FOREIGN PAYMENTS DISCLOSURE

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE

OF THE

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

HOUSE OF REPRESENTATIVES

NINETY-FOURTH CONGRESS

SECOND SESSION

ON

H.R. 15481 and S. 3664

BILLS TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO REQUIRE ISSUERS OF SECURITIES REGISTERED PURSUANT TO SECTION 12 OF SUCH ACT TO MAINTAIN ACCURATE RECORDS, TO PROHIBIT CERTAIN BRIBES, AND FOR OTHER PURPOSES

AND

H.R. 13870 and H.R. 13953

BILLS TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO REQUIRE ISSUERS OF SECURITIES REGISTERED PURSUANT TO SECTION 12 OF SUCH ACT TO MAINTAIN ACCURATE RECORDS AND TO FURNISH REPORTS RELATING TO CERTAIN FOREIGN PAYMENTS, AND FOR OTHER PURPOSES

SEPTEMBER 21 AND 22, 1976

Serial No. 94–155

Printed for the use of the
Committee on Interstate and Foreign Commerce

U.S. GOVERNMENT PRINTING OFFICE

82-981 O

WASHINGTON : 1977

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

HARLEY O. STAGGERS, West Virginia, *Chairman*

JOHN E. MOSS, California
JOHN D. DINGELL, Michigan
PAUL G. ROGERS, Florida
LIONEL VAN DEERLIN, California
FRED B. ROONEY, Pennsylvania
JOHN M. MURPHY, New York
DAVID E. SATTERFIELD III, Virginia
BROCK ADAMS, Washington
W. S. (BILL) STUCKEY, JR., Georgia
BOB ECKHARDT, Texas
RICHARDSON PREYER, North Carolina
JAMES W. SYMINGTON, Missouri
CHARLES J. CARNEY, Ohio
RALPH H. METCALFE, Illinois
GOODLOE E. BYRON, Maryland
JAMES H. SCHEUER, New York
RICHARD L. OTTINGER, New York
HENRY A. WAXMAN, California
ROBERT (BOB) KRUEGER, Texas
TIMOTHY E. WIRTH, Colorado
PHILIP R. SHARP, Indiana
WILLIAM M. BRODHEAD, Michigan
JAMES J. FLORIO, New Jersey
ANTHONY TOBY MOFFETT, Connecticut
JIM SANTINI, Nevada
ANDREW MAGUIRE, New Jersey
MARTIN A. RUSSO, Illinois

SAMUEL L. DEVINE, Ohio
JAMES T. BROYHILL, North Carolina
TIM LEE CARTER, Kentucky
CLARENCE J. BROWN, Ohio
JOE SKUBITZ, Kansas
JAMES M. COLLINS, Texas
LOUIS FREY, JR., Florida
JOHN Y. McCOLLISTER, Nebraska
NORMAN F. LENT, New York
H. JOHN HEINZ III, Pennsylvania
EDWARD R. MADIGAN, Illinois
CARLOS J. MOORHEAD, California
MATTHEW J. RINALDO, New Jersey
W. HENSON MOORE, Louisiana

W. E. WILLIAMSON, *Clerk*
KENNETH J. PAINTER, *Assistant Clerk*

Professional Staff

CHARLES B. CURTIS
LEE S. HYDE
ELIZABETH HARRISON
JEFFREY H. SCHWARTZ
WILLIAM P. ADAMS
ROBERT R. NORDHAUS
BRIAN R. MOIR
KAREN NELSON

MARGOT DINNEEN

NANCY A. NORD, *Minority Staff Assistant*

SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE

JOHN M. MURPHY, New York, *Chairman*

W. S. (BILL) STUCKEY, JR., Georgia
BOB ECKHARDT, Texas
RALPH METCALFE, Illinois
WILLIAM M. BRODHEAD, Michigan
JAMES H. SCHEUER, New York
HARLEY O. STAGGERS, West Virginia
(ex officio)

JOHN Y. McCOLLISTER, Nebraska
MATTHEW J. RINALDO, New Jersey
SAMUEL L. DEVINE, Ohio (ex officio)

SIEGMUND W. SMITH, *Staff Administrator*
FRANZ F. OPPER, *Counsel*

CONTENTS

FOREIGN PAYMENTS DISCLOSURE

TUESDAY, SEPTEMBER 21, 1976

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2322, Rayburn House Office Building, Hon. John M. Murphy, Chairman, presiding.

Mr. MURPHY. The subcommittee will come to order.

Today the Subcommittee on Consumer Protection and Finance will begin hearings on H.R. 15481, and other similar bills to amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of the act, to maintain accurate records, and to prohibit bribes to foreign officials.

While investigating certain contributions to the former Presidential campaign, the Watergate Special Prosecutor uncovered a number of corporate political slush funds. These funds had been concealed from normal corporate accounting controls. Since such activities involved matters of possible significance to public investors, the Securities and Exchange Commission initiated its own investigation. Their investigation revealed that a number of U.S. corporations, in connection with their overseas operations, had used such secret slush funds for questionable or illegal foreign payments. As a result, a number of domestic corporations have come forward voluntarily to publicly disclose the amount and nature of these payments. However, in a number of cases, the Commission has had to resort to injunctive actions to assure public disclosure and cessation of these activities.

Initially, the Commission was subject to substantial criticism from many quarters on the grounds that was the normal way of doing business abroad and that shareholders had no right to such information. The Commission had steadfastly maintained that such activities reflect on the integrity of management and that shareholders should be aware that their company's profits have been derived from and, in the future are dependent upon magnanimity to foreign officials and not upon competitive excellence.

At times, it must have appeared to the Commission that they were waging a very lonely battle. However, largely through their efforts and hearings by the Senate Committee on Banking, Housing and Urban Affairs, and the Senate Foreign Relations Subcommittee on Multinational Corporations, we have become acutely aware of the dimensions of the foreign bribery problem and its deleterious effects on U.S. foreign policy, on the business climate abroad for U.S. corporations and on our own moral expectations.

The revelations concerning our aerospace industry have been the most conspicuous, but as more and more corporations come forward, we recognize that such foreign payments are not isolated transactions. Over 200 corporations have engaged in material questionable foreign payments practices. The largest amount revealed to date is a startling $56 million by Exxon over a 12-year period.

In the Lockheed incident, the SEC charged that since 1970 at least $25 million in payments not reflected on the company's books and records were made to assist the company in obtaining and retaining contracts with foreign governments. The foreign policy implications for the United States are staggering and in some cases, perhaps irreversible. Payments by Lockheed alone may well have advanced the Communist cause in Italy. In Japan, a mainstay of our foreign policy in the Far East, the government is reeling as a consequence of such payments. On August 16, former Prime Minister Tanaka was indicted on charges of accepting $1.7 million from Lockheed. And most recently, the monarchy in the Netherlands has been rocked by the Lockheed scandal.

All of this lends substantial credence to the suspicions by extremists that U.S. businesses operating in their country have a corrupting influence on their political systems.

Contrary to what some of the opponents of any remedial legislation would have us believe, bribery is not just a way of doing business abroad. No country in the world publicly supports bribery of public officials, and under the laws of most countries, such payments are illegal. As Senator Church stated in introducing his legislation, S. 3379:

> While corporations frequently argued that these are practices common and accepted in other cultures, those same corporations have engaged in intricate machinations to conceal the existence of these payments. Double bookkeeping, off-the-books accounts, Swiss bank accounts, dummy or shell corporations set up in Switzerland or Lichtenstein, numerous agents or intermediaries, whose existence is often kept secret, code names and code books dispute the credibility of the common and accepted practice argument.

Many U.S. corporations have never engaged in such practices, and most welcome remedial legislation because it would make it easier to resist pressures from foreign officials. Another reason was expressed by Mr. A. W. Clausen, president of the Bank of America, who recently stated:

> Integrity is not some impractical notion dreamed up by naive do-gooders. Our integrity is the foundation for, the very basis of our ability to do business. If the market economy ever goes under our favorite villains, socialist economies and government regulators, won't be to blame. We will.

Finally, foreign bribery involves outright unfair business practices. Most of the payments revealed thus far have involved American companies competing with American companies for the same business.

I would emphasize that this bill is not concerned with so-called grease or facilitating payments, such as may be necessary to some petty clerk to speed documents through a bureaucracy.

The bill is divided into three sections, and I will summarize them briefly:

Section 1 requires reporting companies to create and to maintain accurate books and records. Second, it requires internal accounting controls sufficient to assure that transactions will be executed in accord-

ance with management's instructions, that transactions will be accurately recorded, that access to corporate assets is carefully controlled, and that the representations on company books will be compared at reasonable intervals with actual assets, and any discrepancies resolved. This section also makes it a crime for a reporting company to falsify books, records, accounts, or documents, or to deceive an accountant in connection with an examination or audit.

Section 2 applies to corporations subject to the jurisdiction of the SEC by virtue of the reporting requirements of the SEC act of 1934. It applies the existing criminal penalties of the securities laws, up to 2 years imprisonment and a fine of up to $10,000, for payments, promises of payment, or authorization of payment of anything of value to any foreign officials, political party, candidate for office, or intermediary, where there is a corrupt purpose. The corrupt purpose must be to induce the recipient to use his influence to direct business to any person, to influence legislation or regulations, or to fail to perform an official function in order to influence business decisions, legislation, or regulations of a government.

Section 3 applies the identical prohibitions and penalties provided by section 2 to any domestic business concern other than one subject to the jurisdiction of the SEC, pursuant to section 2. Violations of the criminal prohibition under section 3 by persons not subject to SEC jurisdiction would be investigated and prosecuted by the Justice Department. Violations under section 2 would normally be investigated initially by the SEC but referred for criminal prosecution to the Justice Department.

Without objection, the text of H.R. 15481, H.R. 13870, H.R. 13953, and S. 3664 will be placed at this point in the record.

[Testimony resumes on p. 17.]

[The text of H.R. 15481, H.R. 13870, H.R. 13953, and S. 3664 follow:]

[H.R. 15481, introduced by Mr. Murphy of New York on September 8, 1976, and S. 3664, passed the Senate September 15, 1976, and referred to the Committee on Interstate and Foreign Commerce on September 16, 1976, are identical as follows:]

A BILL

To amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such Act to maintain accurate records, to prohibit certain bribes, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 13(b) of the Securities Exchange Act (15 U.S.C. 78m(b)), is amended by inserting "(1)" after "(b)" and by adding at the end thereof the following:

"(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall—

"(A) make and keep books, records, and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and

"(B) devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that—

"(i) transactions are executed in accordance with management's general or specific authorization;

"(ii) transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets;

"(iii) access to assets is permitted only in accordance with management's authorization; and

"(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

"(3) It shall be unlawful for any person, directly or indirectly, to falsify, or cause to be falsified, any book, record, account, or document, made or required to be made for any accounting purpose, of any issuer which has a class of securities registered pursuant to section 12 of this title or

which is required to file reports pursuant to section 15 (d) of this title.

"(4) It shall be unlawful for any person, directly or indirectly—

"(A) to make, or cause to be made, a materially false or misleading statement, or

"(B) to omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading to an accountant in connection with any examination or audit of an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15 (d) of this title, or in connection with any examination or audit of an issuer with respect to an offering registered or to be registered under the Securities Act of 1933.".

SEC. 2. The Securities Exchange Act of 1934 is amended by inserting after section 30 the following new section:

"PAYMENTS TO OFFICIALS

"SEC. 30A. It shall be unlawful for any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15 (d) of this title to make use of the mails or of any means or instrumentality of interstate commerce corruptly

to offer, pay, or promise to pay, or authorize the payment of, any money, or to offer, give, or promise to give, or authorize the giving of, anything of value to—

"(1) any person who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual—

"(A) to use his influence with a foreign government or instrumentality, or

"(B) to fail to perform his official functions,

to assist such issuer in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality;

"(2) any foreign political party or official thereof or any candidate for foreign political office for the purpose of inducing that party, official, or candidate—

"(A) to use its or his influence with a foreign government or instrumentality thereof, or

"(B) to fail to perform its or his official functions,

to assist such issuer in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality; or

"(3) any person, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised directly or indirectly to any individual who is an official of a foreign government or instrumentality thereof, or to any foreign political party or official thereof or any candidate for foreign political office, for the purpose of inducing that individual, official, or party—

"(A) to use his or its influence with a foreign government or instrumentality, or

"(B) to fail to perform his or its official functions,

to assist such issuer in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality.".

PAYMENTS TO OFFICIALS

SEC. 3. (a) It shall be unlawful for any domestic concern, other than an issuer which is subject to section 30A of the Securities Exchange Act of 1934, to make use of the mails or of any means or instrumentality of interstate commerce corruptly to offer, pay, or promise to pay, or authorize the payment of, any money, or to offer, give, or promise to give or authorize the giving of, anything of value to—

(1) any individual who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual—

(A) to use his influence with a foreign government or instrumentality, or

(B) to fail to perform his official functions,

to assist such concern in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality,

(2) any foreign political party or official thereof or any candidate for foreign political office for the purpose of inducing that party, official, or candidate—

(A) to use its or his influence with a foreign government or instrumentality thereof, or

(B) to fail to perform its or his official functions,

to assist such concern in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality; or

(3) any individual, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised directly or indirectly to any individual who is an official of a foreign government or instrumentality thereof, or to any

foreign political party or official thereof or any candidate for foreign political office, for the purpose of inducing that individual, official or party—

(A) to use his or its influence with a foreign government or instrumentality, or

(B) to fail to perform his or its official functions,

to assist such concern in obtaining or retaining business for or with, or directing business to, any person or influencing legislation or regulations of that government or instrumentality.

(b) Any person who willfully violates this section shall upon conviction be fined not more than $10,000, or imprisoned not more than two years, or both.

(c) As used in this section—

(1) the term "domestic concern" means an individual who is a citizen or national of the United States, or any corporation, partnership, association, joint-stock company, business trust, or unincorporated organization which is owned or controlled by individuals who are citizens or nationals of the United States, which has its principal place of business in the United States, or which is organized under the laws of a State of the United States or any territory, possession, or commonwealth of the United States; and

(2) the term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State, or between any State and any place or ship outside thereof, and such term includes the intrastate use of a telephone or other interstate means of communication or any other interstate instrumentality.

[H.R. 13870, introduced by Mr. Moss and Mr. Stark on May 18, 1976, and H.R. 13953, introduced by Mr. Pickle on May 21, 1976, are identical as follows:]

A BILL

To amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such Act to maintain accurate records and to furnish reports relating to certain foreign payments, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That section 17 of the Securities Exchange Act of 1934 is amended by adding at the end thereof the following:

"(h) The Commission shall, by rule or regulation, require issuers of securities registered pursuant to section 12 to maintain accurate books, records, or accounts of all transactions in such form and containing such information as the Commission deems necessary to carry out its enforcement responsibilities under this title.".

I—O

SEC. 2. Section 13 of the Securities Exchange Act is amended by adding at the end thereof the following new subsection:

"(g) Each issuer of a security registered pursuant to section 12 shall file with the Commission periodic reports relating to any payment of money or furnishing of anything of value in an amount in excess of $1,000 paid or furnished or agreed to be paid or furnished by the issuer during the period covered by the report (i) to any person or entity employed by, affiliated with, or representing directly or indirectly, a foreign government or instrumentality thereof; (ii) to any foreign political party or candidate for foreign political office; or (iii) to any person retained to advise or represent the issuer in connection with obtaining or maintaining business with a foreign government or instrumentality thereof or with influencing the legislation or regulations of a foreign government. Such reports shall be made available for public inspection and copying and shall include such details as the Commission may prescribe including—

"(1) the amount of each such payment or thing of value and the date it was made or furnished or agreed to be made or furnished;

"(2) the name of the person or entity to which the payment was or is to be made or the thing of value was or is to be furnished and in the case of a person who is

82-981 O - 77 - 2

an official of a foreign government or instrumentality thereof, the official position of that person; and

"(3) the purpose for which the payment was or is to be made or the thing of value was or is to be furnished.".

SEC. 3. The Securities Exchange Act of 1934 is amended by inserting after section 30 the following new section:

"PAYMENTS TO OFFICIALS

"SEC. 30A. It shall be unlawful for any issuer of a security registered pursuant to section 12 to make use of the mails or of any means or instrumentality of interstate commerce to—

"(1) offer, pay, or agree to pay any money or offer, give, or promise to give anything of value to an individual who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual to use his influence within such foreign government or instrumentality to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government;

"(2) pay or agree to pay any money or give or agree to give any thing of value to any person knowing or having reason to know that all or a portion of such moneys or thing of value will be offered, given or prom-

ised directly or indirectly to any individual who is an official of a foreign government or instrumentality thereof for the purpose of inducing that individual to use his influence within such foreign government or instrumentality to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government;

"(3) pay or agree to pay any money or give or agree to give any thing of value to any foreign political party or official thereof or any candidate for foreign political office for the purpose of inducing that party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to obtain or maintain business for or with the issuer or to influence legislation or regulations of that government; or

"(4) pay or agree to pay any money or give or agree to give any thing of value in a manner or for a purpose which is illegal under the laws of a foreign government having jurisdiction over the transaction.".

SEC. 4. (a) The last sentence of section 21(d) of the Securities Exchange Act of 1934 is amended by inserting before the period at the end thereof a comma and the following: "or, notwithstanding any other provision of law, the Commission may initiate (through a presentation to a grand

jury), prosecute, and appeal any criminal action arising under this title.".

(b) The second sentence of section 20(b) of the Securities Act of 1933 is amended by inserting before the period at the end thereof a comma and the following: "or, notwithstanding any other provision of law, the Commission may initiate (through a presentation to a grand jury), prosecute, and appeal any criminal action arising under this title.".

Mr. MURPHY. We are privileged in having as our first witness the Chairman of the Securities and Exchange Commission, the Honorable Roderick M. Hills.

STATEMENT OF HON. RODERICK M. HILLS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. HILLS. Mr. Chairman, I appreciate this opportunity to express the views of the Commission on H.R. 15481.

The Commission's substantial efforts over the past 2 years to deal with the issue of questionable payments has been well documented in our report of May 12, 1976, to the Senate Banking Committee. As the chairman has pointed out, since that time we have reviewed some 90 additional companies that have made disclosures of questionable payments or related practices. We have, therefore, something more than 200 companies that have revealed practices of a questionable nature.

The new disclosures follow essentially the same format, and involved the same kinds of payments and the same kinds of practices as were reviewed in detail in our report of May 12.

To summarize that series of 200 cases, we have found literally hundreds of millions of dollars of corporate funds which were placed in hidden accounts and expended entirely at the discretion of corporate executives who caused or permitted the payments to be inaccurately recorded on corporate books.

The creation of these hidden funds, and the making of questionable and illegal payments from them, in almost every case were concealed from outside directors and independent auditors. It is, of course, important, Mr. Chairman, to make distinctions among these companies. It is quite true that in some cases the payments were cynically and arrogantly made by top corporate officials who knew they were acting contrary to existing laws and regulations and without the authority of their board of directors. Indeed, many went to great lengths to conceal their conduct from the outside auditors, outside directors, and of course, the shareholders.

But it is equally true that in a very large number of cases, the sums of money that have been involved are relatively small and were made by persons at a much lower level of management who went to great pains to conceal their own activities from their superiods. Unfortunately, the distinctions between these different types of corporate misconduct have not been made sufficiently clear to the public.

What we do see, however, common throughout all of these cases, is the sobering fact that this country's system of protection for investors, developed over the past 40 years, which includes corporate self-regulation through independent auditors and outside directors and counsel, and which is ultimately enforced by the Securities and Exchange Commission, has been seriously frustrated. It has, in simple language, broken down.

Whether we speak of the relatively few cases in which top management has intentionally spent millions of dollars for large scale bribery, or of the more numerous cases in which lesser employees bolstered their own performance records with kickbacks and so-called grease payments, the universal fact is that our system missed it for far too long.

The judgment now to be made by this Congress is whether that

system, in which the Securities and Exchange Commission has played the central role, can be corrected, or whether it must be replaced. H.R. 15481 would, in our judgment, provide a satisfactory correction of the system, and for that reason we urge its passage.

By far the most important argument in favor of this legislative approach is, in my judgment, the extraordinarily effective enforcement record of the Commission staff over these past months. We may each be concerned that these practices, now uncovered, have continued for so long a period of time. But it is equally important to emphasize the point that the problem has in fact been uncovered.

Concern is expressed by the public, by the press, and by Members of Congress that there will come a time when the public and the press will lose interest in the matter of corporate bribery, and when the Commission's staff may not be as alert as it has been in recent history. These commentators ask for tougher and stronger laws to protect against such an eventuality. In responding to such comments, we need to emphasize again the point that in the recent problem of corporate bribery, and indeed, in most cases of corporate misconduct, the failure can be traced to a failure in corporate accountability, accountability to outside auditors, to outside directors, to outside counsel, and ultimately, to outside shareholders. The Commission's program for correction, therefore, was based on a threefold approach.

First, we recommend in our report of May 12 that legislation be enacted to tighten internal accounting controls. The chairman has reviewed those proposals, they have been adopted by the Senate in section 1 of S. 3664, and are contained in identical language in the bill now before this subcommittee.

The enactment of this legislation will first demonstrate a strong affirmative congressional endorsement of the need for accurate corporate records and effective internal control measures, and of the unacceptability of deception or obstruction of auditors. It will effectively end any uncertainty about the Commission's proper role in this area, and it will unquestionably make far easier the criminal prosecution of corporate officials who intentionally violate the mandate of the proposed legislation.

The second, and equally important effort of the Commission has been to implement a new accountability of the management of our major publicly held corporations. Essential to implementing this concept is the creation of a new independent character on the boards of directors of those companies, and a new recognition of the professional responsibility of the outside auditors and attorneys who deal with these publicly held companies. Our first effort last winter was to seek an initiative from public accountants and auditors, and in response, the auditing standards executive committee of the American Institute of Certified Public Accountants has proposed a new articulation of accountants' responsibilities with respect to illegal acts by clients. That proposal, which we hope will be finalized shortly, discusses how accountants may become aware of illegal acts by their clients, the inquiries that should be made by them whenever such conduct is suspected, and the procedures that should be followed by them in bringing such suspected conduct to the attention of a level of management that is capable of dealing with such suspicions.

Our second initiative in this respect was a letter to the new chairman of the New York Stock Exchange, Mr. William Batten. In that letter we emphasized our concern and asked the exchange to consider the feasibility of requiring the establishment of audit committees by listed companies. Such committees would be composed of outside directors who would, as a practical matter, be able to deal with questionable conduct uncovered in the audit procedures. We suggested that such an objective could be reached if the exchange would add appropriate conditions to its listing requirements, and we have been, of course, pleased by the response. The board of directors of the New York Stock Exchange on September 2 proposed that all listed corporations be required by the rules of that exchange to maintain the kind of audit committee which we suggested. An important part of that proposal is to exclude from membership on the audit committee persons who have a financial interest in the company, such as outside company counsel.

We continue to be optimistic that this concept of an outside audit committee will be implemented and that this step and similar steps taken by the Stock Exchange and by other self-regulatory organizations will cause a far higher sense of corporate accountability to evolve.

I would be remiss in not adding that over the last 10 years such an evolutionary process has been going on. Corporations such as General Motors, Xerox, Connecticut General, and Texas Instruments, to name only a few, have already established independent audit committees of the type that we have been interested in promoting, and which we believe are important to the further development of a responsible business community.

The third part of our effort, Mr. Chairman, to respond to the problem uncovered, is to create an effective international effort to protect American corporations which play by the rules against the unfair competition of foreign institutions which do not play by the same rules.

To some limited degree, the Commission can play some role in that effort by making certain that the disclosure requirements which we impose upon American businesses are similarly imposed upon foreign businesses which are using our capital markets, either by securing a listing on our Stock Exchange or by securing funds in the United States through public securities offerings. To date, approximately six major foreign-based companies have made the same kinds of disclosure with respect to questionable payments as we have required of American corporations.

Further, efforts of the executive branch of our Government to secure an international agreement with respect to these questionable payments will, if successful, afford added protection for the American business.

As I have said before, I personally believe an additional step can be taken. A determined effort by those executive branch agencies which deal with international business activities can identify unfair practices abroad and effectively discourage them. Obviously such an effort has many ramifications with respect to our foreign relations, but I am convinced that it can produce material results, and I am hopeful that such an effort will develop over the months ahead.

In conclusion, let me comment briefly on the remaining provisions of H.R. 15481. Section 2 would amend the Securities Exchange Act by adding a new section 30A to that act, prohibiting issuers registered

with the Commission from making certain types of payments to foreign governments, officials, or politicial parties. Section 3 would enact a similar prohibition, separate from the securities laws and applicable to any domestic concern other than any issuer which is subject to proposed section 30A.

