation costs," or "individual foreign nationals: participate in the operation of the PAC; serve as officers of the PAC; participated in the selection of persons who operate the PAC; or make decisions regarding PAC contributions or expenditure."⁵

³ Andrew Batson, "China's Foreign Currency Reserves Swell," *The Wall Street Journal*, January 18, 2010 at <http://online.wsj.com/article/SB10001424052748703657604575004501953577566.html>.

⁴ Andrew England, "Abu Dhabi Names New ADIA Boss," *Financial Times*, April 14, 2010 at <http://www.ft.com/cms/s/0/62a0c134-47bb-11df-a4a6-00144feab49a.html> (subscription required).

⁵ Federal Election Commission, "Foreign Nationals Brochure," July 2003, p. 2 at <http://www.fec.gov/pages/brochures/foreign.shtml>.

First, the FECA's current prohibition only applies to PACs and says nothing about direct expenditures by U.S. subsidiaries of foreign corporations, expenditures *Citizens United* now permits corporations to make through election night. China Construction America, the U.S. subsidiary of China's state-owned China State Construction Engineering Corporation, can easily buy advertising space during *American Idol* and run various advertisements urging U.S. citizens to vote for or against any candidate it perceives as sympathetic or hostile to China's interests, without running afoul of the current FECA. In fact, given the \$2.4 trillion held by China in foreign reserves, China Construction America can likely buy *all* of the advertising space during *American Idol*, *Glee* and *Lost*.

Second, the FECA's current prohibition, written in 1974, prior to the explosion of multinational corporations and the formation of complicated corporate structures, is completely unhinged from today's realities. The current FECA assumes that corporate transparency exists: that money can easily be followed from a parent company to a subsidiary. But in fact, that is not the case. Under today's corporate law, there is simply no way to prevent an infusion of capital from one company to another. Aramco Services Company can issue more stock to be purchased by its parent, the Saudi government-controlled Saudi Arabian Oil Company. Aramco Services Company can then take that cash raised from its stock issuance and use it to flood television time with advertisements against any candidate that hints at supporting policies detrimental to Saudi Arabia. This would not violate the current FECA.

In order to limit the very real risk of foreign influence in U.S. elections after *Citizens United*, the FECA must be strengthened to deal with today's multinational corporations and the complex capital structure of parent-subsidiary relationships. Section 102 of the DISCLOSE Act does this. By expanding the definition of foreign nationals to include U.S. subsidiaries where a foreign corporation, government or person owns 20% or more of the voting shares or U.S. subsidiaries where the majority of the board of directors consists of foreign nationals, Section 102 will prevent foreign governments, through their government-run corporations, from impacting our elections. In addition to this general control test analysis, Section 102 also defines foreign nationals as any corporation where foreign nationals have the ability to direct, dictate or control the decision making process as it pertains to interests in the U.S.

Furthermore, Section 102(b) properly places the onus on the chief executive officer, under penalty of perjury, to comply with the legislation. Under Section 102(b), if a corporation chooses to expend funds for electioneering communication, the chief

executive officer is required to file a certification with the Federal Election Commission (FEC) that it is not a U.S. subsidiary that is controlled by a foreign corporation, government or person. It is important that the officers in the U.S. subsidiary are held responsible because they are often the only ones with access to information about share ownership, board membership and decision-making power. Many foreign parent corporations have American subsidiaries that are private, i.e., are not subject to the same reporting requirements as publicly-traded ones. In some states, such private corporations have no reporting requirements at all. With a private corporation, it is difficult to determine share ownership, identity of officers or even names of the directors. This difficult detective work should not become the FEC's responsibility when the officers of the U.S. subsidiary already know this information.

For these reasons I support Section 102 of the DISCLOSE Act as necessary legislation in order to prevent foreign influence in our elections and to guarantee that U.S. elected officials are accountable to the U.S. people.