The Commission does not oppose direct prohibitions against these payments, but we have previously stated that, as a matter of principle, we would prefer not to be involved even in the civil enforcement of such prohibitions. As a matter of long experience, it is our collective judgment that disclosure is a sufficient deterrent to the improper activities with which we are concerned. Having made that point, however, Mr. Chairman, let me say that the Commission recognizes the congressional interest in asserting these rules in the form contained in sections 2 and 3, and, because of this particularly pressing concern, we do not object to their inclusion in the final legislation.

Mr. Chairman, we are obviously passing through an unhappy chapter in the history of American business, but it is important to stress the point that the misconduct of some corporations does not warrant the broad condemnation of the entire business community. Competition based upon price and the quality of the product rather than on hidden bribes and kickbacks and grease payments, in our judgment, remains the hallmark of private enterprise in this country. The aggressive desire, with few exceptions, of the boards of directors of those companies that have uncovered questionable practices, to eliminate such practices, is a testament to that point.

The lesson to be learned, we submit, from our experience, is that increased corporate accountability to the boards of directors and to stockholders will strengthen the quality and morality of corporate management and will increase public confidence both in the business community and in the integrity of the Nation's capital markets.

I would be pleased to answer any questions that the committee may have.

[Mr. Hills prepared statement follows:]

STATEMENT OF HON. RODERICK M. HILLS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION

Mr. Chairman, members of the Subcommittee: I appreciate this opportunity to testify on the need for legislative action dealing with the problem of questionable and illegal corporate payments and practices and, specifically, to offer the Commission's view on H.R. 15481.

The Commission's substantial efforts to deal with this problem are well documented in our May 12, 1976 Report to the Senate Banking Committee. Since that date, approximately 90 additional corporations have made disclosures of questionable or illegal payments and related practices engaged in both in this Country and abroad. There are today, therefore, more than 200 corporations, many of them among the largest in the Nation, which have made disclosure of these so-called questionable practices. These new disclosures follow essentially the same pattern we described in our May 12 Report.

As before, the most commonly reported transactions were payments to foreign officials made in an effort to procure the enactment or favorable application of advantageous tax, customs, or other laws; to assist companies in obtaining or retaining government contracts; to persuade low-level government officials to perform their regular functions; or to meet extortionate demands by foreign government officials. Many companies have indicated that "facilitating" payments to low-level officials are customary and legal in certain parts of the world and that continuation of such payments is necessary in order to transact business.

The next most prevalent transaction, reported by 50 percent of the recent

registrants, involves foreign commercial payments made in a manner suggesting impropriety. Excessive sales commissions, over-compensated foreign business agents or consultants, or inflated invoicing to facilitate kickbacks to buyers' purchasing agents were recurrent techniques used to obtain business. These payments were channelled directly to the management or procurement officer or prospective private-sector buyers, or took the form of excess commissions or consultant's fees to be passed on as payoffs to government officials with intent to influence government contract decisions.

Foreign political contributions were reported by 20 percent of new registrants, but many of these contributions were allegedly legal. In most instances, the payments had nonetheless been inaccurately reflected in company books and records.

Disclosures relating to domestic transactions have been less frequent. Although roughly one-quarter of the companies admitted making domestic political contributions, these payments were generally small and were made at the state and local level where they were often legal. Of greater concern is the revelation that 20 percent of the firms engaged in domestic commercial bribery, most often achieved through improper rebates or kickbacks to purchasers of goods or services.

As noted in our May 12th Report, most instances of reported abuse involved either the falsification of corporate records or the maintenance of incomplete records. Fifty percent of the companies disclosed such inaccuracies, ranging from deceptive descriptions of disbursements to the maintenance of substantial off-book accounts. Although in many instances top management had knowledge of some of the questionable or illegal payments and accounting practices, official disciplinary action was rarely taken.

Since May 12th, the Commission has instituted three significant enforcement actions against corporations which have made unlawful payments. In one case, top management actively approved $330,000 in unlawful domestic political contributions, as well as payments to overseas trade association officials for use in obtaining a price increase from a foreign government. The two other actions were instituted to enjoin unlawful commercial bribery involving $6 million in payments channeled to prospective private-sector purchasers and more than $330,000 to influence government commercial policy and contract decisions. All these companies had materially falsified their books and records to conceal these improprieties.

Each corporation has consented to the entry of a permanent injunction against future violations of the securities laws. The consent decreases also authorize independent audit committees to investigate further irregularities, and the Commission has supported one Audit Committee's petition for judicial relief when a defendant refused to cooperate in supplying specified information. The Commission has several pending inquiries into similar matters, and additional enforcement actions are expected to be commenced shortly.

To summarize, we have found millions of dollars of corporate funds placed in hidden accounts and expended entirely at the discretion of corporate executives who caused or permitted the payments to be inaccurately recorded on corporate books. The creation of these hidden funds and the making of questionable and illegal corporate payments from these funds were, in almost every case, concealed from outside directors and independent auditors.

It is important, of course, to make distinctions among these companies. It is quite true that in some cases the payments were made cynically and arrogantly by top corporate officials who knew they were acting contrary to existing laws and regulations and without the authority of their board of directors. Indeed, they went to great lengths to conceal their conduct from outside auditors, directors and shareholders.

But it is equally true that in a very large number of cases the sums of money have been relatively small and were made by persons at a much lower level of management who concealed their own activities from their superiors. In many cases which fit this latter classification top management has been able, on its own, to diligently ferret out such practices and put an end to them.

Unfortunately, the distinctions between these different types of corporate misconduct have not been made sufficiently clear to the public. It has been all too easy to lump all of these companies into one category, to consider them all as part of the same problem, and to brand the management of all of them as wrongdoers.

What we do see in all of these cases, on the basis of our two-year effort, is the sobering fact that this Country's system of protection for investors, developed

over the past 40 years, and which includes corporate self-regulation with independent auditors, outside directors and counsel, and which is ultimately enforced by the Securities and Exchange Commission, has been seriously frustrated. Whether we speak of the relatively few cases in which top management has intentionally spent millions of dollars in large scale bribery, or of the more numerous cases in which lesser employees bolstered their own performance records with kickbacks and so-called "grease" payments, the universal fact is that our system missed it for far too long.

The judgment now to be made by this Congress is whether that system in which the Securities and Exchange Commission has played the central role can be corrected or whether it must be replaced. H.R. 15481 would, in our judgment, provide a satisfactory correction of the system which we believe has worked overall to the great benefit of American investors in particular, and the American public in general.

We urge its passage.

By far, the most important argument in favor of this approach to legislation is the extraordinarily effective enforcement record of the Commission's staff. Each of us may be concerned that these practices now uncovered have continued for so long, but it is equally important to emphasize the point that the problem has now been uncovered.

We have reaffirmed, at least to the satisfaction of the Commission, the American approach to securities regulation predicated upon the Acts of 1933 and 1934, which, as it now stands, is the most effective system in the world. Accordingly, our joint effort, that of the Congress and the Commission, now should be to take those steps which are sufficient to prevent a renewal of the problem and to similarly prevent other undesirable corporate practices from beginning unnoticed.

Proper concern has been expressed by the public, the press and members of Congress that there will come a time when the public and the press will lose interest in the matter of corporate bribery, and when the Commission's staff may not be as alert as it has been in recent history. These commentators ask for tougher and stronger laws to protect against such an eventuality. In responding to such comments, we need to emphasize the point that in the recent problem of corporate bribery and, indeed, in most cases of corporate misconduct, the failure can be traced to a failure in corporate accountability: accountability to outside auditors, outside directors, outside counsel and, ultimately, to outside shareholders. The Commission's program for correction is based on a threefold approach. First, we recommend in our Report of May 12th that legislation be enacted which would:

Require every issuer subject to the periodic reporting requirements of the Securities Exchange Act to maintain accurate books and records;

Require such issuers to maintain a system of internal controls capable of meeting certain objectives;

Prohibit any person from falsifying the accounting records of any such issuer; and

Prohibit any person from making a false or misleading statement, or omitting to state a material fact, to an accountant in connection with an audit of such an issuer.

The Senate Commitee concurred and these provisions are embodied in Section 1 of the bill that passed the Senate, and which is identical to the bill now being considered by this Subcommitee.

The enactment of this legislation will, first of all, demonstrate a strong, affirmative Congressional endorsement of the need for accurate corporate records and effective internal control meaesures, and of the unacceptability of deception or obstruction of auditors. Such an endorsement will effectively end any uncertainty about the Commission's role and approach to solving the problem and will unquestionably make far easier the criminal prosecution of corporate officials who intentionally violate the mandate of the proposed legislation.

The second, and equally important, effort of the Commission has been to implement a "new accountability" of the management of our major publicly-held corporations. Essential ingredients of this concept include creation of a new independence on the boards of directors of these companies, and a new recognition of the professional responsibility of the outside auditors and attorneys who deal with these publicly-held companies. Our first effort was to seek an initiative from public accountants and auditors. In response, the Auditing Standards Executive Committee of the American Institute of Certified Public Accountants has proposed a new articulation of accountants' responsibilities with respect to "ille-

gal Acts by Clients." That proposal, which we expect to be finalized shortly, discusses how accountants may become aware of illegal acts by their clients, the inquiries that should be made whenever such conduct is suspected, and the procedures that should be followed in beginning such suspected conduct to the attention of a level of management that deals with such suspicions.

Our second initiative in this respect was our letter to William Batten, the Chairman of the New York Stock Exchange. That letter emphasized our concern and asked the Exchange to consider the feasibility of establishing audit committees for listed companies which would be composed of outside directors who would, as a practical matter, be able to deal with questionable conduct uncovered during the course of an audit, and review auditing procedures. We suggested that such an objective could be reached if the Exchange would add appropriate conditions to its listing requirements. We were pleased at the response. The board of directors of the New York Stock Exchange, on September 2, proposed that all listed corporations be required by the rules of the Exchange to maintain audit committees of the kind which we suggested. An important part of their proposal is to exclude from membership on that outside audit committee lawyers who are company counsel and who therefore are necessarily involved to some extent with the management of the company.

We are optimistic that this concept of outside audit committee will be created and that this step and similar steps taken by the Stock Exchange will cause a far higher sense of corporate accountability to evolve in American business.

I should add that over the last ten years such an evolutionary process has been going on. Corporations such as General Motors, Xerox, Connecticut General and Texas Instruments have already established independent audit committees which have created the type of corporate accountability which we believe to be important for the American business community.

I should also add that many of the corporations that have been the subject of our enforcement actions, to date, in the field of questionable payments did not at the time have outside audit committees of this type.

The third part of our effort to respond to the problem uncovered is to create an effective international effort to protect American corporations, which play by the rules which the Commission is charged with enforcing, against the unfair competition of foreign institutions which do not play by the same rules.

To some limited degree, the Commission can play a role in that effort by making certain that the disclosure requirements which we impose upon American businesses are similarly imposed upon foreign businesses which are using our capital markets, either by securing a listing on the Stock Exchange or by seeking funds in the United States from our investors. To date, approximately six major foreign-based companies have made the same kinds of disclosure with respect to questionable payments, as have the approximately 200 American corporations.

At present, efforts of the Executive Branch of our Government to secure an international agreement with respect to these questionable payments will be an added protection for American business.

I personally believe an additional step can be taken. A determined effort by those Executive Branch agencies which deal with international business activities to identify unfair practices abroad can effectively discourage such practices. Obviously, such an effort has many ramifications with respect to our foreign relations, but I am convinced that it can produce material results and I am hopeful that such an effort will develop over the months ahead.

In conclusion, I would like to comment briefly on the remaining provisions of H.R. 15481. Section 2 would amend the Securities Exchange Act by adding a new Section 30A to that Act, prohibiting issuers registered with the Commission from making certain types of payments to foreign governments, officials, or political parties. Section 3 of the bill would enact a similar prohibition, separate from the securities laws, and applicable to any domestic concern other than any issuer which is subject to proposed Section 30A.

While the Commission does not oppose direct prohibitions against these payments, we have previously stated that as a matter of principle, the Commission would prefer not to be involved even in the civil enforcement of such prohibitions. As a matter of long experience, it is our collective judgment that disclosure is a sufficient deterrent to the improper activities with which we are here concerned. Having made this point, however, let me say that the Commission recognizes the Congressional interest in asserting these rules in the form contained in Sections 2 and 3, and because of this particularly pressing concern, we do not object to their inclusion in the final legislation.

We are obviously passing through an unhappy chapter in the history of American business, but it is important to stress the point that the misconduct of some corporations does not warant the broad condemnation of the entire business community. Competition based upon price and the quality of the product rather than on hidden bribes, kickbacks and "grease" payments, remains the hallmark of private enterprise in this Country. The aggressive desire, with few exceptions, of the boards of directors of the companies that have uncovered questionable practices, to eliminate such practices, is a testament to that point.

The lesson to be learned from our experience is that increased corporate accountability to the boards of directors and to stockholders will strengthen the quality and morality of corporate management and will increase public confidence both in the business community and in the integrity of this Nation's capital markets.

Again, I appreciate this opportunity to present the views of the Securities and Exchange Commission on the important issues which this Subcommittee is studying. I will be pleased to respond to any questions you may have.

Mr. MURPHY. Thank you. We appreciate your very frank comments. Just a point of clarification on page 8, you say—

The second, and equally important, effort of the Commission has been to implement a "new accountability" of the management of our major publicly-held corporations. Essential ingredients of this concept include creation of a new independence on the boards of directors of these companies.

What do you mean by independence on the boards of directors?

Mr. HILLS. I mean creating a new independent character on the boards of directors by insisting that those companies which are traded in our broadest securities markets, such as the New York Stock Exchange, have on that board of directors people who are financially independent from management, who do not depend for their jobs or their futures or their livelihood on the management of the company, people that have a sense of independent responsibility to see to it that misbehavior by the corporation can be corrected. An outside audit committee, in our judgment, is the most substantial step toward that independent character.

Seven years ago, in fact, in 1969, a survey was made of the New York Stock Exchange companies, and very few companies had an outside audit committee of any kind. Today something over 80 percent of those companies have some form of outside audit committee, and, if the New York Stock Exchange proposal goes into effect, it will mean that there will be at least three people who will have the capacity to deal with the outside auditors independent of the management which may be responsible for some kind of misconduct.

Mr. MURPHY. Who hires them and pays them?

Mr. HILLS. The board of directors will propose their membership and they are paid, of course, by the corporation, as any outside director is paid. And that of course raises a number of questions. In my judgment, directors of publicly held companies for the most part are not paid enough to justify the sense of responsibility they should bring to the job.

Again, however, we have made considerable progress over the last 5 to 10 years.

Mr. MURPHY. Then on page 12 in the middle of the page you say—

The Commission would prefer not to be involved even in the civil enforcement of such prohibitions. As a matter of long experience, it is our collective judgment that disclosure is a sufficient deterrent to the improper activities.

And yet we have—I don't know if you have read Mr. Sorenson's——

Mr. HILLS. Yes, I have. I have read both his testimony and his article in Foreign Affairs.

Mr. MURPHY. He notes that the bill fails to distinguish between extortion and bribery, and then he goes into the question of a corporate executive choosing between 2 years in a Federal prison if he makes the payment demanded of him, or the confiscation of the family or stockholder's principal investment if he fails to make the payment. Yet we have, of course, criminal penalties in our legislation, and yet the SEC does not want to be involved in criminal penalties.

Mr. HILLS. Well, of course, the SEC——

Mr. MURPHY. In this instance the SEC does have criminal penalties in many other areas.

Mr. HILLS. Yes, but the SEC doesn't enforce them, of course. The Department of Justice enforces them.

I think the point here is twofold. First, as a matter of longstanding tradition and practice, the Securities and Exchange Commission has been a disclosure agency. Causing questionable conduct to be revealed to the public has a deterrent effect. Consistent with our past tradition, we would rather not get into the business, however, we think get involved in prohibiting particular payments. It is a different thing entirely to try to prohibit something, to try to make a decision as to whether it is legal or illegal, or proper or improper. Under present law, if it is material, we cause its disclosure, and we need not get into the finer points of whether it is or is not legal.

In the area under discussion today—its boundaries being confined by the legislative history of this bill and the Senate committee report—we are dealing with what I would call the gross bribe, the serious, intentional corrupt bribe, not some man trying to protect the life or limb of some employee, not somebody trying to react to an emergency.

Because of the congressional and public interest in this kind of activity, we merely are acknowledging that if the Congress wishes to make an exception to our usual rule of materiality for this type of payment, we have no objection to it. We do wish to take the occasion, however, to point out that it is not consistent with our long tradition with respect to corporate disclosure, and therefore we hope that it is in fact an exception and ask that it not be a new trend in requiring different things from the Securities and Exchange Commission.

Mr. MURPHY. Section 13B(2)(a) of the bill requires issuers to devise and maintain an adequate system of internal accounting controls capable of meeting certain specific objectives.

It appears from the Commission's own experience that the problem has not been lack of adequate internal accounting systems, but has been, rather, the circumvention of adequate, or seemingly adequate systems.

Is it not possible that the focus of that section should be on precluding efforts to circumvent existing systems?

Mr. HILLS. Well, it is very hard to know what causes people to have books that misrepresent the facts. The subjective question of what is in someone's mind when he causes something to be misrepresented on the books is hard, indeed, to answer. The requirement that the books and records be accurately and fairly kept seemed to us to be a straightforward effort to deal with a problem that we have uncovered in the some 200 instances. People have all kinds of excuses for why they have not kept accurate books and records. Our own judgment is that the phrase "accurately and fairly," as interpreted and as explained in the

language in the Senate legislative history and the Committee report, puts the responsibility where it belongs.

It is important to note that in the 200 cases we have had involving questionable or illegal payments, according to my recollection, the Commission has not yet brought an enforcement action against any accounting firm, although 21 enforcement actions have been filed.

Now, what we have had, therefore, in our judgment, is a deliberate effort by some of these companies to fool their auditors. At least, that is our judgment as to what has happened, and, therefore, to correct the problem, it seems to us we should get right to the heart of the matter and charge the corporate officers with keeping accurate and fair records. That requires no subjective understanding of why they may presently be keeping their records in a certain way.

Our rules with respect to the auditors will, in turn, result in their giving the public an opinion as to whether or not the management has done a good job in maintaining accurate records. The auditors cannot be expected to render an opinion on whether or not any particular thing is accurate or inaccurate, but rather on whether or not the controls are good. That is something that auditors have been commenting on for years.

What we are trying to do is devise a solution to fit the problem. We have found deliberate, in our opinion, circumvention of the records prepared for the auditors' investigation, and therefore we are saying it shall be wrong to do that and, indeed, there will be a criminal penalty assessed if it is intentionally done.

Mr. MURPHY. That goes to 13B(4) of the bill, which makes it illegal for any person to make a materially false or misleading statement to an accountant in connection with the examination or audit of an issuer. The criminal prohibitions would apply to oral as well as to written statements. There has been a suggestion that this language would have a chilling effect on communications between outside auditors and management, not to mention persons outside of management or the company.

Because of the criminal sanctions for misstatements, wouldn't someone be well advised to speak to an auditor only in the presence of counsel?

Mr. HILLS. Well, Mr. Chairman, I think it is important for me to speak only to the civil prohibition, at least from the standpoint of our enforcement. My opinion as to what the standard of proof would be for criminal responsibility is probably not as relevant as that of the Department of Justice.

I would observe, however, that there are any number of laws, criminal laws, that permit prosecution for oral misstatements of fact. The notion that we should require people, as a civil matter, not to lie, not to make material misrepresentations to auditors, strikes me as not overly burdensome, particularly in view of what we have seen.

And an auditor who comes before a court or before the SEC and says, well, somebody made material misrepresentation to me orally is in no different position than one who received such a misrepresentation in writing.

The notion that one is prohibited and the other isn't is an impractical attempt to divide a single issue. An audit procedure involves oral representations and written representations. I don't see how one can

possibly separate them. If the auditor gives an opinion based upon an oral representation, and if that oral representation proves to be false, then such deception of the auditors should be punishable and would be prohibited under this bill.

I just can't understand why the auditors of this country should be worried that, if the people with whom they deal are told that they may not make material misrepresentations to auditors, then these people will be afraid to communicate with auditors. Again I say, there are many laws in this country already making oral falsehoods, such as perjury, punishable.

Now, let me come back to the standard of proof. The standard of proof for a criminal violation is something that is really beyond the scope of our interest, but I don't see how we can have a set of rules which says that material misrepresentation in writing is prohibited, but that, if the auditor can trace his actions to some false oral comment, we have no responsibility or no capacity to proceed against the person who made the oral statement.

Mr. MURPHY. Getting back to the corporate officer being charged, as you stated earlier, the prohibition would apply to any person, regardless of whether or not he has any connection with the issuer.

Is the scope of this language too broad, or necessary?

Mr. HILLS. Mr. Chairman, it may be very hard to prove that someone who is not affiliated with the issuer has intentionally misrepresented facts, but the notion that such unaffiliated persons are not prohibited from materially misrepresenting facts is a strange one.

Now, it is very hard for the auditors to make a judgment as to whether the books and records fairly portray the circumstances of a company. A simple law which says it is civilly wrong to make a material misrepresentation, whoever you are, to the auditors of a company, of a publicly held company, strikes me by definition as not being too all-encompassing. If it says to people you had better be careful before you make representations to auditors, I think that is to the good. The accounting profession's procedure for auditing records calls for a certification that the records are fair and accurate. Such certifications to corporate shareholders should not be based on materially false representations.

If auditors say we are going to have a hard time obtaining information in the face of a law making material misrepresentations illegal well, maybe that is good also. I doubt that that would happen. I doubt that banks or accounts receivable or trade relations will be jeopardized simply because somebody who is going to fill out a confirmation slip of some sort knows that, if he intentionally misrepresents something, or even if he carelessly misrepresents something, he may be accused of violating the law.

If he doesn't respond, then the auditors are probably going to have to go to a little bit more expense to find out why he didn't respond. It may very well be that people will communicate in writing rather than orally.

But let's come back to what we have found. Hundreds of American companies, literally hundreds of millions of dollars in misrepresentations that the auditors didn't catch.

Now, we have not charged the auditing profession with not catching it. We have said it has been the intentional misrepresentation by

management that has been the cause. To do anything less than require that all representations made to auditors be accurate and not intentionally misleading merely means that a certain amount of those hundreds of millions of dollars that we have missed in the past are going to be subject to being missed again in the future. If you go through the 200 cases that we have had, you will find that in many cases, by no means the majority but in many cases, that the auditors have been misled by some third party arrangement, whether it is through a third party bank account, or whether through a supplier arrangement where the manufacturer has caused a party with whom he deals to misrepresent his records in order that he can cover up the creation of a slush fund.

As we said in our report on May 12, a large number of these slush funds were carried on through foreign bank accounts or were carried on through relations with third parties. The existence of that third party has, in too many cases, permitted the fraud. I don't think under these circumstances that it is an undue burden for this Congress to say that people who intentionally engage in such conduct violate the law.

So, in short, Mr. Chairman, I think that the bill is a response that fits the problem.

If I could just add a footnote, it seems to me that if we had a system by which we had strong prohibitions only on people inside of management, all we would do is create a great deal of encouragement to create the frauds or the misrepresentations by means of third parties.

Mr. MURPHY. Could we accomplish the intent of this bill by limiting section 13B(4) to written representations?

Mr. HILLS. Mr. Chairman, a limitation to written representation means simply that an auditor who relies upon oral misrepresentations is half in and half out. It also poses a problem of proof.

An oral misrepresentation is hard to prove. An auditor deals in writing. The issue is whether or not something there has caused the auditor to misrepresent the facts as they should appear in the books and records of the company.

I have a great deal of trouble understanding why the auditing profession is concerned. It is the auditor who must attach his name to the certification and thus who may find that he has certified statements which are inaccurate because of an oral misrepresentation. Why don't they want to hold the person who makes that oral misrepresentation to a high standard?

Sure, it is going to be harder to prove. It always is harder to prove an oral misrepresentation. That is why we have things like parol evidence rules, that is why we have some kinds of contracts that can only be made in writing, but it seems to me that if we say that you can orally misrepresent the circumstances but you can't do it in writing, then you are only going to create an incentive to do less in writing and to have more oral explanation.

Again, the issue that is raised in this area, it seems to me, is a question of proof. It may be hard to prove. It is conceivable that somebody will be reluctant to talk to their auditors, but why should they be? Why should any manager be relucant to talk to auditors unless there is something he is trying to conceal.

This involves, I think, Mr. Chairman, the cuteness of some of these records that we have gone through. Unless there is something there that he is trying to conceal, something that is materially wrong, unless he is trying to dance around the subject in some way, one shouldn't be afraid of being misunderstood in some oral statement. You don't have misunderstandings as to the question of whether or not the company made $2 million a year or $1 million a year. The principal activities of a corporation, the principal income, the principal supply sources and sales are all in writing.

So we are dealing with the area of that which may be discussed orally and which the auditor will rely on in making certification. We are dealing with questions the auditors raise about the records after they have viewed the records. The records of a company obviously are primarily in writing. Now, if an auditor has questions about the written record, he will ask the manager of the company or the head of the accounting department or the chief financial officer, "What does this mean?" If he is satisfied, but was misled, that means there is something that was misrepresented, something of serious significance that was misrepresented.

Mr. Chairman, I spent 6 years with one of the more difficult corporate recordkeeping situations in the United States. We had $90 million missing off of our balance sheet. It was certified by one national accounting firm, and 1 year later, another one of the so-called big eight said that $90 million had disappeared in between, but that nobody took the money. We spent an agonizing year trying to explain what had happened.

My experience was, and other managers have had similar experiences, that when you are trying to find out what happened and explain it to your auditors, there is nothing to fear. Only if an auditor has missed something material, and he has been persuaded to do it by some oral misrepresentation, would the prohibitions this subcommittee is considering come into play.

I have a hard time finding a simple example. We have talked to the auditing profession. I don't want to be cavalier and say there is no problem. Obviously, people worry about being sued for some oral misrepresentation. I think if you understand and think through the auditing process you will find that the process involves primarily written records. The auditor makes oral inquiry as a result of examining the written record. The auditor doesn't simply listen and change a written record. He will listen, and he may change a previous decision. The auditor will make notes. There will be a record of what was said.

If a man is genuinely misunderstood, and as a result of that some material misrepresentation occurs with respect to the company, is it going to be hard to prove that it was intentional? If it is a bribe, if it is a kickback of some sort, if it is something done without the knowledge of the board of directors, if it is one of the kinds of things that we are dealing with in the investigation of corporate questionable practices, I suggest that it is going to be all too easy for people to try to dance around and hope that, through an oral misunderstanding, or through some written representation that isn't fully explained orally, somehow the auditor who is close to the scent will be thrown off of it.

82-981 O - 77 - 3

But again let me say, it is only because the corporate officer has managed to conceal something. He has managed to get away with it.

And I must say, Mr. Chairman, that I don't see the public interest in trying to protect that kind of misrepresentation. I spent some time this morning with our people trying to figure out the reason for this great concern about an oral misrepresentation. Again I come back to the question of what is it that may result in prosecution. Are they going to be prosecuted because an oral material misrepresentation has occurred as a result of an error in the books of their company? I have yet to see a specific example of a case in which that kind of oral misrepresentation would be of concern.

Let me say that if a corporate officer made a material oral misrepresentation to his auditors, and the auditors wrote down $1 million earnings or 10 cents a share instead of 15 cents a share the officer would have committed a violation of the securities laws. There is no difference between oral and written statements under the existing securities laws if either causes, or is responsible for causing, a material misrepresentation.

I hope very much that this subcommittee will pass the bill in its present form. We recognize, and I want to make this point very clear, we recognize, in the rules that we promulgate, the inherent difficulty in certifying to things such as the adequacy of records and the adequacy of information. It is a very serious matter. It is one we will have to deal with. But I think that most of the auditors' problems can be met by the rules that we will publish for public comment with respect to their responsibility. I don't understand why they are so concerned about protecting somebody who might be found guilty of an oral misrepresentation.

I'm sorry for carrying on so long, but I think it is quite critical to the whole history of these cases.

Mr. MURPHY. Should there be a threshold level?

Mr. HILLS. You mean of $1,000 or $10,000?

Mr. MURPHY. $90 million?

Mr. HILLS. Perhaps, but surely something should be left to the discretion of the prosecuting attorney. Considering how few criminal prosecutions have come out of all these cases, I don't think we need be worried about the smaller amounts. When you see how many of our cases have sprung from a $500 payment that somebody had enough nerve to track down, and which, in turn, led to the discovery of millions of dollars improperly accounted for, I think you will see why we are a little worried about the concept of threshold payments. I would recommend against a threshold payment just because no matter how it is worded, it is going to be a license for someone who will say, "All right, up to that I can get away with it." I just fear, from previous examples, that it would be regarded not as a prohibition but as a license.

So I suggest that there not be any limit, but rather that there be a common sense interpretation of the law which, in almost every case, should be based upon the concept of materiality.

Mr. MURPHY. Is it inherent in this provision that the person making the misstatement must have actual knowledge that such statement is materially false or misleading?

Mr. HILLS. I think people may argue at great length about that issue. If one knows or should reasonably have known, that he is causing someone else to be misled, he would have violated the bill, as I understand it. An innocent, nonnegligent misrepresentation, for example, by someone who is relying in good faith upon somebody else whom he has no reason to distrust, it seems to me would be excused, as I interpret the proposals.

Mr. MURPHY. Thank you very much, Mr. Chairman.

Mr. HILLS. Thank you, sir.

Mr. MURPHY. Our next witnesses will be a panel, Mr. Richard Darman, Assistant Secretary for Policy, U.S. Department of Commerce; Mr. Gerald Parsky, Assistant Secretary for International Affairs, Department of the Treasury; and Mr. Mark Feldman, Deputy Legal Adviser, U.S. Department of State.

Mr. Darman?

STATEMENTS OF J. T. SMITH II, GENERAL COUNSEL, DEPARTMENT OF COMMERCE; RICHARD G. DARMAN, ASSISTANT SECRETARY FOR POLICY, DEPARTMENT OF COMMERCE; GERALD L. PARSKY, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY, ACCOMPANIED BY JOHN WEDICK, DIRECTOR, AUDIT DIVISION, INTERNAL REVENUE SERVICE; AND MARK B. FELDMAN, DEPUTY LEGAL ADVISER, DEPARTMENT OF STATE

Mr. DARMAN. Mr. Chairman, Mr. J. T. Smith, General Counsel of the Department of Commerce, will lead off if it is convenient with the Chair.

Mr. MURPHY. All right.

Mr. DARMAN. I will then supplement with a brief comment, to be followed by Mr. Parsky, and Mr. Feldman. We will then respond to your questions, if that is agreeable.

Mr. MURPHY. OK, Mr. Smith.

STATEMENT OF J. T. SMITH II

Mr. SMITH. Thank you, Mr. Chairman.

Assistant Secretary Darman and I appreciate this opportunity to appear on behalf of Secretary Richardson to present views on H.R. 15481. As you are aware, Secretary Richardson chairs a Cabinet level task force created by President Ford on March 31, 1976, to conduct a sweeping policy review of the problem of questionable payments abroad by American corporations. Assistant Secretary Darman and I serve as cochairmen of the task force's steering committee.

H.R. 15481 would make it a criminal offense, punishable by up to 2 years imprisonment and a fine of up to $10,000, for any domestic business concern corruptly to give anything of value to any foreign official, political party, candidate for office or intermediary. In addition, the bill embodies recommendations, made by the Chairman of the Securities and Exchange Commission and endorsed by President Ford, to amend the Securities and Exchange Act to prohibit falsification of corporate accounting records; to proscribe the making of false

and misleading statements by corporate officials to auditors; and to require corporate managers to establish and maintain certain internal accounting controls. This bill is identical to S. 3664, introduced by Senator Proxmire, which passed the Senate on September 15, 1976.

Chairman Hills of the SEC has explained the basis for his and the administration's support for the corporate recordkeeping and accountability provisions of H.R. 15481. Our testimony will, therefore, be directed to the provisions of the bill which establish domestic criminal sanctions for certain corrupt payments made by American business concerns abroad.

From its inception, the task force has been determined to adopt all necessary and appropriate means to deal with the problem of ending questionable payments and restoring the confidence of the American people and our trading partners in the ethical standards of the American business community. On April 8, 1976, Secretary Richardson, testifying before Senator Proxmire stated, "If I sense the mood of our country correctly, as a people and a nation, we find bribery abhorrent, and we intend to do something about it." To do something about the problem, the task force decided upon, and President Ford approved on June 13th, a comprehensive approach comprised of the following three parts.

First, current law must be vigorously enforced. In this regard, the task force recognizes the leadership role played by the SEC. Also, it fully supports the strong initiatives taken by the Internal Revenue Service. Assistant Secretary Parsky will further outline these latter efforts.

Second, measured and enforceable legislation is needed to enhance and make more explicit, standards of corporate accountability and to require reporting and disclosure of all payments of certain classes made in relation to business with foreign governments.

Third, the United States must pursue by all reasonable means an enforceable, international treaty to end corrupt payments in international commerce. We have no illusions about the difficulty of accomplishing such an agreement. At the same time, as Deputy Legal Adviser of the State Department, Mark Feldman, will describe, some considerable progress is being made on this front.

The task force rejected the approach of direct, unilateral criminalization under U.S. law of corrupt payments made abroad, the approach adopted by the Senate and contained in H.R. 15481. While recognizing that adoption of direct criminal legislation would represent the most forceful possible rhetorical assertion by the President and the Congress of our abhorrence of corrupt foreign payments, we seriously question whether such a criminal provision would be enforceable. We do not believe unenforceable criminal standards should be allowed to take place of meaningful disclosure measures. We fear that unenforceable measures such as these can themselves have a corrosive effect on our society.

Before a criminal defendant can be found guilty, his guilt must be proven beyond a reasonable doubt to a jury. Yet, successful prosecution of offenses under H.R. 15481's criminal proscriptions would typically depend upon witnesses and information beyond the reach of U.S. judicial process. Other nations, rather than assisting in such prosecutions, might resist cooperation because of considerations of

national preference or sovereignty. Similarly, under our system of justice, criminal defendants should be entitled to all reasonable means to conduct a full and fair defense. Here again, access to key witnesses or documents might be impossible. It is because of the difficulty of successful prosecution, and a fair defense related to such prosecution, that the task force concluded that a unilateral criminal proscription would represent little more than a rhetorical assertion.

Our view with regard to the enforceability of direct unilateral criminal sanctions is confirmed in the report of the Senate Committee on Banking, Housing and Urban Affairs, accompanying S. 3664, the Senate counterpart to H.R. 15481. The Senate report appends an opinion of counsel which states, and I quote:

> I think that the bill would be difficult to enforce, especially in the context of a criminal prosecution. The availability of witnesses and evidence in a case the essential elements of which take place abroad would probably be so limited as to preclude proof beyond a reasonable doubt, the standard in a criminal case.

This view was reinforced by Senator Church during floor debate on S. 3664. He stated that a simple criminal proscription was pure tokenism.

We urge the Congress not to substitute tokenism for real action to deal with the questionable payments problem. The danger in such tokenism is that it will create complacency. Congress will wash its hands of an important problem without having taken meaningful, enforceable action.

The President's proposal to deal effectively with the problem, the Foreign Payments Disclosure Act, was forwarded to Congress on August 3 of this year. Disappointingly, neither the Senate nor the House has granted a hearing on this proposal. We would like, Mr. Chairman, with your indulgence, to have included in the official record of these hearings a copy of President Ford's message to the Congress regarding the Foreign Payments Disclosure Act, a copy of the bill itself, H.R. 15149, as well as a section-by-section analysis and a statement of purpose and need which accompanied this legislation when it was transmitted to the Congress. These documents describe the legislation and its purpose quite fully.

The Foreign Payments Disclosure Act is designed to deter improper payments in international commerce by American corporations and their officers to help restore the good reputation of American business; to help discourage foreign extorters from seeking improper rewards from American businessmen; to encourage foreign nations to enforce their own criminal laws against official bribery and corruption; and to set a forceful example to our trading partners and competitors regarding the imperative need to end improper payments. It is designed to complement and supplement laws already on the books, such as the securities laws, the reporting requirements of the Arms Export Control Act, and the Internal Revenue Code. Most important, it has ben carefully tailored to be enforceable. By not seeking unilaterally under U.S. laws to criminalize foreign improper payments, it will not promise more than it can deliver.

It requires, under pain of criminal penalties for willful failure to report, reports by all American businesses to the Secretary of Commerce of certain classes of payments, together with names of recipients made by such businesses and their 50-percent owned foreign subsid-

iaries in relation to business with foreign governments. These reports will subsequently be made available to the public. Reports will be required of all payments above a threshold amount to be set by the Secretary of Commerce, made in connection with sales to, or contracts with, foreign governments or official actions by foreign public officials. The reporting requirement is designed to cover fees of agents and other intermediaries and political contributions as well as payments made to foreign public officials. By requiring reporting of all significant payments, whether proper or improper, made in connection with business with foreign governments, the bill avoids the difficult problems of definition and proof that arise in context of enforcement of legislation that seeks to deal specifically with bribery or extortion abroad.

Prior to their public disclosure, the reports may be transferred to appropriate foreign agencies by the Attorney General or Secretary of State. In this fashion, the reports will serve as a goad to foreign governments to enforce their own laws. Nearly every nation in the world, according to the researches of the task force, has laws against public bribery and extortion.

We believe that a combination of sunlight and encouragement of other nations to enforce their own laws represents a much more effective way to end corrupt payments than does direct, unilateral criminalization by this country of actions taking place in foreign jurisdictions.

We share fully Congress' concerns about the corrosive effect of corruption on our business institutions and our international relations. We regret that our proposed legislation has not been allowed a hearing. We urge that Congress not act in haste to adopt an essentially rhetorical, token solution in lieu of the more meaningful proposals put forth by President Ford.

Thank you, Mr. Chairman.

[Testimony resumes on p. 82.]

[The documents referred to follow:]

EMBARGOED FOR RELEASE
UNTIL 2:30 P.M., E.D.T. AUGUST 3, 1976

Office of the White House Press Secretary

THE WHITE HOUSE

TO THE CONGRESS OF THE UNITED STATES:

Certain improper activities abroad undertaken by some American corporations have resulted in an erosion of confidence in the responsibility of many of our important business enterprises. In a more general way, these disclosures tend to destroy confidence in our free enterprise institutions.

With this in view, I established the Task Force on Questionable Corporate Payments Abroad on March 31, 1976, and directed it to undertake a sweeping policy review of approaches to deal with the questionable payments problem. On June 14, after reviewing an interim report of the Task Force, I directed the Task Force to develop, as quickly as possible, a specific legislative initiative calling for a system of reporting and disclosure to deter improper payments.

Today, I am transmitting to the Congress my specific proposal for a Foreign Payments Disclosure Act. This proposal will contribute significantly to the deterrence of future improper practices and to the restoration of confidence in American business standards.

This legislation represents a measured but effective approach to the problem of questionable corporate payments abroad:

-- It will help deter improper payments in international commerce by American corporations and their officers.

-- It will help reverse the trend toward allegations or assumptions of guilt-by-association impugning the integrity of American business generally.

-- It will help deter would-be foreign extorters from seeking improper payments from American businessmen.

-- It will allow the United States to set a forceful example to our trading partners and competitors regarding the imperative need to end improper business practices.

-- It does not attempt to apply directly United States criminal statutes in foreign states and thus does not promise more than can be enforced.

-- Finally, it will help restore the confidence of the American people and our trading partners in the ethical standards of the American business community.

The legislation will require reporting to the Secretary of Commerce on certain classes of payments made by U.S. businesses and their foreign subsidiaries and affiliates in relation to business with foreign governments. The reporting requirement covers a broad range of payments relative to government transactions as well as political contributions and payments made directly to foreign public officials. By requiring reporting of all significant payments, whether proper or improper, made in connection with business with foreign governments, the legislation will avoid the difficult problems of definition and proof that arise in the context of enforcement of legislation that seeks to deal specifically with bribery or extortion abroad.

The Secretary of Commerce will, by regulation, further define the scope of reporting required. Small or routine payments will be excluded, as will certain clearly bona fide payments such as taxes. Reports will include the names of recipients.

Reports will be made available to the Departments of State and Justice as well as to the Internal Revenue Service and the Securities and Exchange Commission. The Department of Justice and the State Department will, in appropriate instances, relay reported information to authorities in foreign jurisdictions to assist them in the enforcement of their own laws.

Reports also will be made available to appropriate congressional committees. All reports would be made available to the public one year from the date of their filing, except in cases where a specific written determination is made by the Secretary of State or the Attorney General that considerations of foreign policy or judicial process dictate against disclosure.

This proposed legislation is intended to complement and supplement existing laws and regulations which can affect questionable corporate payments abroad.

In this regard, I wish to recognize and build upon the fine record of the Securities and Exchange Commission. The Commission already has taken prompt and vigorous action to discover questionable or illegal corporate payments and to require public disclosure of material facts relating to them. Moreover, as the Commission has noted, public disclosure of matters of this kind generally leads to their cessation. In virtually all the cases reported to the Commission, companies discovering payments of this kind have taken effective steps to stop them and to assure that similar payments do not recur in the future.

A principal emphasis of the Commission's activities in this area has been to prompt the private sector to take actions that would restore the integrity of the existing system of corporate governance and accountability. I applaud this approach and expect the Secretary of Commerce to follow the same spirit in administering this new legislation.

However, not all firms engaged in international commerce are regulated under the securities laws and are subject to the disclosure requirements of the Commission. The Commission requires disclosure of payments only when necessary or appropriate for the protection of investors. Further, it has not generally required reporting of the name of a recipient, a requirement which I believe can be an important deterrent to extorters. In addition, the Commission's system of disclosure -- focusing as it does primarily on the interests of the investing public -- is not designed to respond to some of the broader public policy and foreign policy interests related to the questionable payments problem.

Accordingly, the legislation which I am proposing deals with all U.S. participants in foreign commerce -- not just firms subject to Commission regulatory requirements -- and it calls for the active involvement of the Secretaries of State and Commerce and the Attorney General in administering a system which addresses the full range of public policy interests inherently involved in the questionable payments problem.

The Secretary of Commerce will take every feasible step to minimize the reporting burdens under this new legislation. The legislation directs the Secretary to consult with other federal agencies to eliminate duplicative reporting. Where appropriate, agencies are authorized to combine reporting and record-keeping in single forms.

In this regard, I also wish to recognize and build upon the Securities and Exchange Commission's acknowledged expertise in financial reporting. Persons subject to the Commission's jurisdiction must maintain books and records that are sufficient to provide data the Commission believes should be disclosed. The requirement that persons subject to SEC jurisdiction maintain adequate books and records is now implicit in existing law; the legislation recommended by the Commission, which the Task Force and I support, would make that requirement explicit. It is contemplated that the Commission will take further steps to assure that companies it regulates maintain adequate systems of internal accounting controls. Thus, it may well be unnecessary for the Secretary of Commerce to impose additional record-keeping requirements on companies regulated by the Commission to enable compliance with the proposed legislation.

We remain mindful that the questionable payments problem is an international problem which cannot be corrected by the United States acting alone. Consequently, we are continuing our efforts to secure an international agreement which will establish a mutually acceptable framework for international cooperation in eliminating improper business practices.

The legislation I am proposing today can contribute in an important way to the restoration of confidence in America's vital business institutions. I urge its prompt consideration and enactment by the Congress.

GERALD R. FORD

THE WHITE HOUSE,

August 3, 1976.

# # #

UNITED STATES DEPARTMENT OF
COMMERCE
NEWS
WASHINGTON, D.C. 20230

OFFICE
OF THE
SECRETARY

STATEMENT BY ELLIOT L. RICHARDSON, SECRETARY OF COMMERCE AT A NEWS CONFERENCE ON THE PROPOSED FOREIGN PAYMENTS DISCLOSURE ACT IN WASHINGTON, D.C., TUESDAY, AUGUST 3, 1976

Today on behalf of President Ford I am transmitting to the Congress the President's proposal for a Foreign Payments Disclosure Act. In deciding upon this legislation, the President and the Task Force were guided by:

(1) a review of the ongoing efforts of the federal government with regard to the questionable payments problem;

(2) an analysis of the current laws dealing with the problem, and;

(3) an evaluation of alternative means to strengthen deterrence of improper payments and to increase confidence in American business.

This legislation is an important first step in dealing with the questionable payments problem. The ultimate legal basis for adequately addressing the questionable payments problem must be an international treaty which would make the criminalization of foreign bribery fully enforceable.

While continuing to pusue this long term approach toward an international agreement, it is nonetheless necessary to supplement current U.S. law.

I, therefore, urge the Congress to take swift and positive action on the proposed legislation.

###

PROPOSED FOREIGN PAYMENTS DISCLOSURE ACT

STATEMENT OF PURPOSE AND NEED

The proposed Foreign Payments Disclosure Act was prepared by the Cabinet-level Task Force on Questionable Corporate Payments Abroad, created by President Ford on March 31, 1976 to conduct a sweeping policy review of the questionable payments problem.

Based upon an interim report of the Task Force, President Ford on June 14 directed that legislation be prepared requiring reporting and disclosure of certain payments made in relation to business with foreign governments.

The proposed legislation is designed to help deter improper payments in international commerce by American corporations and their officers; to help restore the good reputation of American business; to help deter would-be foreign extorters from seeking improper rewards from American businessmen; and to set a forceful example to our trading partners and competitors regarding the imperative need to end improper business practices.

Most important, as stated by President Ford in his message to the Congress regarding this legislation, it:

> "will help restore the confidence of the American people and our trading partners in the ethical standards of the American business community. In so doing, it can yield substantial long-term benefits to American business, to American foreign policy, and to international commerce."

In deciding upon a legislative approach, the President and the Task Force: (i) reviewed the ongoing efforts of the federal government with regard to the questionable payments problem; (ii) analyzed the adequacy of current laws in dealing with the problem; and (iii) evaluated alternative means to strengthen deterrence of improper payments and to increase confidence in American business.

Ongoing Approach to the Questionable Payments Problem

The current Administration approach to the questionable payments problem includes both (a) vigorous enforcement of current law and (b) pursuit of effective international agreements.

(a) Enforcement of Current Law

Investigative enforcement activities are being conducted by audit agencies, the Internal Revenue Service (IRS), the Federal Trade Commission (FTC), the Department

of Justice, and the Securities and Exchange Commission (SEC). The investigative activities of all these agencies are ongoing -- and the product of their investigations will continue to emerge in accord with fair and orderly legal process.

It is reasonable to conclude that the exposures to date have increased the attentiveness of responsible enforcement agencies in general -- and that they have increased the deterrent effect of current law thereby. A particularly noteworthy example is provided by the IRS's guidelines of May 10, 1976 -- requiring affidavits concerning "slush funds," bribes, kickbacks or other payments, regardless of form, made directly or indirectly to obtain favorable treatment in securing business or special concessions; or made for the use or benefit of, or for the purpose of opposing any government, political party, candidate or committee.

As is well known, the SEC has played a leadership role in this area. Its prompt and vigorous actions to discover questionable or illegal corporate payments and to require public disclosure of material facts relating to them, is contributing an important measure of deterrence to such practices.

(b) Pursuit of International Agreements

The recent Organization for Economic Cooperation and Development (OECD) Ministerial Conference adopted the following declaratory policy:

"Enterprises should:

(i) not render -- and they should not be solicited or expected to render -- any bribe or other improper benefit, direct or indirect, to any public servant or holder of public office;

(ii) unless legally permissible, not make contributions to candidates for public office or to political organizations;

(iii) abstain from any improper involvement in local political activities."

Ambassador Dent has asked the General Agreement on Tariffs and Trade to take up the questionable payments issue, as called for in Senate Resolution 265. The resolution proposes negotiation in the Multilateral Trade Negotiations of an international agreement to curb "bribery, indirect payments, kickbacks, unethical political contributions and other such similar disreputable activities." The U.S. has indicated that negotiation of such an agreement is a matter of top priority.

Most significantly, the U.S. has proposed negotiation in the United Nations of a treaty on corrupt practices. The proposal is for an agreement to be based on the following principles:

(i) It would apply to international trade and investment transactions with governments, i.e., government procurement and other governmental actions affecting international trade and investment as may be agreed;

(ii) It would apply equally to those who offer to make improper payments and to those who request or accept them;

(iii) Importing governments would agree to establish clear guidelines concerning the use of agents in connection with government procurement and other covered transactions, and establish appropriate criminal penalties for defined corrupt practices by enterprises and officials in their territory;

(iv) All governments would cooperate and exchange information to help eradicate corrupt practices;

(v) Uniform provisions would be agreed upon for disclosure by enterprises, agents and officials of political contributions, gifts and payments made in connection with covered transactions.

The proposal is currently under review in the UN Economic and Social Council (ECOSOC) with a strong U.S. recommendation that ECOSOC give the issue priority consideration.

The U.S. objective is to have ECOSOC pass a resolution on corrupt practices which will create a group of experts charged with writing the text of a proposed international treaty on corrupt practices and reporting that text back to ECOSOC in the summer of 1977. The U.S. goal would then be to forward an agreed text to the UN General Assembly for action in the fall of 1977.

It is the view of the President and the Task Force that the ultimate legal basis for adequately addressing the questionable payments problem must be an international treaty along the lines proposed by the United States. A treaty is required to make the "criminalization" of foreign bribery fully enforceable -- for, in the absence of foreign

82-981 O - 77 - 4

cooperation, it would be extremely difficult, and in many cases impossible, for U.S. law enforcement officials and potential defendants to be assured of access to relevant evidence. A treaty is also required to treat the actions of foreign as well as domestic parties to a questionable transaction. And a treaty is required to assure that all nations, and the competing firms of differing nations, are treated on the same basis.

In order to advance the prospects of favorable international action with respect to the U.S. proposal, the State Department has coordinated a special series of direct representations to foreign governments. We will continue to pursue a satisfactory international agreement by every appropriate means.

While continuing to pursue the long-term approach toward an international agreement, it is nonetheless necessary to supplement current U.S. law -- as indicated by the following discussion.

Sufficiency of Current Laws

The Task Force undertook a review and analysis of the sufficiency of current laws to deal with the problem of deterring questionable payments by American businessmen

and to restore public confidence in business standards. It concluded that current law, while providing a number of indirect means to deal with the problem was not fully sufficient.

It is clear that existing securities laws and the Internal Revenue Code can have important bearing upon the questionable payments problem -- the former by requiring disclosure of "material" improper payments, and the latter by denying tax deduction of illegal payments. In addition, vigorous application of securities and tax standards is prompting increased internal corporate accountability.

Further, the Task Force identified a range of anti-trust provisions which might be applied to questionable or illegal payments abroad. However, effective application of these laws to transactions involving foreign payments is problematical. Finally, the Task Force identified a number of certification requirements imposed on companies doing business abroad with federal assistance, such as that provided by the Export-Import Bank and the Agency for International Development. Deliberate falsification of such certifications can give rise to criminal liability. Nevertheless, these certification

requirements can only apply to firms which avail themselves of these federal assistance programs.

The Task Force is persuaded that the SEC's system of reporting and disclosure offers substantial deterrence to future improper practices by SEC-regulated firms. To further strengthen the SEC's capacity to perform its vital functions, the Administration endorsed -- and will continue to support the enactment of -- legislation first proposed by Chairman Hills of the SEC. By making explicit what is already implicit in the SEC's authorities, this legislation can enhance the effectiveness of the SEC disclosure system as it pertains to SEC-regulated companies by assuring integrity of corporate reporting systems and the accountability of corporate officials.

However, by no means all firms engaged in international commerce are regulated under the securities laws and subject to the disclosure requirements of the Commission. Also, the Commission requires disclosure of payments only when necessary or appropriate for the protection of investors. Further, it has not generally required reporting of the name of a recipient of a material, improper payment, a requirement which the Task Force believes can be an

important deterrent to extorters. In addition, the Commission's system of disclosure -- focusing as it does primarily on the interests of the investing public -- is not designed to respond to some of the broader public policy and foreign relations interests related to the questionable payments problem.

Accordingly, the Foreign Payments Disclosure Act deals with all U.S. participants in foreign commerce -- not just Commission regulated firms -- and it calls for the active involvement of the Secretaries of State and Commerce and the Attorney General in administering a system which addresses the full range of public policy interests inherently involved in the questionable payments problem.

Selection of "Disclosure" Rather Than "Criminalization" Approach

The Task Force considered two principal competing legislative approaches -- a "disclosure" approach and a "criminalization" approach. While it is possible to design legislation which requires disclosure of foreign payments and makes certain payments criminal under U.S. law, the Task Force unanimously rejected this approach. The disclosure-plus-criminalization scheme would, by its very ambition, be ineffective. The existence of U.S. criminal penalties for

certain questionable payments would deter their disclosure and thus the positive value of the disclosure provisions would be reduced. In the Task Force's opinion, the two approaches cannot be compatibly joined.

The Task Force carefully considered the option of "criminalizing", under U.S. law, improper payments made to foreign officials by U.S. corporations. Such legislation would have represented the most forceful possible rhetorical condemnation of such conduct. It would have placed business executives on clear and unequivocal notice that such practices should stop. It would have made it easier for some corporations to resist pressures to make questionable payments.

The Task Force concluded, however, that the criminalization approach would represent little more than a policy assertion, for the enforcement of such a law would be very difficult if not impossible. Successful prosecution of offenses -- and fair defense in relation to such prosecutions -- would typically depend upon access to witnesses and information beyond the reach of U.S. judicial process. Other nations, rather than assisting in such prosecutions, might resist cooperation because of considerations of national preference or sovereignty. Other nations might be especially offended

if we sought to apply criminal sanctions to foreign-incorporated and/or foreign-managed subsidiaries of American corporations. The Task Force concluded that unless reasonably enforceable criminal sanctions were devised, the criminal approach would represent poor public policy.

Based upon analysis of the sufficiency of current law and of the options described above, the President decided to ask the Congress to enact legislation providing for full and systematic reporting and disclosure of payments in connection with their commercial relations with foreign governments.

Proposed Legislation

The Foreign Payments Disclosure Act will require reporting to the Secretary of Commerce of certain classes of payments made by U.S. businesses and their foreign subsidiaries and affiliates in relation to business with foreign governments. Specifically, reports will be required of all payments made in connection with sales to or contracts with foreign governments or official actions by foreign public officials, where such are for the commercial benefit of the payor or his foreign affiliate.

The reporting requirement covers fees of agents and other intermediaries and political contributions as well as payments made directly to foreign public officials.

The legislation provides that the Secretary of Commerce shall issue regulation necessary to carry out its purposes. These regulations shall contain a requirement that reports include names of recipients of payments and shall establish a threshold amount below which payments need not be reported. An exception is made to this threshold concept for multiple payments totaling the threshold amount with respect to a single transaction. The purpose of this threshold will be to exclude so-called "grease" or "facilitating" payments, i.e., small payments made to expedite low level official actions such as customs processing. Reporting of such minor payments could create burdens far outweighing the benefits sought by this legislation. The Secretary will further have the authority to define by regulation certain types of payments which will not be required to be reported because they are regular business payments not inconsistent with the purposes of the Act, or are bona fide payments to a foreign government such as taxes or other fees paid pursuant to law, regulation or other legal action.

The Secretary is also authorized to require, by regulation, the keeping of records necessary to carry out the purposes of the Act and to make investigations, inspect books and issue subpoenas as necessary and appropriate to the enforcement of the Act.

Civil penalties are provided for failures to report or maintain required records or negligent omissions or misstatements in reports filed. Criminal misdemeanor penalties are provided for knowing failures to file or to maintain records or to include complete or correct information in records. Filing of a report containing false statements or knowing omission of required information will be penalized as a criminal felony.

Reports filed pursuant to this legislation shall be kept confidential for one year from the date of filing so as to protect business proprietary concerns and to lessen possible foreign relations problems. On receipt, however, the reports submitted to the Secretary of Commerce would be made available to the Departments of State and Justice, the IRS and, where appropriate, to the SEC. The Department of Justice or the State Department can as appropriate relay information contained in such reports

to authorities in foreign jurisdictions. The reports will also be transmitted upon request and with appropriate arrangements for confidentiality to appropriate Committees of the Congress. After the expiration of the one-year period, reports will be made available for public inspection and copying unless a specific written determination is made by the Secretary of State that foreign policy interests dictate against public disclosure, or a specific written determination is made by the Attorney General that the status of an ongoing investigation or prosecution dictates against public disclosure through other than conventional judicial processes.

The bill will seek to avoid duplication of reporting and record keeping requirements. First, it exempts sales of defense articles or defense services under the Arms Export Control Act from the reporting requirements. This exemption is based upon the fact that the Arms Export Control Act, as recently amended, provides for comprehensive reporting to the State Department and the Congress of information regarding payments with respect to such transactions. Second, the Secretary of Commerce is given authority to work with other agencies to eliminate unnecessary duplication in reports and records. The legislation explicitly states that it is not designed

to amend in any way current legal requirements relating to reporting and disclosure, enforced by other agencies of government such as the SEC and the IRS.

PROPOSED FOREIGN PAYMENTS DISCLOSURE ACT

SECTION-BY-SECTION ANALYSIS OF THE BILL

Short Title

Section 1 of the bill provides that it may be cited as the Foreign Payments Disclosure Act.

Definitions

Section 2 defines certain terms used in the bill. "Person" is defined to mean individuals who are the citizens or resident aliens of the United States or legal entities organized under the laws of the United States or any state or political subdivision thereof. An exception is made for government entities which are not organized for commercial purposes. Federal, state or local government entities having commercial or trade promotion purposes would be subject to the Act.

"Anything of value" is defined broadly to include any direct or indirect gain or advantage to a direct beneficiary or to any third party beneficiary.

"Foreign affiliate" is defined to mean any legal entity organized under the laws of a foreign country, whenever it is at least 50 percent beneficially owned by persons subject to the Act. More complex definitions of ownership or control were rejected for the purposes of clarity and simplicity of administration.

"Foreign public official" is defined to mean an officer of employee of a foreign government, whether elected or appointed, or an individual acting for or on behalf of a foreign government. The term further is defined to include an individual who has been nominated or appointed to be a foreign public official but who has not yet formally entered office.

"Official action" is defined to mean any decision, opinion, recommendation, judgment, vote, or other conduct involving an exercise of discretion by a foreign public official in the course of his employment.

"Foreign government" is defined broadly to include any government of a foreign country; a department or agency thereof; a corporation or other legal entity under control of a foreign government; any political subdivision of a foreign government; and any public international organization.

Reporting Requirements

Section 3 of the bill sets forth classes of payments which must be reported to the Secretary of Commerce in accordance with regulations promulgated by the Secretary. These include payments made, after passage of the bill, on behalf of a person subject to the Act or the person's

foreign affiliate to any other individual or entity in connection with: an official action, or sale to or contract with a foreign government for the commercial benefit of the person or his foreign affiliate.

This reporting requirement will be further delineated by the issuance of regulations pursuant to Section 9(a) of the bill, which requires the Secretary, by regulation, to set a threshold amount below which payments need not be reported, and to define types of payments which need not be reported. Thus, while the reporting requirements of the bill will extend to proper as well as improper or illegal payments, the regulations issued by the Secretary will exclude from reporting certain regular business payments not inconsistent with the purposes of the bill and bona fide payments such as taxes.

The terms "individual or entity," as used in Section 3, refer to foreign public officials, foreign governments, and agents or intermediaries used in connection with covered transactions or official actions.

Record Keeping Requirements

Section 4 allows the Secretary of Commerce to promulgate rules and regulations prescribing record keeping, necessary to carry out the purposes of the Act. The Secretary is to consult in the design of these record keeping requirements with other federal agencies so as to eliminate unnecessary duplication of record keeping. It is anticipated that the SEC's record keeping requirements for firms regulated by the SEC may suffice for purposes of compliance with this bill.

Enforcement

Section 5 grants the Secretary of Commerce authority to inspect books and records, issue subpoenas and take sworn testimony as necessary and appropriate to the enforcement of the Act.

Civil Remedies

Section 6 provides a civil penalty of not more than $100,000 for failure to file a report required by Section 3, failure to maintain records required by Section 4, or for negligent omission or inclusion of false information in a report required under Section 3. Section 6 also gives the Secretary the power to request the Attorney General of the United States to bring an action in federal

district court to enjoin a person from continuing to engage in any act or practice that constitutes a violation of the bill.

Criminal Penalties

Section 7(a) provides criminal penalties for knowing violations of the requirements of Sections 3 and 4 of the Act. Individuals may be fined not more than $10,000 or imprisoned for not more than one year, and a fine of $100,000 is provided for legal entities such as corporations. Section 7(b) penalizes as a felony, knowing falsification of reports required by Section 3. Individual offenders may be fined not more than $100,000 and imprisoned not more than three years. A legal entity is subject to a criminal fine of up to $500,000.

Dissemination of Reports

Section 8(a) requires the Secretary, upon receipt of a report, to disseminate it to the Departments of State and Justice, the Internal Revenue Service and, where appropriate, to the Securities and Exchange Commission.

Section 8(b) states that the Department of Justice or the State Department can, as appropriate, relay information

contained in such reports to authorities in foreign jurisdictions. Except for the aforementioned dissemination, the Secretary of Commerce must keep reports confidential in accordance with 18 U.S.C. § 1905, for one year from date of receipt. This one-year period will help protect business competitive information and lessen possible foreign relations problems. Reports are to be shared, however, upon request and subject to appropriate assurances of confidentiality, with Committees of Congress having appropriate legislative jurisdiction. After the expiration of the one-year period, reports are to be available for public inspection and copying, unless a specific determination is made in writing by the Secretary of State that foreign policy interests dictate against public disclosure, or the Attorney General makes a specific determination in writing that the status of an ongoing investigation or prosecution dictates against public disclosure through other than conventional judicial processes.

Regulations

Section 9(a) grants the Secretary of Commerce broad regulatory authority.

Regulations are to include a requirement that names of recipients of payments be reported. Further, they are to contain a definition of types of payments not required to

be reported because they are regular business payments not inconsistent with the purposes of the Act, or are bona fide payments to a foreign government, such as taxes or fees paid pursuant to law, regulation, decree or other action.

In addition, in accordance with Section 9(a)(1), the Secretary is to set a threshold amount below which payments need not be reported. An exception is made to this threshold concept for multiple payments totaling the threshold amount with respect to a single transaction. The purpose of this threshold will be to exclude so-called "grease" or "facilitating" payments, i.e., small payments made to expedite low level official actions such as customs processing. Reporting of such minor payments could create burdens far outweighing the benefits sought by the Act.

Section 9(b) directs the Secretary, in devising reporting regulations, to consult with other federal agencies to eliminate unnecessary duplication. Agencies are authorized, where appropriate, to combine in a single form, reports required under this bill and any other law.

Conforming Amendment

Section 10 states that the provisions of the Act, other than Section 9(b), shall not apply to certain sales

of defense articles and services pursuant to the Arms Export Control Act. This exemption is based upon the fact that the Arms Export Control Act provides for comprehensive reporting to the State Department and the Congress of information regarding payments with respect to such transactions (Section 604 of P.L. 94-329).

Provisions of Law Not Affected

Section 11 makes clear that the requirements of the bill in no way alter or affect rights and duties arising under laws administered by the Securities and Exchange Commission. Similarly, it states that nothing in the bill is to be construed as affecting or conditioning the authority of the Securities and Exchange Commission. It provides further that the Commission shall have the authority to premise enforcement or investigative actions on information received under Section 8(a) of the bill from the Secretary of Commerce.

Rights and Remedies Preserved

Section 12 states that the bill does not take away any rights and remedies which may exist at law or in equity. Thus, nothing in the bill should be construed to affect rights and remedies of individuals who may bring shareholder derivative suits under state law.

A BILL

To require the disclosure of payments to foreign officials and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Foreign Payments Disclosure Act".

DEFINITIONS

SEC. 2. For purposes of this Act:

(a) "person" means:

(1) an individual who is a citizen of the United States;

(2) an individual who has been lawfully admitted for permanent residence as described in section 101(a)(20) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(20)); or

(3) a legal entity, other than a noncommercial government entity, organized under the laws of the United States or a State or political subdivision thereof;

(b) "anything of value" means any direct or indirect gain or advantage, or anything that might reasonably be regarded by the beneficiary as a direct or indirect gain or advantage, including a direct or indirect gain or advantage to any other individual or entity;

(c) "foreign affiliate" means a legal entity organized under the laws of a foreign country, or political subdivision thereof, at least 50 per cent of which is beneficially owned directly or indirectly by a person or persons subject to the provisions of this Act;

(d) "Secretary", unless otherwise specified, means the Secretary of Commerce;

(e) "foreign public official" means:

(1) an officer or employee, whether elected or appointed, of a foreign government; or

(2) an individual acting for or on behalf of a foreign government;

and includes an individual who has been nominated or appointed to be a foreign public official or who has been officially informed that he will be so nominated or appointed;

(f) "official action" means a decision, opinion, recommendation, judgment, vote, or other conduct involving an exercise of discretion by a foreign public official in the course of his employment;

(g) "State" means a State of the United States, the District of Columbia, Puerto Rico, or any territory or possession of the United States; and

(h) "foreign government" means:

(1) the government of a foreign country, irrespective of recognition by the United States;

(2) a department, agency, or branch of a foreign government;

(3) a corporation or other legal entity established or owned by, and subject to control by, a foreign government;

(4) a political subdivision of a foreign government, or a department, agency, or branch of the political subdivision; or

(5) a public international organization.

REPORTING REQUIREMENTS

SEC. 3. A person shall report to the Secretary, in accordance with regulations promulgated by the Secretary, payments hereafter made on behalf of the person or the person's foreign affiliate to any other individual or entity in connection with: an official action, or sale to or contract with a foreign government, for the commercial benefit of the person or his foreign affiliate.

RECORDKEEPING REQUIREMENTS

SEC. 4. In order to insure that a person who is required to report under section 3 of this Act has sufficient information in his possession to report accurately, the Secretary may promulgate rules and regulations requiring such person to keep such records, in the form and manner prescribed by the Secretary, as he deems necessary to carry out the purposes of this Act. In devising the record keeping requirements, the Secretary shall consult with other federal agencies to eliminate unnecessary duplication in records required by the agencies. The agencies are authorized, where appropriate, to combine in a single form the records required under this Act and under any other Act.

ENFORCEMENT; COMPLIANCE WITH REQUIREMENTS

SEC. 5. To the extent necessary or appropriate to the enforcement of this Act, the Secretary, and officers and employees of the Department of Commerce specifically designated by the Secretary, may make such investigations and obtain such information from, make such inspections of the books, records, and other writings of, and take the sworn testimony of, any individual or entity. In addition, such officers or employees may administer oaths or affirmations, and may by subpoena require any individual or entity to appear and testify or to appear and produce books, records, and other writings, or both, and in the case of contumacy by, or refusal to obey a subpoena issued to, any such individual or entity, the district court of the United States for any district in which such individual or entity is found or resides or transacts business, upon application by the Attorney General, and after notice to any such individual or entity and hearing, shall have jurisdiction to issue an order requiring such individual or entity to appear and give testimony, or to appear and produce books, records, and other writings, or both, and any failure to obey such order of the court may be punished by such court as a contempt thereof.

CIVIL REMEDIES

SEC. 6. (a) Civil Penalties.-- A person who fails to file a report required under section 3 of this Act, or who fails to maintain the records required under section 4, or who files a report under section 3 but negligently omits information required to be reported under section 3 or negligently states false information required to be reported under section 3, shall

be subject to a civil penalty of not more than $100,000.

(b) Injunction.-- Upon evidence satisfactory to the Attorney General that a person is engaged in an act or practice that constitutes a violation of this Act, the Attorney General may bring an action in a district court of the United States to enjoin such an act or practice, and, upon a proper showing, a permanent or temporary injunction or restraining order shall be granted by the court together with such other equitable relief as may be appropriate.

CRIMINAL PENALTIES

SEC. 7. (a) Failure to File.-- A person who knowingly:

(1) fails to file a report required under section 3 of this Act;

(2) fails to maintain records required under section 4 of this Act; or

(3) omits required information from, or falsifies information in, records kept under section 4 of this Act;

shall be fined not more than $10,000 or imprisoned for not more than one year, or both, except that a legal entity shall be fined not more than $100,000.

(b) Knowing Falsification.--A person who files a report required by this Act which he knows or should know contains a false statement, or which he knows or should know omits required information, shall be fined not more than $100,000 and imprisoned not more than three years, except that a legal entity shall be fined not more than $500,000.

DISSEMINATION OF REPORTS

SEC. 8. (a) Dissemination within the United States.-- The Secretary shall, upon receipt of a report, disseminate copies of the report to the Department of Justice, the Department of State, and the Internal Revenue Service. If the person who filed the report is subject to the jurisdiction of the Securities and Exchange Commission, the Secretary shall also transmit a copy of the report to the Securities and Exchange Commission. Until the report is released to the public, it shall be maintained in accordance with section 1905 of title 18, United States Code. The report shall be transmitted, upon request, subject to an appropriate arrangement to assure its confidentiality, to Committees of the Congress having legislative jurisdiction over the subject matter of the report. A report shall be made public one year after receipt in accordance with rules and regulations promulgated by the Secretary, unless the Secretary of State makes a specific determination in writing that foreign policy interests dictate against disclosure, or unless the Attorney General makes a specific determination in writing that the status of an ongoing investigation or prosecution dictates against public disclosure through other than conventional judicial processes.

(b) Dissemination to a Foreign Government. The Attorney General, with the concurrence of the Secretary of State, may furnish any information contained in a report made under this Act to the appropriate law enforcement authorities of the foreign government concerned in accordance with applicable procedures and international agreements. The Secretary of State, with the concurrence of the Attorney General, may provide any such information to the foreign government concerned.

REGULATIONS

SEC. 9(a). Promulgation of Regulations.-- The Secretary shall promulgate such regulations as are necessary to carry out the purposes of this Act. The regulations shall include:

(1) a requirement that the report include the name of every recipient who receives anything of value over a specified amount and the amount received by each such recipient;

(2) a requirement that the report include information concerning multiple payments with respect to a single transaction which total over a specified amount; and

(3) a definition of certain types of payments which are not required to be reported because they are regular business payments not inconsistent with the purposes of this Act, or are bona fide payments to

a foreign government, such as taxes or fees paid pursuant to duly promulgated laws, regulations, decrees, or other legal action.

(b) Consultation with Other Agencies.-- In devising the reporting regulations, the Secretary shall consult with other federal agencies to eliminate unnecessary duplication in reports required by the agencies. The agencies are authorized, where appropriate, to combine in a single form the reports required under this Act and under any other act.

CONFORMING AMENDMENT

SEC. 10. The provisions of this Act, other than section 9(b), shall not apply to payments made in connection with (a) sales of defense articles or defense services under section 22 of the Arms Export Control Act or (b) commercial sales of defense articles or defense services licensed or approved under section 38 of the Arms Export Control Act.

PROVISIONS OF LAW NOT AFFECTED

SEC. 11. (a) Rights and Duties Under Certain Other Laws Unaffected.-- Nothing in this Act shall be construed as affecting the rights or duties arising under the Securities Act of 1933, 15 U.S.C. 77a et seq., the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq., the Public Utilities Holding Company Act of 1935, 15 U.S.C. 79a et seq., the Trust Indenture Act of 1939, 15 U.S.C. 77aaa, the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., and the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 et seq., and any subsequent amendments thereto. Persons subject to this Act shall be required to

make such public disclosure of the matters described in section 3 of this Act as may be otherwise required under the statutes listed above. Nothing in this Act shall preclude persons reporting pursuant to the provisions of this Act from making public disclosure of any payment described in section 3.

(b) Authority of Securities and Exchange Commission.-- Nothing in this Act shall be construed as affecting or conditioning the authority of the Securities and Exchange Commission to enforce the statutes listed in subsection (a) or to investigate violations thereof. The Commission shall have the authority to premise such enforcement or investigation on information received pursuant to section 8(a) of this Act.

RIGHTS AND REMEDIES PRESERVED

SEC. 12. The rights and remedies provided by this title shall be in addition to, and shall not be in derogation of, any and all other rights and remedies that may exist at law or in equity.

A BILL

To require the disclosure of payments to foreign officials and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Foreign Payments Disclosure Act".

DEFINITIONS

SEC. 2. For purposes of this Act:

(a) "person" means:

(1) an individual who is a citizen of the United States;

(2) an individual who has been lawfully admitted for permanent residence as described in section 101(a)(20) of the Immigration and Nationality Act, as amended (8 U.S.C. 1101(a)(20)); or

(3) a legal entity, other than a noncommercial government entity, organized under the laws of the United States or a State or political subdivision thereof;

(b) "anything of value" means any direct or indirect gain or advantage, or anything that might reasonably be regarded by the beneficiary as a direct or indirect gain or advantage, including a direct or indirect gain or advantage to any other individual or entity;

(c) "foreign affiliate" means a legal entity organized under the laws of a foreign country, or political subdivision thereof, at least 50 per cent of which is beneficially owned directly or indirectly by a person or persons subject to the provisions of this Act;

(d) "Secretary", unless otherwise specified, means the Secretary of Commerce;

(e) "foreign public official" means:

(1) an officer or employee, whether elected or appointed, of a foreign government; or

(2) an individual acting for or on behalf of a foreign government;

and includes an individual who has been nominated or appointed to be a foreign public official or who has been officially informed that he will be so nominated or appointed;

(f) "official action" means a decision, opinion, recommendation, judgment, vote, or other conduct involving an exercise of discretion by a foreign public official in the course of his employment;

(g) "State" means a State of the United States, the District of Columbia, Puerto Rico, or any territory or possession of the United States; and

(h) "foreign government" means:

(1) the government of a foreign country, irrespective of recognition by the United States;

(2) a department, agency, or branch of a foreign government;

(3) a corporation or other legal entity established or owned by, and subject to control by, a foreign government;

(4) a political subdivision of a foreign government, or a department, agency, or branch of the political subdivision; or

(5) a public international organization.

REPORTING REQUIREMENTS

SEC. 3. A person shall report to the Secretary, in accordance with regulations promulgated by the Secretary, payments hereafter made on behalf of the person or the person's foreign affiliate to any other individual or entity in connection with: an official action, or sale to or contract with a foreign government, for the commercial benefit of the person or his foreign affiliate.

RECORDKEEPING REQUIREMENTS

SEC. 4. In order to insure that a person who is required to report under section 3 of this Act has sufficient information in his possession to report accurately, the Secretary may promulgate rules and regulations requiring such person to keep such records, in the form and manner prescribed by the Secretary, as he deems necessary to carry out the purposes of this Act. In devising the record keeping requirements, the Secretary shall consult with other federal agencies to eliminate unnecessary duplication in records required by the agencies. The agencies are authorized, where appropriate, to combine in a single form the records required under this Act and under any other Act.

ENFORCEMENT; COMPLIANCE WITH REQUIREMENTS

SEC. 5. To the extent necessary or appropriate to the enforcement of this Act, the Secretary, and officers and employees of the Department of Commerce specifically designated by the Secretary, may make such investigations and obtain such information from, make such inspections of the books, records, and other writings of, and take the sworn testimony of, any individual or entity. In addition, such officers or employees may administer oaths or affirmations, and may by subpoena require any individual or entity to appear and testify or to appear and produce books, records, and other writings, or both, and in the case of contumacy by, or refusal to obey a subpoena issued to, any such individual or entity, the district court of the United States for any district in which such individual or entity is found or resides or transacts business, upon application by the Attorney General, and after notice to any such individual or entity and hearing, shall have jurisdiction to issue an order requiring such individual or entity to appear and give testimony, or to appear and produce books, records, and other writings, or both, and any failure to obey such order of the court may be punished by such court as a contempt thereof.

CIVIL REMEDIES

SEC. 6. (a) Civil Penalties.-- A person who fails to file a report required under section 3 of this Act, or who fails to maintain the records required under section 4, or who files a report under section 3 but negligently omits information required to be reported under section 3 or negligently states false information required to be reported under section 3, shall

be subject to a civil penalty of not more than $100,000.

(b) Injunction.-- Upon evidence satisfactory to the Attorney General that a person is engaged in an act or practice that constitutes a violation of this Act, the Attorney General may bring an action in a district court of the United States to enjoin such an act or practice, and, upon a proper showing, a permanent or temporary injunction or restraining order shall be granted by the court together with such other equitable relief as may be appropriate.

CRIMINAL PENALTIES

SEC. 7. (a) Failure to File.-- A person who knowingly:

(1) fails to file a report required under section 3 of this Act;

(2) fails to maintain records required under section 4 of this Act; or

(3) omits required information from, or falsifies information in, records kept under section 4 of this Act;

shall be fined not more than $10,000 or imprisoned for not more than one year, or both, except that a legal entity shall be fined not more than $100,000.

(b) Knowing Falsification.--A person who files a report required by this Act which he knows or should know contains a false statement, or which he knows or should know omits required information, shall be fined not more than $100,000 and imprisoned not more than three years, except that a legal entity shall be fined not more than $500,000.

82-981 O - 77 - 6

DISSEMINATION OF REPORTS

SEC. 8. (a) Dissemination within the United States.-- The Secretary shall, upon receipt of a report, disseminate copies of the report to the Department of Justice, the Department of State, and the Internal Revenue Service. If the person who filed the report is subject to the jurisdiction of the Securities and Exchange Commission, the Secretary shall also transmit a copy of the report to the Securities and Exchange Commission. Until the report is released to the public, it shall be maintained in accordance with section 1905 of title 18, United States Code. The report shall be transmitted, upon request, subject to an appropriate arrangement to assure its confidentiality, to Committees of the Congress having legislative jurisdiction over the subject matter of the report. A report shall be made public one year after receipt in accordance with rules and regulations promulgated by the Secretary, unless the Secretary of State makes a specific determination in writing that foreign policy interests dictate against disclosure, or unless the Attorney General makes a specific determination in writing that the status of an ongoing investigation or prosecution dictates against public disclosure through other than conventional judicial processes.

(b) Dissemination to a Foreign Government. The Attorney General, with the concurrence of the Secretary of State, may furnish any information contained in a report made under this Act to the appropriate law enforcement authorities of the foreign government concerned in accordance with applicable procedures and international agreements. The Secretary of State, with the concurrence of the Attorney General, may provide any such information to the foreign government concerned.

REGULATIONS

SEC. 9(a). Promulgation of Regulations.-- The Secretary shall promulgate such regulations as are necessary to carry out the purposes of this Act. The regulations shall include:

(1) a requirement that the report include the name of every recipient who receives anything of value over a specified amount and the amount received by each such recipient;

(2) a requirement that the report include information concerning multiple payments with respect to a single transaction which total over a specified amount; and

(3) a definition of certain types of payments which are not required to be reported because they are regular business payments not inconsistent with the purposes of this Act, or are bona fide payments to

a foreign government, such as taxes or fees paid pursuant to duly promulgated laws, regulations, decrees, or other legal action.

(b) Consultation with Other Agencies.-- In devising the reporting regulations, the Secretary shall consult with other federal agencies to eliminate unnecessary duplication in reports required by the agencies. The agencies are authorized, where appropriate, to combine in a single form the reports required under this Act and under any other act.

CONFORMING AMENDMENT

SEC. 10. The provisions of this Act, other than section 9(b), shall not apply to payments made in connection with (a) sales of defense articles or defense services under section 22 of the Arms Export Control Act or (b) commercial sales of defense articles or defense services licensed or approved under section 38 of the Arms Export Control Act.

PROVISIONS OF LAW
NOT AFFECTED

SEC. 11. (a) Rights and Duties Under Certain Other Laws Unaffected.-- Nothing in this Act shall be construed as affecting the rights or duties arising under the Securities Act of 1933, 15 U.S.C. 77a et seq., the Securities Exchange Act of 1934, 15 U.S.C. 78a et seq., the Public Utilities Holding Company Act of 1935, 15 U.S.C. 79a et seq., the Trust Indenture Act of 1939, 15 U.S.C. 77aaa, the Investment Company Act of 1940, 15 U.S.C. 80a-1 et seq., and the Investment Advisers Act of 1940, 15 U.S.C. 80b-1 et seq., and any subsequent amendments thereto. Persons subject to this Act shall be required to

make such public disclosure of the matters described in section 3 of this Act as may be otherwise required under the statutes listed above. Nothing in this Act shall preclude persons reporting pursuant to the provisions of this Act from making public disclosure of any payment described in section 3.

(b) Authority of Securities and Exchange Commission.-- Nothing in this Act shall be construed as affecting or conditioning the authority of the Securities and Exchange Commission to enforce the statutes listed in subsection (a) or to investigate violations thereof. The Commission shall have the authority to premise such enforcement or investigation on information received pursuant to section 8(a) of this Act.

RIGHTS AND REMEDIES PRESERVED

SEC. 12. The rights and remedies provided by this title shall be in addition to, and shall not be in derogation of, any and all other rights and remedies that may exist at law or in equity.

Mr. SMITH. Assistant Secretary Darman would like to make a few brief remarks.

Mr. MURPHY. The jurisdiction of this subcommittee does not have oversight on that particular piece of legislation; the Transportation and Commerce Subcommittee does. And I believe they have been acting legislatively on areas which the Department of Commerce felt was more vital to them. That is why they haven't gotten to it yet. It came up late in August, which did not permit the subcommittee to get it. I think there was a national convention in August that precluded the Congress from meeting for several weeks, and then, of course, we were in the closing session of this Congress.

Perhaps if it had come up sooner, it might have gotten closer scrutiny and attention, but we are going in this subcommittee today to the principle embodied in that legislation.

Mr. SMITH. Mr. Chairman, I would just say, I do not mean to chastise the Congress for being slow in action. We have a difficult problem, though, in that we view our legislation as an alternative to the legislation that is before your committee, and it is hard to discuss the alternative without also keeping in focus our legislation, which I recognize has been assigned to a different subcommittee.

Mr. MURPHY. I think Mr. Parsky is next?

Mr. SMITH. Mr. Darman would like to say a few words.

Mr. MURPHY. Mr. Darman.

STATEMENT OF RICHARD G. DARMAN

Mr. DARMAN. Mr. Chairman, let me elaborate just briefly on one point of Mr. Smith's testimony, if I might.

The basic question, it seems to us, which one must address in considering the foreign payments direct criminalization provision is this: What reason is there to enact a provision of law which an overwhelming majority of responsible legal scholars, law enforcement officials, and serious analysts of this issue, view to be essentially unenforceable. It cannot be said to be for reasons of practicable moral leadership, for this would be potentially hypocritical. The answer must depend upon either a conception of the value of unenforceable law as a force for change, through the power of declaratory policy alone; or it must depend upon a conception of the value of unenforceable law as a stabilizing force, through the periodic purgatorial effects of ritualistic collective expressions of outrage.

With respect to the latter explanation, we take the problem to be too serious to settle for what might be a passing symbolic gesture. As to the former, as my colleague has sugegsted, we believe it to be shortsighted. Whatever leadership value may be associated with essentially unenforceable law is surely to be counterbalanced by the ultimate corrosive effects of its exposure as fundamentally false.

In contrast to the approach which would proceed first by enacting unenforceable law, the approach which we recommend, would, we believe, treat with appropriate seriousness not only the problem of questionable payments, but also the role of law itself as a poistive force in the domestic and international community.

In short, we believe declaratory values to be of great importance, but feel there is an equal obligation to attend to the serious development of a workable and enforecable system of law to give these values responsible meaning and effect.

Thank you, Mr. Chairman.

If I may, I shall pass to Mr. Parsky.

Mr. MURPHY. Mr. Smith, I think the Senate didn't get to your proposal either, did they?

Mr. SMITH. No, they didn't, Mr. Chairman.

Mr. MURPHY. Is there any reason Senator Tower didn't take it up?

Mr. SMITH. I believe that the Senate Banking, Housing, and Urban Affairs Committee had already reported out on June 21, the legislation introduced by Senator Proxmire and the Senate committee, viewing that Senator Proxmire's bill alternative to our disclosure approach, apparently did not feel it was timely or appropriate to reverse course.

Mr. MURPHY. All right. I had the impression that Senator Tower was looking for something with a little more sinew.

Mr. SMITH. I am aware that Senator Tower chose to support the criminalization approach. You and I may differ as to the extent that approach embodies the sinew you mention.

Mr. MURPHY. Mr. Parsky.

STATEMENT OF GERALD L. PARSKY

Mr. PARSKY. Thank you, Mr. Chairman.

I have a somewhat lengthy statement which I would appreciate it if it could be included in the record, and I would like to summarize, if I might.

Mr. MURPHY. Without objection, your entire statement will be printed in the record immediately following your oral summary [see p. 86].

Mr. PARSKY. Mr. Chairman, since the first revelations of illicit payments abroad by American corporations, both the executive branch and the Congress have been actively involved in determining the scope of the problem and exploring possible solutions. As a result, the President has proposed legislation which would supplement the effective work that is already being done in this area by a number of U.S. Government departments and agencies. Although some disagreement remains as to the most effective approach to remedy abuses in this area, I think all parties share a determination to take effective action.

Illicit payments are ethically abhorrent and undermine the functioning of a competitive free enterprise system. When the major criterion in a buyer's choice of a product is the size of a bribe rather than its price and quality and the reputation of its producers, the fundamental principles on which a market economy is based are put in jeopardy. More specifically, the result has to be higher prices and lower quality of goods and services to the consumer. Moreover, illicit payment practices can seriously distort international trade and investment flows and contribute to a general deterioration in the climate for fair and open international trade and investment. Finally, our bilateral relations with other governments often are adversely affected by revelations of illicit activities by American firms in their countries. In short, there is no question that rigorous action is needed to minimize these damaging practices.

In considering the most effective approach to the improper payments problem, we have kept in mind that there is a substantial basis in existing law for effective action by the U.S. Government. Moreover, the history of recent actions by the Securities and Exchange

Commission, the Internal Revenue Service, the State and Defense Departments, and other departments and agencies is evidence that these laws are being vigorously enforced.

The Internal Revenue Service, as part of its longstanding effort to reveal corporate tax fraud, has attempted to uncover improper deductions of illicit payments for tax purposes. In August of last year, the Service issued instructions to its revenue agents which make it mandatory for them to interview selected corporate officers and key employees regarding the use of slush funds and other corporate schemes used to circumvent the tax laws. They also provide for use of the IRS Office of International Operations to examine the books and records of U.S. companies abroad.

Established audit techniques, however, are frequently not sufficient to uncover illegal payments because they are usually handled in "off-books" transactions. Accordingly, these instructions were supplemented earlier this year by new guidelines that require revenue agents to ask 11 specific questions of selected corporate officials and request attestation of the responses by the corporation's accounting firm. Those selected for questioning are present or former officials that might be aware of the possible misuse of funds within their respective corporations.

This latter measure has proven to be an effective audit technique in detecting such "slush fund" issues. As of June 30, 1976, the IRS used the 11-question procedure in almost 2,000 cases, and identified the "slush fund" issue in 126 cases, many of which also were reported to the SEC. The IRS is proceeding to determine the tax impact of these payments to insure that every corporate taxpayer is properly reporting its taxable income and claiming only those deductions permitted by law. In the process, some of the cases will undoubtedly prove not to have been improper from a tax-liability point of view. The IRS is continuing vigorously to pursue this effort.

The Securities and Exchange Commission has also played a particularly active role in this area through its administration of laws that mandate full and fair disclosure of material facts concerning the business operations of companies which are subject to the reporting requirements of the Federal securities law. Chairman Hills has outlined the activities of the Commission in much more detail.

On the basis of the SEC analysis, as well as other information, it appears to us that the vast majority of American business is honest and ethical. The evidence of corporate wrongdoing simply does not indicate that illicit foreign payments is a general practice uniformly followed by U.S. businesses operating abroad.

Although I do not wish to minimize the seriousness of the problem, the situation can be put in the proper light by noting that the approximately 200 firms come from a total of more than 9,000 that regularly file with the Commission. The same point can be made if we look at this figure in relation to the 1,700 U.S. firms with direct investments overseas valued at more than $2 million each that report to the Commerce Department, or the 20,000 or so U.S. firms involved in exporting overseas.

Only a relatively few firms appear to have engaged in making questionable payments abroad. The vast bulk of our firms conduct their businesses ethically and completely in accord with the laws of the

United States. We should not let the activities of a minority of U.S. firms operating abroad cast doubts on the nature or conduct of U.S. business generally.

U.S. Government agencies are taking effective action to deal with this problem domestically, and we believe that the legislative proposals that the administration has made will greatly strengthen our capabilities in this regard. But action by the United States alone is not enough. American firms are not the only ones who have engaged in improper practices in international commerce. Moreover, bribery is a two-way street, and it must be deterred at the receiving or soliciting end as well as at the source.

In March of this year, the United States proposed that a comprehensive international agreement be negotiated to curb corrupt practices in international commerce. Last month the U.N. Economic and Social Council took action to advance our proposal by establishing an intergovernmental working group on the problem.

Mr. Feldman of the State Department, I am sure, will comment on the details of this initiative.

In considering H.R. 15481, Mr. Chairman, I think that most of my reservations are contained in my prepared text. I would just briefly indicate that the principal ones were outlined by Mr. Smith and Mr. Darman. They include the particularly difficult enforceability aspect of the criminalization approach; the extraterritorial application of U.S. laws and the problems that they impose; and the fact that we believe that the criminalization approach solves only one part of the foreign payments problem, in that it fails to provide really for an effective sanction against those who solicit bribes abroad.

In closing, I would add that while we in the Government condemn questionable payments and have been actively searching for solutions to deter them, we remain firm in the belief that the private sector has a basic responsibility to come to grips with this problem themselves. It is a fact, unfortunate but true, that some corporations have engaged in such activities. However, their actions color the views of the public and possibly foreign governments about the vast majority of the members of the American business community who are honest businessmen and would never engage in such acts. Thus, American business at large is denied the reputation it deserves because of the improper activities of a few of its members.

Given this situation, not only is it a moral imperative for the majority of American busienssmen to act to try to combat improper activities by those in their midst, but also it is in their practical interest to do so. One obvious solution is for them to make sure that their own houses are in order, by instructing their employees or their representatives overseas to guard against engaging in improper practices. But this is not enough. We believe that it is incumbent upon all businessmen to speak out for good ethics in business and for the business community as a whole to take effective action to govern itself.

In this respect, the International Chamber of Commerce has provided a good example in establishing its commission on unethical practices, a distinguished panel of leaders in international business, to develop guidelines for promoting ethical and proper conduct in international commercial affairs. We certainly look forward to receiving its findings and recommendations.

Here in this country, the U.S. Chamber of Commerce has issued a forthright statement condemning improper payments and making the case for ethical business practices.

Finally, a number of individual firms have taken action internally to insure that their business affairs are conducted in accordance with sound and ethical precepts and publicly stated their determination to adhere to such standards.

Such action is a clear indication that individual enterprises and business organizations alike recognize that they have an important responsibility. There is a need to take further action that will convince the public both here at home and abroad that American business is honest. The stakes are high and the consequences of inaction are serious. I do not believe that it would be an overstatement to say, in fact, that not only their individual interests but also the vitality of our free enterprise system are at stake.

Thank you, Mr. Chairman.

[Mr. Parsky's prepared statement follows:]

STATEMENT OF HON. GERALD L. PARSKY, ASSISTANT SECRETARY FOR INTERNATIONAL AFFAIRS, DEPARTMENT OF THE TREASURY

Mr. Chairman and Members of the Subcommittee: I appreciate your invitation to present my views on H.R. 15481 which was introduced by the Chairman and is under consideration by the Subcommittee today.

Mr. Chairman, since the first revelations of illicit payments abroad by American corporations, both the Executive Branch and the Congress have been actively involved in determining the scope of the problem and exploring possible solutions to it. As a result, the President has proposed legislation which would supplement the effective work that is already being done in this area by a number of U.S. Government departments and agencies. Although some disagreement remains as to the most effective approach to remedy abuses in this area, all parties share a determination to take effective action.

Illicit payments are ethically abhorrent and undermine the functioning of a competitive free enterprise system. When the major criterion in a buyer's choice of a product is the size of a bribe rather than its price and quality and the reputation of its producers, the fundamental principles on which a market economy is based are put in jeopardy. More specifically, the result has to be higher prices and lower quality of goods and services to the consumer. Moreover, illicit payment practices can seriously distort international trade and investment flows and contribute to a general deterioration in the climate for fair and open international trade and investment. Finally, our bilateral relations with other governments often are adversely affected by revelations of illicit activities by American firms in their countries. In short, there is no question that rigorous action is needed to minimize these damaging practices.

ENFORCEMENT OF EXISTING LAW

In considering the most effective approach to the improper payments problem, we have kept in mind that there is a substantial basis in existing law for effective action by the U.S. Government. Moreover, the history of recent actions by the Securities and Exchange Commission, the Internal Revenue Service, the State and Defense Departments, and other departments and agencies is evidence that these laws are being vigorously enforced.

The Internal Revenue Service, as part of its longstanding effort to reveal corporate tax fraud, has attempted to uncover improper deductions of illicit payments for tax purposes. In August of last year, the Service issued instructions to its revenue agents which make it mandatory for them to interview selected corporate officers and key employees regarding the use of "slush funds" and other corporate schemes used to circumvent the tax laws. They also provide for use of the IRS Office of International Operations to examine the books and records of U.S. companies abroad.

Established audit techniques, however, are frequently not sufficient to uncover illegal payments because they are usually in "off-books" transactions. Accordingly, these instructions were supplemented earlier this year by new guidelnes that require revenue agents to ask 11 specific questions of selected corporate officials and request attestation of the responses by the corporation's accounting firms. Those selected for questioning are present or former officials that might be aware of the possible misuse of funds within their respective corporations. This latter measure has proven to be an effective audit technique in detecting "slush fund" issues. As of June 30, 1976, the IRS used the 11-question procedure in almost 2,000 cases (1,982) and identified the "slush fund" issue in 126 cases, many of which also were reported to the SEC. The IRS is proceeding to determine the tax impact of these payments to insure that every corporate taxpayer is properly reporting its taxable income and claiming only those deductions permitted by law. In the process, some of the cases will undoubtedly prove not to have been improper from a tax liability point of view. The IRS is continuing vigorously to pursue this effort.

Pursuant to the International Security Assistance and Arms Export Control Act of 1976, the State Department, in consultation with the Department of Defense, has developed proposed rules on the subject of agent's fee and political contribution reporting in international arms sales. These rules would require reporting on political contributions and fees or commissions paid, or offered or agreed to be paid, in connection with both governmental or commercial sales of defense articles or services abroad. These regulations are proposed to become effective on October 1, 1976.

The Securities and Exchange Commission has also played a particularly active role in this area through its administration of laws that mandate full and fair disclosure of material facts concerning the business operations of companies which are subject to the reporting requirements of the Federal securities law. You have heard Chairman Hills' report this morning, so I will comment only briefly on SEC activities in this area.

Under these laws, the SEC has taken vigorous action to discover illicit payments and to require public disclosure of material facts relating to them. It has instituted injunctive actions against a number of corporations which have resulted in settlements with the corporate defendants. These defendants have been enjoined from further violating the Federal securities laws and have been required to establish special review committees to conduct full investigations of the irregularities alleged in the Commission's complaint. This has been supplemented by a voluntary disclosure program under which a company which determines that it may have violated existing laws, may discuss the matter with the Commission's staff and commit to subsequent steps to disclose its improper activities and to insure that such practices are not repeated.

In a report it released last May, the Commission provided a detailed analysis of the disclosures U.S. firms had made regarding their questionable or illegal payments, under the voluntary program and as a result of SEC action. Of the 95 companies that had made such disclosures up to that time, 66, or more than two-thirds, were engaged in manufacturing. Broken down by industry, the two largest groups were drug producers and firms involved in petroleum refining and related services, accounting for 12 enterprises each. Thus, judging from the cases exposed so far, the industries that have been making questionable or illegal payments seem to be widely dispersed, so that there is no basis for pointing a finger at any one industry. Since that report, some 90 additional firms disclosed instances of questionable payments, bringing the current total to about 200 firms.

On the basis of the SEC analysis, as well as other information, it appears that the vast majority of American business is honest and ethical. The evidence of corporate wrongdoing simply does not indicate that illicit foreign payments is a general practice uniformly followed by U.S. businesses operating abroad. Although I do not wish to minimize the seriousness of the problem, the situation can be put in the proper light by noting that the approximately 200 firms come from a total of more than 9,000 that regularly file with the Commission. The same point can be made if we look at this figure in relation to the 1,700 U.S. firms with direct investments overseas valued at more than $2 million each that report to the Commerce Department or the 20,000 or so U.S. firms involved in exporting overseas.

Only a relatively few firms appear to have engaged in making questionable payments abroad. The vast bulk of our firms conduct their businesses ethically and completely in accord with the laws of the United States and their host countries. We should not let the activities of a minority of U.S. firms operating abroad cast doubts on the nature and conduct of U.S. business generally.

INTERNATIONAL ACTIONS

In addition to vigorous enforcement of existing domestic laws, the United States is also taking initiatives in international organizations with the objective of obtaining agreement for cooperative action among governments to deal with this problem. In our view, cooperation among governments is essential if we are to make any real progresse in eliminating improper practices from international commerce. U.S. Government agencies are taking effective action to deal with this problem domestically, and we believe that the legislative proposals that the Administration has made will greatly strengthen our capabilities in this regard. But action by the United States alone is not enough. American firms are not the only ones who have engaged in improper practices in international commerce. Moreover, bribery is a two-way street, and it must be deterred at the receiving or soliciting end as well as at the source.

In March of this year, the United States proposed that a comprehensive international agreement be negotiated to curb corrupt practices in international commerce. Our proposal was welcomed by many governments which share our views about the need for effective international action to deal with this problem. Last month the U.N. Economic and Social Council took action to advance our proposal by establishing an intergovernmental working group on the problem. The group is charged with examining the problem of corrupt practices and elaborating in detail "the scope and contents of an international agreement to prevent and eliminate illicit payments. . . . in connection with international commercial transactions." The first meeting of this group is scheduled for early next month, and it is expected to report back to the ECOSOC at its session next summer.

Also, in June the member governments of the Organization for Economic Cooperation and Development approved Guidelines for Multinational Enterprises which included a provision on ethical conduct suggested by the United States.

ADMINISTRATION PROPOSAL

In March 1976, as you know, the President established a Cabinet-level Task Force on Questionable Corporate Payments Abroad to conduct a coordinated review of these activities and to recommend any new actions it might consider necessary. The Task Force—of which Secretary Simon is a member and active participant—first undertook an exploration of the nature and extent of the illicit payments problem as well as a review of the activities of the U.S. Government agencies that were dealing with it. On the basis of that investigation, we thne proceeded to refine and eventually present to the President a number of options for measures to supplement those already underway.

On June 14, 1976, the President announced that he had directed the Task Force to prepare legislation that would require reporting and disclosure of certain payments made in relation to business with foreign governments. The Task Force subsequently drafted legislation, the Foreign Payments Disclosure Act, which the President transmitted to Congress on August 3.

The bill requires reporting to the Department of Commerce of certain classes of payments made by U.S. businesses and their foreign subsidiaries and affiliates in relation to business with foreign governments. It covers a broad range of payments relating to government transactions, as well as political contributions and payments made directly to foreign public officials.

We believe that this measure will contribute in an important way to the restoration of confidence in America's vital business institutions. It represents an effective response to the problem of questionable corporate payments abroad as it will help deter (1) American corporations and their affiliates from making improper payments in international commerce and (2) foreign parties from seeking such payments. Furthermore, it would allow the United States to present an example both to the American people and to foreign countries with regard to our determination to deal effectively with this problem. We anticipate that in doing so it would help to restore the damage that has been done to the good reputation of American business.

The Administration has also announced its support for legislation originally proposed by the Securities and Exchange Commission and since incorporated in Senator Proxmire's bill, S. 3664, and in the legislation before us today, H.R. 15481. Insofar as this legislation would improve the internal reporting and accountability of registered firms, it should strengthen considerably the Commission's capability to deal with the problem of questionable payments by such firms.

COMMENTS ON H.R. 15481

In considering the options for action in this area, the Task Force identified two possible legislative approaches which appeared to offer the greatest potential for enabling us to deal effectively with the questionable payments problem—a reporting/disclosure requirement and criminal sanctions. After carefully considering the advantages and disadvantages of each, we concluded that the reporting/disclosure option represented the most effective approach. Accordingly, the legislation that the Administration has proposed is based on that concept. By contrast, H.R. 15481—the Senate version of which passed last week—would make certain foreign payments criminal under U.S. law.

Rather than comment on this legislation on a section-by-section basis, I believe it to be more useful for me to discuss with you the general reservations we had about the criminalization aproach. In essence, we have the following concerns with this approach:

(1) It would involve substantial extraterritorial application of United States' law which could evoke adverse reactions from foreign governments;

(2) It would be particularly difficult to enforce; and

(3) The criminalization approach solves only part of the foreign payments prob'em in that it fails to provide an effective sanction against those who solicit bribes abroad.

1. *Extraterritorial Application.*—Any attempt to apply a U.S. criminal statute to acts consummated abroad would involve an extraterritorial application of U.S. law. While there are no absolute legal prohibitions on such extraterritorial application, attempts by the United States to apply our anti-trust and export control laws in a similar way have created substantial problems in the past. The application of our law abroad often conflicts with foreign laws or practices and is looked upon as an unwarranted intrusion into the sovereignty of other states. The history of the extraterritorial application of our laws shows all too clearly that foreign nations may react strongly when we attempt to enforce our laws with respect to acts consummated in their territories. It can be expected that similar reactions would be forthcoming in the present instance.

2. *Enforceability.*—In addition, the prosecution of offenses would depend upon our access to information, witnesses, and other evidence which may be beyond the reach of U.S. judicial processes. In a criminal bribery action, the intent of the payor, and possibly the payee, would have to be proved. Proving intent is usually difficult and would be particularly difficult where the payee resides outside of the United States and is not a U.S. citizen. Furthermore, the probable sensitivity of other nations to possible extraterritorial application of U.S. criminal sanctions may reduce their willingness to cooperate in any prosecutions.

3. *Coverage.*—This approach would enable us to solve only half the problem insofar as it involves action solely against those who make questionable payments. As I indicated earlier, we need to get at the receiving or soliciting end of the problem as well. The criminalization approach does not do this.

For these reasons, Mr. Chairman, we believe that the Administration bill, S. 3741, offers a more effective means of dealing with the quetsionable payments problem. It does not involve the potential difficulties that the bill before you today does.

CONCLUSION

In closing, I would add that, while we in the Government condemn questionable payments and have been actively searching for solutions to deter them, we remain firm in the belief that the private sector has a basic responsibility to come to grips with this problem. It is a fact, unfortunate but true, that some corporations have engaged in questionable payments. However, their actions color the views of the public and possibly foreign governments about the vast majority of the members of the American business community who are honest businessmen and would never engage in such acts. Thus, American business at large is denied the good reputation it deserves because of the improper activities of only a few of its members.

Given this situation, not only is it a moral imperative for the majority of American businessmen to act to try to combat improper activities by those in their midst, but also it is in their practical interest to do so. One obvious solution is for them to make sure that their own houses are in order, by instructing their employees or their representatives overseas to guard against engaging in improper practices. But this is not enough. We believe—and Secretary Simon and I have emphasized this repeatedly over the past year—that it is incumbent upon all businessmen to speak out for good ethics in business and for the business community as a whole to take effective action to govern itself.

In this respect, the International Chamber of Commerce has provided a good example in establishing its Commission on Unethical Practices—a distinguished panel of leaders in international business—to develop guidelines for promoting ethical and proper conduct in international commercial affairs. We certainly look forward to receiving its findings and recommendations. Here in this country, the U.S. Chamber of Commerce has issued a forthright statement condemning improper payments and making the case for ethical business practices. Finally, a number of individual firms have taken action internally to insure that their business affairs are conducted in accordance with sound and ethical precepts and publicly stated their determination to adhere to such standards.

Such action is a clear indication that individual enterprises and business organizations alike recognize that they have an important responsibility. There is a need to take further action that will convince the public both here at home and abroad that American business is honest. The stakes are high and the consequences of inaction are serious. I do not believe that it would be an overstatement to say, in fact, that not only their individual interests but also the vitality of our free enterprise system are at stake.

Mr. MURPHY. Mr. Feldman.

STATEMENT OF MARK B. FELDMAN

Mr. FELDMAN. Thank you, Mr. Chairman. I am pleased to be here today to discuss H.R. 15481. In view of all that has been said this morning, I prepared a very brief statement dealing with those matters within the special competence of the Department of State.

The State Department is, of course, deeply concerned about the problem of illicit payments by U.S. companies abroad. We know that illicit payments are ethically wrong and that they unfairly distort trade. We also know that revelations of such payments do great harm to the companies and the countries involved, that they complicate and encumber our relations with other countries, and that they tarnish both the reputation of U.S. businessmen and the image of the private enterprise system in general.

The State Department firmly supports the President's three-pronged assault on this problem, which includes effective enforcement of existing laws and regulations, additional legislation where needed, and an international arrangement, which is necessary to support and complement our domestic efforts.

The question before this committee today is what additional legislation will best deter illicit payments abroad and minimize the damage caused to our foreign relations, our companies and our friends abroad.

We believe that the President's proposed legislation will best serve these purposes. Other administration witnesses have already described the President's proposals this morning as well as those features of H.R. 15481 which the President has endorsed. I need only add that the State Department joins with our sister agencies in support of section 1 of the bill, and we share the concerns that have been mentioned

concerning the other provisions of H.R. 15481, establishing new criminal laws. It is our view that a unilateral criminal law will not effectively deter illicit payments abroad, and that attempts to enforce such leigslation where deterrence fails could further damage rather than improve our foreign relations.

I say this because in any proceeding under such a law, an official of a foreign government will necessarily be accused of accepting a bribe, which is a crime in his country as well. This will complicate any efforts to gather the necessary evidence in an official's country, a process which depends on the good will and cooperation of his government. This is always a delicate matter. In a criminal case in which a public official is directly involved, it will cause friction and resentment and will likely be unsuccessful.

This problem of enforcement points up the need for international agreements to cope with an international problem. The most effective solution would be a multilateral agreement under which governments would cooperate in the enforcement of their laws relating to bribery.

I would like briefly to give you a status report on our efforts to obtain such a treaty in the United Nations. In August, after extensive efforts on our part, the Economic and Social Council of the United Nations adopted a consensus resolution establishing a working group with a broad mandate to study corrupt practices in commercial transactions and to elaborate the scope and contents of a treaty on illicit payments. The Council in effect mandated the working group to develop the substance of a draft treaty, while reserving its formal decision whether to prepare such a treaty. However, the report of the working group is to be submitted in a form that will enable the Council to transmit concrete recommendations to the General Assembly for final action.

Thus we have the opportunity to do the work on a treaty within the working group.

The working group's first meeting is scheduled for October 11, and its report to the Council is due by next summer. We hope that by that time there will be general agreement on the need for and the contents of a treaty which will effectively deter illicit payments. As we have stated, such a treaty should provide for the enactment by governments of uniform disclosure legislation and for cooperation among governments in the enforcement of these disclosure laws and the bribery laws of host governments.

I have given the committee a more detailed report on this initiative.

I should also like to call your attention, Mr. Chairman, to the regulations published by the Department of State in the Federal Register for September 20, yesterday, implementing the new provisions of the Arms Export Control Act which require reporting of certain foreign payments made in connection with the sale of defense articles or services to or for the use of foreign armed forces. The regulations, which amend the State Department international traffic in arms regulations, apply to sales under the foreign military sales program as well as commercial sales for which licensing or approval of exports is required under the ITAR. In accordance with the statute, the regulations require reporting on both political contributions and

fees or commissions which are paid for the solicitation or promotion or to secure the conclusion of a sale of the covered defense articles or services. The regulations establish certain thresholds and fix responsibility for reporting and for recordkeeping. They become effective on December 1, 1976.

In preparing these regulations, the Department of State consulted with the Department of Defense, and we also had the benefit of numerous comments made in response to the Department's notice of rulemaking. We believe that the regulations will be effective in deterring questionable foreign payments in the sensitive military sales sector.

Thank you, Mr. Chairman, I would be happy to answer any questions you may have on the international aspects of this problem.

Mr. MURPHY. Thank you, Mr. Feldman.

Gentlemen, as I understand the administration bill, which I presume all of you support, the company making the corrupt payment would notify the Commerce Department, which may conceal such disclosure from public scrutiny for up to 1 year. The Commerce Department might even bar such disclosure entirely if it finds our national interest would be adversely affected.

Where is the substance of that legislation?

Mr. SMITH. Mr. Chairman, I would be glad to address that.

The reporting requirement to the Secretary of Commerce is not just for corrupt payments, but for all payments, both proper and improper, if they are payments made in relation to business with foreign governments. The Commerce Department would keep the reports confidential for 1 year. The basis for that provision is to allow time to transfer that information, when it does reveal an improper payment, to foreign governments, to allow them to develop investigative leads through the normal criminal process, if appropriate.

Since we are sweeping in proper as well as improper payments, it also allows some degree of lag time to protect business proprietary concerns such as business plans to do business with a certain country, and it also allows discussion in diplomatic channels, between our Government and foreign governments, of the nature of the information disclosed prior to its public disclosure.

The Secretary of Commerce has no discretion to keep the reports confidential beyond 1 year, but the bill does provide that the Secretary of State, if he finds important foreign policy or national security concerns dictate, to ask that the reports be continued to be kept confidential, and likewise the Attorney General may, if there exists an investigation or prosecution, ask that disclosure be delayed so as not to prejudice an ongoing proceeding.

In either case, intervention would have to be justified to appropriate committees of Congress since the reports will be available to Congress, upon request, immediately after receipt at the Department of Commerce. Under these circumstances, I think either the Secretary of State or the Attorney General would exercise his authority to withhold disclosure, with extreme caution, and exercise it only when a compelling case for nondisclosure exists.

Mr. MURPHY. Mr. Parsky.

Mr. PARSKY. Yes, sir.

Mr. MURPHY. Does the IRS have a guideline on an agency fee or a commission that it feels is proper for representation in the——

Mr. PARSKY. Mr. Chairman, I am not aware of any guideline. As I have indicated to you, there are a series of questions that are asked as a part of the normal audit procedure. Individual cases are taken one at a time and the normal audit process would result in the determination as to whether or not a particular practice would be permissible under the law. I am not aware of any general guidelines that are put out other than the normal regulations that are in effect.

Mr. MURPHY. Could you give us the 11 questions that you ask, or are they in your statement?

Mr. PARSKY. They are not in my statement. They are rather lengthy, but I would be delighted to supply them for the record, if you would like.

Mr. MURPHY. Yes; please submit them for the record.

Mr. PARSKY. Yes, sir, I would be glad to.

[Testimony resumes on p. 105.]

[The following information was received for the record:]

IRS' ELEVEN QUESTIONS

The questions that IRS poses to domestic corporations to uncover slush funds and other schemes that circumvent normal accounting procedures are set forth in Manual Supplement 42G–348, "Coroporate Slush Funds," dated May 10, 1976. Section 3 of this Supplement contains eleven specific questions that will be asked in every coordinated examination and in other corporate examinations when warranted by the facts and circumstances and after approval by the group manager. Section 3 also contains guidelines for asking the eleven questions and receiving the responses.

This Supplement was amended on June 25, 1976 but no change was effected in asking the eleven questions of corporate officials and key employees.

I have attached, for your information, a copy of the basic Supplement and the Amendment.

manual supplement

Department of the Treasury Internal Revenue Service

42G-348
40G-119 84G-12
47G-111 8(24)G-123
4(12)G-9 93G-168
82G-81

urgent

May 10, 1976

Corporate Slush Funds

Section 1. Purpose

This Supplement provides guidelines for the use of additional techniques and compliance checks to help identify schemes used by corporations to establish "slush funds" and other schemes which may be used to circumvent the tax laws. The procedures in Section 3 of this Supplement were issued by TWX on April 6, 1976, from Director, Audit Division, to all Regional Commissioners, District Directors and Director of International Operations. Two additional TWX's were issued, one on April 16 and the other on April 27, 1976, amplifying the procedural instructions set forth in the April 6 TWX.

Section 2. Background

Recent investigations of some major corporations by the Service and other enforcement agencies have disclosed intricate corporate schemes, outside normal internal audit controls, designed to generate large amounts of cash for illegal or improper use and to reduce taxable income unlawfully. These schemes to create secret slush funds and to consciously misrepresent corporate taxable income by claiming unallowable deductions or exclusions from income, or otherwise, are of great concern to the Service. The diversity of techniques used is almost unlimited. Slush funds have been used for such illegal purposes as corporate political contributions, bribery, lobbying, kickbacks and diversions to personal use. The very difficult task of discovering slush funds in corporate examinations requires effective planning of in-depth probes and the use of imaginative audit techniques. Frequent characteristics of these schemes are the involvement of top level corporate officers and the creation of slush funds through the use of foreign subsidiaries, foreign bank accounts, foreign affiliates, foreign intermediaries, or unrelated foreign entities. While major use has been made of foreign sources, schemes have been detected that are not connected with the foreign area. All such schemes which circumvent or evade the tax laws must be dealt with effectively by the Service.

Section 3. Affidavits Required in Corporate Examinations

.01 In every coordinated examination, as defined in IRM 42(11)3, selected corporate officials, key employees and the managing partner (i.e., the partner who determines the scope of their audit and the type of opinion to be rendered) of the corporation's accounting firm will be asked, as a minimum, questions 1 thru (11) below. Additional questions should be asked when warranted by the facts and circumstances in a particular case; however, consideration should be given to obtaining the assistance of Regional Counsel in developing such questions. This procedure may be used in noncoordinated examinations where the facts and circumstances warrant and after approval by the group manager/case manager. The individuals selected for questioning should be those present or former employees or directors who would be likely to have or have had sufficient authority, control or knowledge of corporate activities to be aware of the possible misuse of corporate funds. This would include, for example, chief executive officer, chief financial officer, officer in charge of international operations, officer in charge of governmental activities, directors who are not corporate officers but who serve on audit committees or have

Section 3. cont.

similar responsibilities, and others as appropriate. It should be clearly understood by the individual selected for questioning that the term "corporation" includes the taxpayer under examination, all affiliates and related entities as defined in IRC 482, domestic and foreign. The individuals being questioned should be advised as to the years to which the questions relate. As a minimum the questions will cover all tax years assigned to Audit whether under examination, in Review or in Conference and will include all subsequent years for which returns have been filed. If warranted by facts and circumstances the questions will also cover any year open under the statute of limitations, including any nondocketed year in Appellate. However, in consultation with Regional Counsel, the District Director and Chief, Appellate Branch Office, should mutually decide upon and agree to the extension of this procedure to nondocketed years in Appellate. The decision of District Director and Chief, Appellate Branch Office, should be confirmed in a memorandum of understanding. (See Section 9 for Appellate Division Responsibilities.) If the taxpayer objects to the extension of the questions to open years not yet under examination, the District Director will determine whether he/she will immediately place such years under examination or wait to obtain answers when those returns would normally be examined. The approval of Regional Counsel is required if these questions are to be asked with respect to years under the jurisdiction of any court.

1 During the period from _____ to _____, did the corporation, any corporate officer or employee or any third party acting on behalf of the corporation, make, directly or indirectly, any bribes, kickbacks or other payments, regardless of form, whether in money, property, or services, to any employee, person, company or organization, or any representative of any person, company or organization, to obtain favorable treatment in securing business or to otherwise obtain special concessions, or to pay for favorable treatment for business secured or for special concessions already obtained?

2 During the period from _____ to _____, did the corporation, any corporate officer or employee or any third party acting on behalf of the corporation, make any bribes, kickbacks, or other payments, regardless of form, whether in money, property or services, directly or indirectly, to or for the benefit of any government official or employee, domestic or foreign, whether on the national level or a lower level such as state, county or local (in the case of a foreign government also including any level inferior to the national level) and including regulatory agencies or governmentally-controlled businesses, corporations, companies or societies, for the purpose of affecting his/her action or the action of the government he/she represents to obtain favorable treatment in securing business or to obtain special concessions, or to pay for business secured or special concessions obtained in the past?

3 During the period from _____ to _____, were corporate funds donated, loaned or made available, directly or indirectly, to or for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

Section 3. cont.

4 During the period from_____to_____, was corporate property of any kind donated, loaned, or made available, directly or indirectly, to or for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

5 During the period from_____to_____, was any corporate officer or employee compensated, directly or indirectly, by the corporation, for time spent or expenses incurred in performing services for the benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

6 During the period from_____to_____, did the corporation make any loans, donations or other disbursements, directly or indirectly, to corporate officers or employees or others for the purpose of making contributions, directly or indirectly, for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

7 During the period from_____to_____, did the corporation make any loans, donations or other disbursements, directly or indirectly, to corporate officers or employees or others for the purpose of reimbursing such corporate officers, employees or others for contributions made, directly or indirectly, for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

8 During the period from_____to_____, did any corporate officer or employee or any third party acting on behalf of the domestic corporation have signatory or other authority or control over disbursements from foreign bank accounts?

9 During the period from_____to_____, did the corporation maintain a bank account or any other account of any kind, either domestic or foreign, which account was not reflected on the corporate books, records, balance sheets, or financial statements?

(10) During the period from_____to_____, did the corporation or any other person or entity acting on behalf of the corporation maintain a domestic or foreign numbered account or an account in a name other than the name of the corporation?

(11) Which other present or former corporate officers, directors, employees, or other persons acting on behalf of the corporation may have knowledge concerning any of the above areas?

Section 3. cont.

.02 The case manager or group manager will determine whether these questions are presented during an interview or mailed in letter form. If not personally delivered, then certified mail will be used for all communications under this section between the Internal Revenue Service and taxpayer or third parties. A reasonable amount of time should be allowed to the respondent to reply. Where a reply is not received after delivery or mailing by the Internal Revenue Service within 20 workdays, prompt followup by personal contact will be made.

.03 The responses to these questions will be reduced to writing and signed by the respondent in either affidavit form or under the written declaration that it is made under the penalties of perjury, the contents of which the respondent believes to be true and correct as to every material matter. If the individual refuses to sign the affidavit or written declaration but confirms the statement by oath or affirmation in the presence of two Internal Revenue employees, a legend will be inserted at the end of the statement as follows:

"This statement was read by _____ (the Subject) on _____ 19__, who stated under oath that it was true and correct but refused to sign it.

"

_____ Witness

_____ Witness

If any individual refuses to answer any of the examiner's questions or refuses to confirm a written statement by oath or affirmation, a summons should be issued to that individual in accordance with IRM 4022 and testimony obtained under oath pursuant to IRC 7602.

.04 When any of these questions is answered in the affirmative, all details surrounding the transaction should be secured. Responses to all questions will be reviewed along with all other available information. If further clarification is required, follow-up interviews will be conducted.

.05 False statements provided to the Internal Revenue Service concerning any matter arising under the Internal Revenue Laws can subject the individual, or others, to criminal penalties under Titles 18 and 26 of the United States Code. Therefore, whenever there is any indication that the answers contained in an affidavit or statement are false, the matter will be immediately referred to the Intelligence Division for appropriate criminal action.

.06 The individuals questioned will be expected to answer fully and truthfully, to the best of their knowledge and belief, and to the best of their recollection. However, individuals obviously cannot be required to state details of matters as to which they had no knowledge.

Section 4. Audit Plan and Compliance Checks

.01 During the preplanning and the examination of all returns, case mangers and examiners will be alert to situations which lend themselves to the creation of slush funds and illegal payments. When deemed appropriate and necessary, the audit plans will include some or all of the following compliance checks. For any compliance check not included in the audit plan, the reason will be explained in the examiners' workpapers.

Section 4. cont.

1 Interview other corporate officers and key employees not included in Section 3.01 (i.e., those who have been dismissed or changed jobs, corporate airplane pilots, security officers, etc.). Where appropriate, the use of summonses and affidavits will be considered.

2 Examine internal audit reports and related workpapers to determine if any reference is made to the creation of any secret or hidden corporate fund.

3 Review taxpayer's copy of reports filed with other governmental regulatory agencies.

4 Determine the number and nature of foreign trips by top executives in the company. Examiners should be especially alert for itinerary stops in countries with protective banking and secrecy laws.

5 Trace significant corporate contractual arrangements with foreign individuals and entities.

6 Extend the examination to controlled foreign subsidiaries where the operations and activities of those corporations lend themselves to the creation and use of slush funds. (Be especially alert for shell corporations established in tax havens or countries with protective banking and secrecy laws.) For assistance in resolving legal and practical problems that will arise regarding the accessibility of records, refer to Sections 6 and 7 below.

7 Determine the manner in which funds are repatriated from subsidiaries, affiliates and/or associates.

8 Examine foreign cables to identify diversion of funds transactions.

9 Trace the use of foreign establishments to furnish services or products which are competitively available here.

(10) Trace foreign pricing arrangements and excessive charges by foreign entities.

(11) Scrutinize unusual transactions with foreign individuals or entities.

.02 Items 4 through (11) are generally covered in Chapter 600 of IRM 4(12)10, Tax Audit Guidelines - Individuals, Partnerships, Estates and Trusts, and Corporations. They are repeated here to extend their use within the context of this Supplement.

.03 In the preplanning stages where it is deemed advisable to make an on-site examination in a foreign country, assistance from the Office of International Operations (OIO) should be secured at the very earliest stage. In these instances, OIO should be contacted during preparation of the Audit Work Plan. The provisions of Section 6, Request for Office of International Operations Assistance, will be followed.

.04 Where individuals' returns are associated with the examination of a corporation pursuant to Manual Supplement 48G-208 (Rev.3), CR 81G-17(Rev. 3), and 91G-29 (Rev. 3), dated August 8, 1975, or for any other reason, the audit plan will include procedures necessary to determine if the individual acted either as a conduit for corporate transactions or held secret corporate funds.

Section 4. cont.

.05 Case managers and group managers will be responsible for planning sufficient time to carry out the aforementioned compliance checks. Case managers will indicate in Item 29 of Form 4451 (Large Case Status Report, Report Symbol No-CP:A-164) staff-days spent during the quarter and cumulative figures in complying with the provisions of this Manual Supplement. Significant information such as date of fraud referrals, issue involved, and date of acceptance or rejection by Intelligence Division should also be included.

.06 All Audit Division managers should ensure that employees under their supervision are familiar with Chapter (12)00, In-Depth Probes, of IRM 42(11)8, Handbook for Field Audit Case Mangers, and IRM 4235, Techniques Handbook for In-Depth Audit Investigations, where appropriate. Also, audit managers will ensure that their employees are familiar with various evasion and slush fund schemes found in Intelligence Digests (Document No. 5590), and Manual Supplement 42G-319, CR 43G-14, dated December 31, 1974.

.07 Case Managers and examiners should check with the Intelligence Division for any information they might have about the corporation, its affiliates or related entities and the individuals selected for questioning.

.08 Upon finding indication of fraud during the examination, the examiner will refer the matter to the Intelligence Division in accordance with IRM 4565 or 42(11)9, as appropriate.

Section 5. Information From Other Government Agencies

.01 During the preplanning and examination of corporate cases, case managers, group managers, and examiners should consider IRM 4083, Information Requested From Government Agencies, and IRM 4084, Information Furnished by Government Agencies.

.02 The National Office has established special liaison with the Securities and Exchange Commission to obtain information relating to slush funds, bribes, political contributions, and other tax-related information.

Section 6. Request for Office of International Operations Assistance

.01 To properly examine taxpayers with foreign slush fund issues and other schemes in the foreign area, it is necessary to obtain first-hand knowledge and independently verify information concerning related foreign entities or foreign branches of domestic entities. In most instances, information may be obtained from United States sources more quickly than from foreign sources. However, if it is determined that an on-site examination should be made in a foreign country, a request for support should be made to OIO. This request should be made following the coordinated examination support request provisions of IRM 42(11)5:(4)(f). Collateral request provisions of IRM 4597 will be followed in noncoordinated examination cases. OIO will work with the requesting district in developing the audit plan for an on-site examination and assist in planning other details of the on-site audit.

Section 6. cont.

.02 Once the details of the on-site examination have been finalized, formal request for approval of the on-site examination and foreign travel authorization will be made in accordance with IRM 42(10)(10) and Section 420 of IRM 1763, Travel Handbook.

Section 7. Use of Summons

.01 Every effort should be made to secure taxpayer's records, responses to questions and other pertinent financial data without the issuance of a summons. However, in certain instances it may be necessary to issue a summons. Under such circumstances, IRM 4022 will be followed in considering the need to issue such a summons.

.02 Before issuing a summons where the records are outside the United States, a copy of the proposed summons will be submitted to the appropriate Regional Counsel for review. Regional Counsel will coordinate their review with Chief Counsel, CC:GL:I, which in turn will coordinate the matter with the appropriate National Office Division. The proposed summons will be accompanied by a statement describing the circumstances and efforts that have been made to secure the records and data from the taxpayer and why the taxpayer will not make the requested records available. In no event will the examiner issue the summons until advice has been received from the Regional Counsel.

Section 8. Information Concerning Possible Nontax Violations of Federal, State, or Local Laws

The purpose of these procedures is to obtain information that may relate to violations of Federal tax laws. However, if the Service receives information indicating violations of Federal laws which are not administered by the Service, or of violations of State or local laws, the case manager will set forth in a memorandum the pertinent facts concerning the suspected violation. Such memorandum, together with any documentation, will be promptly forwarded through the Chief, Audit Division, to the Chief, Intelligence Division for appropriate referral. (See IRM 4097.) However, see MS 12G-134, dated January 15, 1976, for exceptions.

Section 9. Appellate Division Responsibilities

.01 The Chief of each Appellate Branch Office will contact the District Director, in consultation with Regional Counsel, to decide on a case-by-case basis for every coordinated examination case in Appellate inventory whether the 11 questions in Section 3 above will be asked. The decision of the District Director and Chief, Appellate Branch Office, should be confirmed in a memorandum of understanding.

.02 In a nondocketed case, where the taxpayer or his representative offers to make payment of additional tax liability for slush funds deductions or reveals their existence to Appellate officials for the first time, Appellate consideration of the case will be discontinued. The case will be returned to the Audit Division for verification of appropriate facts and possible referral to Intelligence. Under similar circumstances in a docketed case, Regional Counsel should be immediately consulted.

Section 10. Intelligence Division Responsibilities

.01 All Referral Reports will be handled in accordance with IRM 9322.2 or 9322.3, as appropriate.

.02 Intelligence Division personnel will be made available, as needed, to advise and assist Audit in training their personnel in interviewing procedures and techniques.

.03 Information concerning possible violations of any local, state or Federal statute will be processed in accordance with IRM 9382.4 or Manual Supplement 12G-134, dated January 15, 1976, as appropriate.

Section 11. Application

.01 The compliance checks listed in Section 4 will be applied to all cases not processed to Review as of March 4, 1976. The applicability of these compliance checks to cases pending in Review as of March 4, 1976 is as follows:

1 If the compliance checks listed in Section 4 were not applied to the examined returns of a corporation with foreign subsidiaries or other foreign interests, the case should be returned to the examiner for such application.

2 If the compliance checks listed in Section 4 were not applied to the examined returns of a corporation without foreign subsidiaries or other foreign interests, the Chief, Review Staff, or Chief, Technical Branch, in some districts, will make a judgment as to the slush fund potential and either return the case to the examiner or release the case. In either instance, a statement of his/her decision and the basis for it will be included in the case file.

Section 12. Effect on Other Documents

.01 Manual Supplement 42G-329, CR 40G-111, 47G-107 and 4(12)G-8, dated August 29, 1975, and Amend. 1, dated April 6, 1976, are superseded. Annotations referring to that Supplement at IRM 4022, 4083, 4084, 4241.1, 4241.4, 42(11)6, 4724.1 and Chapters 500 and 600 of IRM 4(12)10, Tax Audit Guidelines--Individuals, Partnerships, Estates and Trusts, and Corporations, should be removed.

.02 This supplements IRM 4022, 4083, 4084, 4241.1, 4241.4, 42(11)6, 4724.1, 8223, 8430, 9360 and 9382.4. This also supplements Chapters 500 and 600 of IRM 4(12)10, Tax Audit Guidelines--Individuals, Partnerships, Estates and Trusts, and Corporations; and 681 and 682 of IRM 8(24)40, Appellate Division Supervisors' Guide. This "effect" should be annotated by pen-and-ink beside the basic text and Handbook text cited, with a reference to this Supplement.

S. B. Wolfe
Assistant Commissioner
(Compliance)

manual supplement

Department of the Treasury Internal Revenue Service

42G-348, Amend. 1
40G-119, Amend. 1
47G-111, Amend. 1
4(12)G-9, Amend. 1
82G-81, Amend. 1
84G-12, Amend. 1
8(24)G-123, Amend. 1
93G-168, Amend. 1

urgent

June 25, 1976

Corporate Slush Funds

Section 1. Purpose

Manual Supplement 42G-348* requires that the managing partner (i.e., the partner who determines the scope of their audit and the type of opinion to be rendered) of the corporation's accounting firm be asked the eleven questions contained in Section 3 and his/her answers be submitted in affidavit form. This amendment modifies this requirement. Instead, the managing partner will be required to attest to the affidavits submitted by selected corporate officials and key employees.

Section 2. Changes to Basic Supplement

.01 The introductory paragraph preceding the eleven questions in Section 3.01 is changed to read as follows:

"In every coordinated examination, as defined in IRM 42(11)3, selected corporate officials, key employees and other individuals described below will be asked questions 1 thru (11) below. Additional questions may be asked when warranted by any response to any question or by the facts and circumstances in a particular case; however, consideration should be given to obtaining the assistance of Regional Counsel in developing such questions. This procedure may be used in noncoordinated examinations where the facts and circumstances warrant but only after approval by the group manager/ case manager. The individuals selected for questioning should be those present or former employees or directors who would be likely to have or have had sufficient authority, control or knowledge of corporate activities to be aware of the possible misuse of corporate funds. This would include, for example, chief executive officer, chief financial officer, officer in charge of international operations, officer in charge of governmental activities, directors who are not corporate officers but who serve on audit committees or have similar responsibilities, and others as appropriate. It should be clearly understood by the individual selected for questioning that the term "corporation" includes the taxpayer under examination, all affiliates and related entities within the meaning of IRC 482, domestic and foreign. The individual being questioned should be advised as to the years to which the questions relate. As a minimum, the questions will cover all tax years assigned to Audit whether under examination, in Review or in Conference and will include all subsequent years for which returns have been filed. If warranted by facts and circumstances, the questions will also cover any year open under the statute of limitations, including any nondocketed years in Appellate. However, in consultation with Regional Counsel, the District Director and Chief, Appellate Branch Office, should mutually decide upon and agree to the extension of this procedure to nondocketed years in Appellate. The decision of District Director and Chief, Appellate Branch Office, should be confirmed in a memorandum of understanding. (See Section 9 for Appellate Division Responsibilities.) If the taxpayer objects to the extension of the questions to open years not yet under examination, the District Director will determine whether he/she will immediately place such years under examination or wait to obtain answers when those returns would normally be examined. The approval of Regional Counsel is required if these questions are to be asked with respect to years under the jurisdiction of any court."

CR's 40G-119, 47G-111, 4(12)G-9, 82G-81, 84G-12, 8(24)G-123, and 93G-168, dated May 10, 1976

Section 2. -- cont.

.02 New Section 3.07 should be added, as follows:

"3.07 The managing partner (i.e., the partner who determines the scope of the audit and the type of opinion to be rendered) of the corporation's accounting firm will be asked to attest in writing with regard to responses submitted by persons described in Section 3.01 to the Internal Revenue Service to the questions in such subsection as provided in Attachment 1. If the statement in the second paragraph of Attachment 1 does not describe the audit, the managing partner may substitute his/her description of that audit. If the managing partner is unable to sign a statement as reflected in Attachment 1, because he/she wants to amplify, modify, expand on, or contradict any or all of the responses shown him/her to the questions posed pursuant to this Supplement, he/she may do so in writing or in an interview, provided the conditions of Section 3.03 above are satisfied. If the managing partner refuses to attest in writing to such responses or otherwise fails to comply with the provisions of this subsection, he/she must be required to answer the questions in Section 3.01 personally in accordance with the provisions of this Section. Nothing contained in this Section will preclude the Service from pursuing applicable investigatory procedures when warranted by the facts and circumstances."

Section 3. Effect on Other Documents

This amends and supplements Section 3 of Manual Supplement 42G-348, CR 40G-119, 47G-111, 4(12)G-9, 82G-81, 84G-12, 8(24)G-123, 93G-168, dated May 10, 1976. This "effect" should be noted by pen-and-ink on that supplement with a reference to this Amendment.

S. B. Wolfe
Assistant Commissioner
(Compliance)

Attachment 1 to MS 42G-348, Amend. 1; CR 40G-119, Amend. 1; 47G-111, Amend. 1; 4(12)G-9, Amend. 1; 82G-81, Amend. 1; 84G-12, Amend. 1; 8(24)G-123, Amend. 1; 93G-168, Amend. 1

Addressee: Insert Name and Address of District Director

I am a partner in the firm of _____ and have been the partner in charge of the audit of _____ for the years _____. Messrs. _____ and _____ of _____ have provided me with copies of statements or affidavits dated _____, which they have submitted to the Internal Revenue Service in response to questions, pursuant to Manual Supplement 42G-348, which were posed to them.

Under my direction, the above audit for those years was conducted in accordance with generally accepted auditing standards for the purpose of expressing an opinion as to the fair presentation of the financial position of _____, and the results of its operations for such years, in conformity with generally accepted accounting principles.

I have carefully reviewed these questions and the answers of the above individuals. I hereby state that to the best of my knowledge and belief and to the best of my recollection, the submissions made to the Internal Revenue Service by Messrs. _____, _____, _____, and _____ are complete and accurate, and that I have no knowledge or recollection of any facts and circumstances which would cause me to believe that any statement or representation in such submission should be modified, amended or amplified to reflect my knowledge or recollection of the facts and circumstances.

In accordance with Section 7206(1), IRC, under penalties of perjury, I declare that to the best of my knowledge and belief my statement is true, correct and complete.

_____

Signature and Title Date

M-6418 (6-76)

Mr. MURPHY. Does the IRS authorize a 20-percent agent payment?

Mr. PARSKY. Mr. Wedick, would you like to comment on that?

I have with me is John Wedick, who is the Director of the Audit Division of the IRS, and I would appreciate it if he could respond.

Mr. MURPHY. He may respond.

Mr. WEDICK. The determination of what is a reasonable commission rate depends on the facts and circumstances in each particular case.

Mr. MURPHY. What range has the commission approved?

Mr. WEDICK. Pardon me?

Mr. MURPHY. What range?

Mr. WEDICK. The IRS does not have a table of commission rates which we accept for tax purposes.

Mr. MURPHY. Well, of the ones that have audited, you have probably heard of some 3 percenters. How high up do you go?

Mr. WEDICK. Offhand, I really don't know. Here again, it goes back to the facts and circumstances in a particular case.

Mr. MURPHY. Well, I understand that.

But after you have considered these thousands of cases, you must have established a range. Do you have a normal bell curve that goes from 3 to 30 percent?

Mr. WEDICK. No, it depends on the practice of the particular business. In certain businesses the commissions will be very low, and other businesses the commissions would be very high.

Mr. MURPHY. Give me some instances.

Mr. WEDICK. Well, I think, for example, in the food business, the commissions would be relatively low, whereas in certain other areas they would be much higher.

Mr. MURPHY. In my dealings with the IRS on a personal basis, I got the distinct impression that mathematics was an exact science, 3 percent, 5 percent. What is the general average in the food business?

Mr. WEDICK. Offhand, I don't know.

Mr. MURPHY. Do you have any idea, in any individual cases, as to what the commissions authorized by the IRS are?

Mr. WEDICK. No. These cases don't flow to us at the national level.

Mr. PARSKY. Mr. Chairman, I think it would be useful if I got from the Commissioner as detailed a breakdown for you as we could on what has been audited, and I will be glad to get that for you.

Mr. MURPHY. You can understand the relevance of that question.

[The following information was received for the record:]

IRS POLICY REGARDING COMMISSION RATES

No quantified range of commission rates are authorized in IRS examination programs.

The program guidelines or accepted Audit practice allow only those commission rates which are ordinary and necessary in the course of a trade or business as determined on a case by case basis (Section 162, IRC). Commission expense, determined as being at rates in excess of this requirement, would be denied as a deduction to the taxpayers to the extent in excess, as a violation of Section 162.

On a case by case basis, commission rates between affiliated companies are required to be at levels which unrelated parties would deem ordinary and necessary under similar facts and circumstances, or can be altered to those levels by the Commissioner under Section 482 to clearly ". . . reflect the income of any such organizations, trades, or businsses." Again, these rates will vary widely based on the industry or activities involved, and the particular facts and circumstances.

For example, in the case of one taxpayer in the oil industry, three different

commission rates were deemed to be appropriate according to arm's length standards.

Crude oil: approximately 1 cent per barrel brokers fee in 1967–1980.

Refined oil products: 1 to 2 percent in the same period, but in subsequent years, as low as ¼ percent to ½ percent on large volumes and as high as 3 to 15 percent with more than mere brokerage services performed.

Tanker chartering: 1¼ to 2½ percent in the same 1967–1970 period.

The taxpayer's affiliated companies in these instances had charged cost.

IRS regulations under Section 82 provided for imputing the brokerage fee on crude oil transfers. But, IRS regulations prohibited the imputation of commission fees for tanker chartering in this instance since the taxpayer was deemed not to be in the trade or business.

In another case involving certain oil field equipment, the taxpayer provided a Canadian affiliate a 10 percent commission on list. With the interjection of a Western Hemisphere Trade Corporation (WHTC) between the parent and the Canadian affiliate, an additional 10 percent was given the WHTC with the Canadian retaining its 10 percent discount.

It was found that 12 to 14 percent was the arm's length standard in Canada in the 1960–64 period and the combined 20 percent WHTC-Canadian affiliate discount was reduced to that amount. In South America, the arm's length standard was 10 percent but it was found that the affiliate also provided significant additional services, including maintenance and spare part warehousing, which justified an additional 10 percent. Competitive factors in this industry have changed these arm's length rates significantly.

Finally, we have the example of another industry with the domestic parent handling marketing promotion for an affiliated company (IRC 931) for a 25 percent commission, including cost reimbursement. The parent was deemed by the IRS to be receiving an inadequate fee and the remuneration was increased to a rate equivalent to over 45 percent, including cost reimbursement. This increase was based on the joint venture relationship which would have been developed between independents.

Mr. MURPHY. When you have asked your 11 questions and certain practices that you feel are not proper are uncovered, what do you do with them? Do you refer them to the SEC or other enforcement agencies?

Mr. PARSKY. No. There is an enforcement process within the Internal Revenue Service that could result in prosecution if there was an intentional fraud created. The enforcement capability is there, and if there is a criminal violation, then it could be referred to the Justice Department.

Mr. MURPHY. Mr. Parsky, on pages 12 and 13, you indicated that H.R. 15481 only solves part of the problem since it fails to provide effective sanctions against those who solicit bribes abroad.

What do you feel would be effective in dealing with that element of the problem?

Mr. PARSKY. I feel that is where our work internationally is particularly relevant. It has seemed to us from the beginning, in considering this problem, that unless we secure an international agreement in which countries that were on the receiving end, if you will, of such payments, participated, we wouldn't be able to solve the complete problem. We would solve only one aspect of it.

Also, such an agreement would involve other countries that are making such payments. So it is the international approach to this problem that I think would be the most effective way to address that deficiency. And I think that our approach in terms of acting unilaterally has to be done in coordination with what we are trying to do internationally.

Mr. MURPHY. Mr. Darman?

Mr. DARMAN. I agree with that, Mr. Chairman, as I am sure the other members of the panel do. I would just like to note in this context, as Mr. Smith did in his prepared statement, the contribution which the disclosure approach could make in encouraging foreign governments to enforce their own laws. And I would note further that a survey of foreign law done for the task force suggests that an overwhelming majority—I believe it was all but 5 of 141 countries surveyed—have statutes which, if enforced, would apply in this area. The goal must be to get foreign governments to enforce their own laws as well as to deal with those elements of the problem which U.S. law alone might reach.

We do not pretentd that our proposed disclosure legislation would be wholly adequate to get at the foreign elements of the problem. We simply suggest that it would be a contribution to that end. Ultimately what we feel we need, as Mr. Parsky suggested, is an international treaty so that we can get at both the foreign and the domestic elements of the questionable transactions.

If I might make one further comment, I think this discussion points to the fundamental failing of the direct criminalization approach. For it is reasonable to assume that companies which would wish to continue illicit practices could satisfy the tightened U.S. law by accounting properly for transactions from a tax and auditing standpoint and by insulating themselves from the actions of intermediaries beyond the reach of the law. That is we could end up in a situation in which illicit payments are simply moved, as necessary, down the chain—a situation in which foreign-based intermediaries are in all cases guilty of the offense. And unless one has some way to reach the other end of the chain, we don't see how the problem can, as a practical matter, be solved.

Mr. MURPHY. Mr. Feldman, would enactment of H.R. 15481 place U.S. firms at a competitive disadvantage with foreign firms?

Mr. FELDMAN. Mr. Chairman, I think that few U.S. firms would assert a right to conduct their business on the basis of the specific behavior prohibited by this bill. On the other hand, a number of U.S. firms have expressed their concern that uneven action in the international communities, that is to say, more vigorous action by the U.S. Government across the range of problems associated with the topic of questionable payments, would place them in a position of competitive disadvantage aboard. However, I would have to say we have not seen evidence that would lead me to conclude that the particular provisions of this bill would place U.S. firms in a position of competitive disadvantage.

Mr. MURPHY. Would not?

Mr. FELDMAN. I have not seen evidence of it. There is concern about that aspect of the problem, but I have not seen any evidence that the particular narrowly drawn criminal provisions of this bill would place firms in a position of competitive disadvantage.

The problem that we see with this legislation, in addition to the concern which has been mentioned by several witnesses in respect to its lack of enforceability, is the impact on U.S. relations with a particular foreign country where the instrumentalities for disclosure of alleged wrongdoings by officials of that country are U.S. institutions

and processes. We believe that it would make much greater sense and it would be more effective in dealing with the problem to seek an agreement in the international community as to the proper role of home and host governments in copying with the illicit payments problem.

We believe that the main responsibility for enacting and enforcing criminal laws rests with the State whose officials are involved, and we believe that there is an important role for cooperation in law enforcement on the part of the home countries of companies, or of exporting countries such as the United States. The United States has perferred that role in recent months by providing documents and evidence to foreign governments which have been conducting their own inevstigations. We think that is the way to go. We are encouraged by the developments in the Untied Nations Economic and Social Council. I believe we have a good shot at getting that kind of agreement in the near future.

Mr. MURPHY. This whole area is very sensitive as far as foreign governments are concerned, particularly democracies. I had a call from the U.S. Ambassador to one of the 11 or 12 remaining democracies, just before the elections in that country. An American airplane manufacturer had sold some aircraft to that country through its own agent that it had in that country for over 20 years, and allegations were being made that it was an improper sale. He asked me for the details of the sale, which I was able to get for him, including the normal commission that was paid to that agent, and that had been paid over the years. They were nonmilitary aircraft, but had I not had that information, that government, because it had a free press, could have been in jeopardy over the sale of that type of aircraft. And that is how sensitive it gets in some countries.

In other countries, I don't think it would be so sensitive.

Mr. DARMAN. Mr. Chairman.

Mr. MURPHY. Mr. Darman.

Mr. DARMAN. I wonder if I could add something to the prior question on the competitive disadvantage point. To the extent that we are correct in arguing that the direct criminalization approach is unenforceable, as a matter of logic the argument should suggest that there would not be a significant competitive disadvantage associated with that approach because one presumes there would be essentially no effect other than the rhetorical effect.

I would note further that the question of possible competitive disadvantage was initially a serious concern of the task force. But we, in the course of our analysis, and the SEC similarly, in the course of its investigations, were unable to develop evidence which suggested that there would be a serious competitive disadvantage to any of the approaches which are now being discussed.

This is for two reasons: Unenforceability in the case of the direct criminalization approach and, in general, the fact that there has been a significant deterrent effect already from the enforcement of existing law. The incremental contribution of any action we take with respect to U.S. firms alone will be marginal at best. Again this suggests—as, indeed would the contrary argument with respect to competitive disadvantage—the importance of coming up with a multilateral system which would fully get at foreign behavior as well as that which U.S. law might adequately reach.

Mr. MURPHY. Mr. Smith, wouldn't the mere existence of a flat criminal prohibition on bribes make it easier for U.S. corporations to resist pressures to make questionable payments, perhaps more effectively than the indirect threat of disclosure?

Mr. SMITH. I would agree, Mr. Chairman, that the existence of the criminal proscription would be of some value to an American businessman in resisting improper requests for payments abroad. I don't believe, however, that it would have as much value as the disclosure requirements, for the following reasons. A would-be foreign extorter who asks for $50,000 to do something of importance to the American company, on the one hand would be told, "I can't give you that money because if I do I might have to go to jail," and the extorter says, "That is your problem, bud, but there is no way, your law can reach me." If you have a disclosure provision and the American businessman says, "If I give you that money, I am going to have to report the payment to the Department of Commerce, possibly to the SEC, and it will therefore be in the public record, and your name will be in the public record." If we are right that every other country in the world, virtually every other country, has laws against public bribery and extortion, then it is our guess that the extorter will be substantially deterred.

Mr. MURPHY. It would be right that he was extorting? If you make an allegation that he was extorting——

Mr. SMITH. Mr. Chairman, we would not be making an allegation that he was extorting. We would leave his motives for others to decide. We would say that the transaction would have to be a matter of public record.

Mr. MURPHY. Some other jurisdictions aren't as charitable as ours. I have other questions that I am going to submit to you in writing. if you would respond for our record.

Mr. SMITH. We would be glad to, Mr. Chairman.

[The following letters were received for the record.]

ASSISTANT SECRETARY OF THE TREASURY,
Washington, D.C., October 20, 1976.

Hon. JOHN M. MURPHY,
Chairman, Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, House of Representatives, Washington, D.C.

DEAR MR. CHAIRMAN: Enclosed are my responses to the questions you sent me following your Subcommittee's hearings on H.R. 15481 on September 21, 1976.

I appreciated your giving me the opportunity to present the Treasury Department's views on this bill.

Sincerely yours,

GERALD L. PARSKY.

Enclosures.

Question. Would enactment of legislation such as H.R. 15481 place U.S. firms at a competitive disadvantage with foreign firms?

Would this in turn adversely affect our balance of payments?

Answer. As I indicated in my prepared statement, I believe that the great majority of American firms operating overseas conduct their business honestly. Moreover. I am sure that those firms that have engaged in improper practices abroad and been exposed, are also now acting in accordance with the standards of good ethics and the laws of the countries in which they operate. Consequently, I would not expect that enactment of this legislation would—even in the event that the serious problems regarding its enforceability could be resolved—have a significant effect on the competitive position of U.S. firms in international commerce. Accordingly, we also would not anticipate that there would be any appreciable effects on the U.S. trade balance either.

Question. Could you elaborate on the kinds of questions the IRS poses to domestic corporations to uncover "slush funds" and other circumventions of normal accounting procedures?

When such practices are uncovered, as a matter of course, are they referred to the SEC and other enforcement agencies?

Answer. A full discussion of the eleven questions the IRS asks is contained in the "Manual Supplement" I have submitted separately pursuant to a request made by the Chairman during the Subcommittee's hearings.

In response to the second part of the question, I would say that the IRS' sole objective in asking the eleven questions is to obtain information that may relate to violations of Federal tax laws. However, pursuant to Section 6103 of the Code and the Regulations thereunder, the information which the IRS obtains in its information gathering and audit responsibilities may be made available to other enforcement agencies in connection with some matter officially before that department or agency.

If disclosures of this information are made to other agencies, and they occasionally will be, they are made only after a request for such information has been made by such other agency and established procedures with respect to the making of that request, and the transmittal of that information to the requesting agency, are followed.

Question. You indicated on pages 12 and 13 of your statement, that H.R. 15481 only solves part of the problem since it fails to provide effective sanctions against those who solicit bribes abroad. What do you feel would be effective in dealing with that element of the problem?

Answer. As I indicated during my appearance before the Subcommittee, I believe that the international agreement on improper payments proposed by the United States would be an effective measure for dealing with those who solicit or receive improper payments. Among the principles we suggested as a basis for such an agreement are the following:

Importing governments would agree to establish (1) clear guidelines concerning the use of agents in connection with transactions covered by the treaty and (2) appropriate criminal penalties for defined corrupt practices by enterprises and officials in their territories;

All governments would cooperate and exchange information to help eradicate corrupt practices:

Uniform provisions would be agreed for disclosure by enterprises, agents, and officials of political contributions, gifts, and payments made in connection with covered transactions.

Insofar as the implementation of an agreement based on these principles would involve coordinated action by importing and exporting and investors' home and host countries, we believe that it would not involve the potential difficulties involved with a unilateral U.S. effort and generally represents the most promising approach for dealing with the improper payments problem.

DEPARTMENT OF STATE,
Washington, D.C., October 22, 1976.

FRANZ F. OPPER, Esq.,
Counsel, Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, Washington, D.C.

DEAR MR. OPPER: I have received your letter of October 14 conveying certain questions concerning my testimony on H.R. 15481 of last September 21. I am happy to respond to those questions as follows:

1. We agree that the Government of Japan and the Netherlands Government have moved quickly and decisively on these matters. As you know, the United States Government cooperated fully with and facilitated those investigations by providing information from our files through law enforcement channels. This experience is consistent, we believe, with the view that criminal prosecutions by the government directly concerning will be more effective and less disruptive of foreign relations than criminal prosecutions by other countries under legislation such as H.R. 15481.

2. We recognize the difficulties in obtaining broad support for an effective international agreement on illicit payments. However, we are determined to pursue this matter vigorously and hopeful that meaningful action can be obtained in a reasonable time. Further, there is no arguments that the United States should take appropriate steps now to put its own house in order. The Administration has supported such action including disclosure legislation.

3. With respect to the prior knowledge of the Department of foreign bribery, my impression is that businessmen and others involved have not been in the habit of informing the Department of their shady activities. Of course, most persons interested in international business, whether in the private sector or the various branches of government, have been aware in general terms that a problem exists, but we have all learned a great deal from the disclosures that have been made in recent months. The need for corrective action including steps to protect honest American businessmen abroad is apparent. In our view, the best protection would be afforded by a uniform system of comprehensive disclosure embodied in an international agreement and implemented through national penal laws. We will make every effort to promote such an agreement.

I hope you will find these clarifications of the Department's position helpful.

Sincerely yours,

MARK B. FELDMAN,
Deputy Legal Adviser.

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C., October 14, 1976.

Mr. MARK FELDMAN,
Deputy Legal Adviser,
U.S. Department of State,
Washington, D.C.

DEAR MR. FELDMAN: As you recall, there was only limited time for questions to you at the Subcommittee's hearing on H.R. 15481 on September 21. Following are questions to which the Subcommittee would appreciate receiving your response.

1. You state on page 2, that "attempts to enforce legislation such as is being considered today could damage, rather than improve, our foreign relations." Isn't this a rather cynical view of our friends and trading partners? It appears that with respect to Japan and the Netherlands, both countries were offended by the activities of their own government officials, and have moved quickly and decisively to clean house.

2. You suggest on page 4 of your testimony, that we should rely on the United Nations to develop an effective and widely accepted treaty to deter foreign payments.

(a) Would you comment on the following statement by Mr. Theodore Sorensen?

"... awaiting development of an international code by ... the United Nations is largely an excuse for delay and inaction. Most of the members ... are not in agreement on what should be done, and many are not enthusiastic about doing anything. Such codes, if they were to be truly meaningful and enforced, would have to sink to the level of the lowest common denominator. [g]eneralized resolutions from the United Nations are the best they are likely to produce."

(b) Wouldn't it make sense, that as a prelude to entering into any such international arrangement, we put our own house in order first?

3. Given recent revelations, the paying of foreign bribes appears to be so widespread that it is difficult to believe that the State Department has not long been aware of such practices. If this is true, what steps has the State Department ever taken to discourage such activities? Has any thought been given to affording protections to honest American businessmen abroad from their more unscrupulous American competitors?

Thank you for your cooperation in this matter.

Sincerely,

FRANZ F. OPPER, *Counsel.*

DEPARTMENT OF COMMERCE,
OFFICE OF THE GENERAL COUNSEL,
Washington, D.C., November 11, 1976.

FRANZ F. OPPER, Esq.
Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, U.S. House of Representatives, Washington, D.C.

DEAR MR. OPPER: Thank you for your letter of October 14, 1976 forwarding questions resulting from the Subcommittee's hearing on H.R. 15481 on September 21, 1976. For ease of reference, I will set out each of your questions prior to my response.

Question No. 1. "Recent disclosures have revealed that foreign bribes and payoffs by U.S. corporations have occurred with disturbing frequency. What kinds of initiatives has the Department of Commerce undertaken to rectify this situation?"

Response. As Secretary of Commerce and as Chairman of the President's Task Force on Questionable Corporate Payments Abroad, Secretary Richardson has enunciated his abhorrence of improper corporate payments in numerous formal and informal statements to business leaders and to other concerned public groups.

As you know, the Department of Commerce has no authority to administer the existing laws which affect questionable corporate payments. These laws include: the securities, tax and antitrust laws; Eximbank regulations requiring declaration of any commissions, fees or other costs beyond the actual value of goods sold; AID regulations affecting loans made under the Foreign Assistance Act; regulations issued by the Department of the Treasury under the Bank Secrecy Act of 1970; and the reporting requirements of the Arms Export Control Act.

Therefore, the principal initiative of the Department, under the auspices of the President's Task Force, has been the recommendation and introduction of strong, comprehensive disclosure legislation. A copy of the legislation was previously submitted to the Subcommittee together with a section-by-section analysis and a statement of purpose and need. It is noteworthy that the President's proposed legislation would give the Secretary of Commerce the legal authority to take direct and active steps to deter questionable payments.

In addition, the Department of Commerce has participated in the development of the United States' international initiative to negotiate a binding international agreement, under United Nations' auspices, to deal with the problem of questionable in international commerce.

Question No. 2. "On page 4 of your testimony, you stated that criminal provisions aimed at prohibiting bribery would be unenforceable and should not be allowed to displace 'meaningful' disclosure measures. Why do you think it would be any more difficult to enforce a prohibition of bribery than to enforce a requirement that corporations report all overseas payments? Is there any substantive difference in the standard of proof required?

"Are you suggesting that we avoid applying criminal sanctions to what we all agree is reprehensible behavior, solely because some cases may be difficult to prove?"

Response. We believe that it will be more difficult to enforce a prohibition of bribery than to enforce a reporting requirement for all overseas payments for the reasons spelled out in our testimony. Proof of foreign bribery would require proof, beyond a reasonable doubt, of certain complex elements with regard to motive of the payor. As we know from the experience of domestic prosecutions for public bribery, such proof is very difficult. An alleged bribe can be defended as a legitimate political contribution or as a bona fide personal gift.

The Administrations' reporting legislation eschews proof of motive and intent with regard to the making of a payment. It requires reporting of all payments made in relation to business with foreign governments. Criminal prosecution for a failure to file a report will, of course, require proof that the failure to report was knowing. However, lack of criminal intent will not excuse failure to file a required report, failure to maintain the required records, or negligent omission from a filed report of required information, all of which are subject to civil penalties including fines of up to $100,000. The burden of proof required in such a civil action is, of course, less onerous than the "beyond a reasonable doubt" standard of criminal trials.

H.R. 15481's criminal proscriptions will require proof of motive and intent. Effective prosecution and a fair defense will depend on witnesses and information beyond the reach of U.S. judicial process. It is for this reason that Senator Church has described the Senate counterpart of H.R. 15481 as pure "tokenism." It is for this reason that counsel to the Senate Committee which prepared this legislation, opined that its criminal provisions would not be enforceable.

It is true that the enforcement of the criminal provisions of the Administration's bill may involve some of the same difficulties with regard to availability of information and witnesses. However, the avoidance of the need to prove difficult intent and motive elements should help mitigate these problems.

Question No. 3. "You suggest in your testimony that by seeking unilaterally to criminalize foreign, improper payments, we will be promising more than we can deliver.

"(a) Is it not true that a great number of the questionable payment cases involved one U.S. company competing against another U.S. company for the same business?

"(b) Why can't we assume that foreign countries would welcome our efforts to discover offenses committed by U.S. corporations insofar as their bribing local government officials?

"(c) Isn't it possible that as the most dominant factor in world commerce, that initiatives by the U.S. might well set examples to be followed by our trading partners and might well lead to international agreements to enforce the provisions of this bill?"

Response. (a) It is true that in some of the most highly publicized cases—such as that of Lockheed, questionable payments were made by one U.S. company in competition with another. This fact, by itself, would not appear relevant to the question of enforceability of a direct criminal proscription for acts done in foreign jurisdictions.

(b) It may be appropriate to assume that foreign countries welcome efforts by this country to deter or discover efforts by U.S. corporations to bribe local government officials. On the other hand, where the foreign payment involves elements of extortion, as is sometimes the case, this presumption may not stand up. At any rate, the issue is how best to deter or discover such payments. We would argue that comprehensive disclosure is more meaningful than criminalization.

(c) We agree completely that the United States has leadership responsibilities. We have taken the lead in seeking an international agreement under United Nations auspices to deal with the questionable payments problem. The Administrations support for disclosure legislation is in part predicated upon the need for the United States to take a leadership role before such international agreement is negotiated. Such an agreement would, among other things, provide for active international cooperation in the enforcement of national standards against bribery within national jurisdictions.

Question No. 4. "Over the past year, several hundred major corporations have revealed their involvement in the payment of bribes to foreign officials. What perceived affect have such disclosures had in terms of curtailing foreign bribery?"

Response. The assertion in the question that several hundred major corporations have been involved in the "payment of bribes to foreign officials" is an overstatement.

Approximately 200 corporations have indicated that they have reason to believe that they or their foreign subsidiaries have made payments or political contributions under questionable circumstances, where a full accounting was not made of the moneys involved. Some of these payments undoubtedly were bribes while others were not. Putting semantics to one side, it is fair to conclude that the disclosures of the past 18 months should act as a substantial deterrent to such behavior in the future. In view of the extensive efforts made during the past year by the SEC and the IRS, in our opinion, only the most reckless and callous corporate executives would continue to tolerate unethical or illegal corporate payments. In any case, the President's disclosure bill, which extends the scope of disclosure beyond the jurisdiction of the tax and securities laws, should provide an added margin of deterrence and help restore public confidence in the conduct of our business institutions.

Sincerely,

J. T. SMITH, *General Counsel.*

Mr. MURPHY. Our next witness is Mr. Theodore C. Sorensen, attorney, New York law firm of Paul, Weiss, Rifkind, Wharton & Garrison.

STATEMENT OF THEODORE C. SORENSEN, ATTORNEY, NEW YORK, N.Y.

Mr. SORENSEN. Mr. Chairman. I appreciate the subcommittee's invitation to express my personal views growing out of my observations as both a private practitioner and public servant on the matter under discussion today. I have previously set forth my views in some detail

on this subject in an article in the July issue of "Foreign Affairs" which I would be happy to submit for inclusion in the record.

Mr. MURPHY. Without objection, it will be included in the record, following your statement [see p. 118].

Mr. SORENSEN. I want to begin by commending this subcommittee and Congress for acting to halt the payment of bribes by U.S.-based corporations to foreign government officials and politicians. Such payments represent an immoral, intolerable, and indefensible subversion of our national interests, tarnishing our country's image, undermining the legal, political, and economic order of friendly host governments, and rendering those governments, as well as our own, more vulnerable to an anti-American backlash, no matter how well entrenched and routinely accepted such practices may have been in any particular host country.

The first section of H.R. 15481 provides the SEC with the amendments it has requested to strengthen its traditional tools of disclosure and corporate accountability, including a specific requirement for adequate internal accounting controls and a specific ban on false or misleading statements or omissions in corporate records and in corporate communications with auditors. Experience may demonstrate that the SEC will require still more authority to prohibit more precisely and penalize more severely and certainly the various techniques used to conceal corrupt practices from both corporate and governmental accountability systems. But for the present, the vigor with which the SEC under Chairman Hills, unlike the executive branch generally, has responded to the post-Watergate rash of revelations of corporate misconduct, endows, in my opinion, with substantial credibility that agency's recommendations in the particular area for which it is responsible, namely, the accountability of publicly held corporations to their stockholders and prospective investors.

H.R. 15481, however, wisely recognizes that this is but one small part of the problem; that privately owned companies can injure U.S. interests by engaging in these practices as well as publicly held corporations; that disclosure does not always lead to penalty or reform if those receiving the facts are concerned only with private profits rather than public good; and that disclosure is not strong enough to carry the whole burden of altering human behavior and enforcing criminal laws. Sections 2 and 3 of this bill thus go further and actually outlaw any payments by any U.S.-based enterprise to any foreign government officials and politicians which are made for the purpose of inducing those officials to either use their influence or neglect their duties in such a way as to help the enterprise or favor obtain or retain business, channel business to someone else, or alter local legislation or regulations. Recognizing that a $10,000 fine is often minuscule compared to the amounts involved, the bill would also impose a 2-year prison term for violators as well as a fine—in this sense, like the SEC Act.

The operative language of these two sections could, in my opinion, be broadened to prevent any loopholes, to more clearly include subsidiaries as well as parent companies, subsequent reimbursement and condonation as well as authorization, indirect as well as direct payments, loans as well as gifts, employees and representatives of foreign governments as well as officials, rewards for past action as well as

inducements for future action, and foreign government proclamations, orders, decisions, awards, and agreements as well as legislation or regulations. Consideration might also be given by the appropriate committee to a more comprehensive bill, which could include provisions requiring disclosure to the Government and to the public by business concerns not subject to SEC jurisdiction, provisions regularizing the use of foreign agents and consultants, provisions authorizing executive branch sanctions against U.S. violators and against those foreign competitors who continue to pay bribes, and provisions encouraging self-regulation by American business. Brief suggestions on each of these points are contained in the foreign affairs article I am submitting.

But, basically, H.R. 15481 is a soundly drafted bill, rightly comprehensive in its coverage of agents and consultants as well as corporate employees, of payments to those who influence as well as those who decide, and of promises to pay regardless of whether payment was actually made or the desired results obtained or the promise legally enforceable. Wisely, in my view, the bill does not prohibit lawful political contributions; nor does it prohibit legitimate payments to legitimate agents, consultants, and other professionals who provide legitimate services abroad; nor does it place any ceiling on their compensation. It does not attempt to prohibit what the law cannot enforce, and thus includes no ban on so-called low-level grease payments made to encourage some foreign functionary to do his duty instead of neglecting or violating it; no ban on payments unrelated to government; no ban on genuine gifts or acts of good will and hospitality; and no ban on practices prohibited by foreign law. Nor, wisely, does it deem acceptable every action permitted by foreign law, or set a dollar minimum beneath which bribery will be allowed. Nor, finally, does it become sidetracked by providing other remedies not central to this particular issue—a new right of action for shareholders or competitors, for example, or Federal insistence on independent outside directors and audit committees for all corporations.

The one instance in which the bill may go too far is its failure to distinguish between extortion and bribery. The bill correctly prohibits a bribe regardless of who first suggested it; and I recognize that an exception for extortion will invite manipulation by both payors and payees and require close and careful judgments. But that is true domestically as well; and no business executive or representative who, in the future, finds himself subjected to genuine, uninvited coercion by a ruthless host government should be forced to choose between 2 years in Federal prison if he makes the payment demanded of him, and the confiscation of his family's or stockholders' principal investment if he fails to make such payment. There are other remedies for such extortion, beginning with a more alert and concerned U.S. executive branch.

The principal policy issue raised by this bill, of course, is whether it should prohibit the bribery of foreign officials at all. The Ford administration, as presented by the panel which preceded me, prefers to rely solely upon the offending corporation notifying the Department of Commerce of its misdeed, with the Department not making that fact known until as much as a year later, and then only if our national interest would not be adversely affected.

What a pitifully pallid response to a major moral crisis. Have we learned nothing from the attempted coverup of Watergate? Have we no shame, no decent respect for the opinions of mankind? How could this country continue to preach abroad the virtues of the free competitive market system and continue to call for economic justice and political integrity, how could we hope to avoid unreasonable restrictions and attacks on American corporations abroad, if we are unwilling to specifically and directly prohibit and penalize this wasteful, corrosive, shabby practice? Do we really wish to aline ourselves around the world with the cynical and the corrupt, with those who profit from bribery or wink at it as customary and unavoidable, or should we not instead aline ourselves with those business and government officials who have stoutly resisted all pressures and temptations, and who would be vastly relieved today if a U.S. criminal statute said loudly and clearly that all U.S.-based enterprises continuing to engage in such practices did so at their own peril.

It was said this morning by the four horsemen of the administration who preceded me to this stand that such a ban without cooperation from other governments would be unenforceable. I have no doubt that some offenders would escape and some new circumventions would be created. But penalizing nondisclosure presents the same problems, and recent experience demonstrates that ultimately witnesses to most evil will surface. Moreover, most governments would be hard put to refuse our request for coperation, and even the inability to detect and punish all violations would not eliminate the impact of this criminal statute on would-be violators, on those preferring not to bribe, and on both our admirers and our detractors around the world.

It was said this morning that other nations, sensitive to their sovereign rights, would resent our policing their ethics, imposing our moral standards on their internal affairs, and exposing and embarrassing their officials for engaging in time-honored practices. But this bill, like our antitrust, tax, trademark, trading with the enemy, and other statutes, simply requires business enterprises based in our country to adhere, wherever they operate, to a standard that represents our values and serves our interests.

It is said, finally, that such a ban in the absence of some multilateral proscription will, if it proves enforceable, place U.S. exporters at a competitive disadvantage in comparison with those of other exporting nations who continue to pay bribes to get business; and frankly, I have no doubt that some sales may be lost, at least in the short run. But in every foreign country in which bribes have been paid to get business, other American companies have operated successfully without paying them. Those companies too inefficient to compete in terms of price, quality or service, or too lazy to engage in honest salesmanship, or too intent upon unloading upon a recipient government a marginal weapons system it cannot afford or does not need or will not be able to operate, are not the companies upon which our balance of payments should depend. In many instances, they use bribes to beat out other U.S. exporters; in other instances their tactics have impaired the market for all U.S. exporters. No admonition from the OECD or resolution from the UN can correct this situation or enable our Government to avoid its own responsibility, nor should foreign corporations who do continue such practices after passage of this law assume

for a moment that the U.S. Government is without means of effective economic retaliation.

Mr. Chairman, I know of no crime which can be deterred by disclosure alone, or which does not require the drawing of difficult distinctions by law enforcement agencies, or which is universally vanquished or even universally condemned after the passage of a proscriptive law. But neither do I know of any challenge facing the United States of America more important today than the reassertion of its moral authority in the world. This bill is an important step in that direction.

[Testimony resumes on p. 135.]

[The article referred to follows:]

IMPROPER PAYMENTS ABROAD: PERSPECTIVES AND PROPOSALS

By Theodore C. Sorensen

Reprinted From

FOREIGN AFFAIRS

AN AMERICAN QUARTERLY REVIEW

JULY 1976

FOREIGN AFFAIRS

AN AMERICAN QUARTERLY REVIEW

JULY 1976

Vol. 54, No. 4.

IMPROPER PAYMENTS ABROAD: PERSPECTIVES AND PROPOSALS

By Theodore C. Sorensen

LIKE motherhood and apple pie (zero population growth? food additives?), corporate bribery abroad is not the simple, safe issue it seems at first blush. Sharp division and delay have characterized its consideration by the U.S. Securities and Exchange Commission, Department of Justice and Internal Revenue Service, and by several Committees of the U.S. Congress, the Organization for Economic Cooperation and Development (OECD), and the International Chamber of Commerce. In the United States, a Presidential Cabinet-level Task Force—and in the United Nations, the Committee on Transnational Corporations—have been asked to untangle the problem; but no solution is yet agreed upon.

The practice of exporters and investors offering special inducements to host country officials is at least as old as Marco Polo. But in the United States a post-Watergate climate of pitiless exposure for all suspect practices connected with government has intensified both the investigations of these payments and the oversimplified publicity given to them. Indeed the seeds of the present furor were sown in Watergate. When the Special Prosecutor traced some of the "cover-up" financing to unreported corporate campaign contributions, often transmitted through foreign "slush funds," the SEC initiated a major check on all undisclosed payments to governments and politicians, both domestic and foreign, by the publicly owned companies subject to its jurisdiction.

As a result, U.S. corporate officials have engaged in the most painful rush to public "voluntary" confession since China's Cultural Revolution. Scores of U.S.-based companies have been investigated by one or more arms of the U.S. executive branch, legislative branch, and news media—or by their own directors. Many foreign officials of varying prominence have been forced to resign, deny, or both. The going rate for bribery has reportedly fallen in some countries as fear of disclosure increases, and risen in others as officials discover the full potential of their position. Debates between businessmen asserting

---

Theodore C. Sorensen, a lawyer, was Special Counsel to the President, 1961–64, and is the author of *Kennedy; Decision-Making in the White House; Watchmen in the Night: Presidential Accountability After Watergate* and other works.

that only they live in the "real world" ("Of course, I'm against bribery, but . . . .") and bureaucrats asserting that only they are without sin ("No payment of any kind or size for any reason should escape . . . .") have thus far produced more heat than light.

It is to be hoped that a calmer, more long-range perspective can soon prevail. Otherwise, genuinely legitimate business practices will be inhibited by an atmosphere of fear and suspicion, generated by sweeping and hasty reactions, while those truly intent on corruption will merely wait for the emotional storm to pass.

II

Clearly, our understanding of the problem is not enhanced by the tendency in some quarters to place all the blame on those few U.S. corporations which have received the most publicity. Those engaged in the sale of arms, aircraft, oil and pharmaceuticals—all highly government-oriented businesses—may have been in the forefront; but nearly all other kinds of business have been engaging in these practices as well: privately held corporations as well as publicly owned; small as well as large; strong as well as weak; producers of civilian goods as well as of military hardware; those who buy or invest as well as those who sell; and, most importantly, companies which are based abroad as well as companies based here in the United States.

Moreover, our country has no monopoly on the resulting stain. Contrary to common assertion, nor does the Third World. Bribe recipients have served in every kind of government on virtually every continent: anti-U.S. administrations and political parties as well as pro-U.S.; democracies as well as dictatorships; communist as well as non-communist governments; and rich industrialized nations as well as poor and underdeveloped nations. Nor is the blame confined to governments and business—members of the accounting and legal professions have played a role as well.

The picture has been further distorted by an outpouring of self-serving, self-righteous hypocrisy on both sides. Among the biggest hypocrites have been the following:

—those foreign governments which since time immemorial have closed their eyes and held out their hands, but which now denounce the United States for introducing corruption to their shores;

—those U.S. politicians who professed ignorance of the illegality of the corporate campaign contributions they received (or knew others received) in cash in sealed envelopes behind a barn or men's room door, but who now insist that various company ex-

ecutives be prosecuted because they should have known of their subordinates' improper activities abroad;

—those agencies of the U.S. government which long knew of and even approved of barely concealed payoffs by companies engaged in favored overseas sales and investments, but which now wring their hands at the unbelievable shame of it all; and

—those U.S. and foreign newspaper commentators who long winked at free junkets and passes for newsmen, even a little extra income doing public relations for the organizations they were covering, but who now condemn the ethical standards of the business community.

Nor have those issuing sweeping condemnations always noted certain valid distinctions. Not every payment to a foreign government employee is a bribe. Nor is every corporate political contribution abroad improper. Not every foreign consultant or sales agent is corrupt or retained to perform some improper function.

Political contributions paid in cash or in secret to foreign candidates or parties are rightfully suspect. But properly recorded corporate political contributions, with no quid pro quo, are legal in many if not most of the states of the United States; and the new Campaign Finance Reform Law, passed in the very wake of Watergate, permitted corporate-sponsored political activity in our federal elections. It is thus unfair and illogical to attack any and all participation by U.S. corporations or their subsidiaries in the political campaigns of other countries which also permit it by law.

Similarly, payments to a foreign consultant, agent, lawyer or marketer, if made in cash or not fully reported or if wholly out of proportion to his services, most likely deserve condemnation. But properly recorded payments, of an amount appropriate under the circumstances, to a qualified and responsible professional for his performance of legitimate and necessary services, may well be perfectly justifiable. To be sure, such individuals may be making the most of their personal, political, business or family ties with key government officials—a phenomenon not unfamiliar in our own country. But they also know the local language, procedures, personnel, regulations, press and sources of supplies and information. They can provide the visiting businesssman with a local headquarters, communications and a means of scheduling and coordinating appointments, as well as valuable advice on strategy and presentation. Local government officials, for perfectly legitimate reasons including their sense

of uneasiness in dealing with foreigners, may prefer or insist upon working with a compatriot they know. The payment of a large commission to an agent is no more clear evidence of illegality than is payment of a large commission to an American real estate agent on the sale of an expensive home.

Not even all payments made to foreign government officials should be judged alike. Although U.S. statutes and judicial interpretations vary, the legal essence of *bribery* is a payment voluntarily offered for the purpose of inducing a public official to do or omit to do something in violation of his lawful duty, or to exercise his official discretion in favor of the payor's request for a contract, concession or privilege on some basis other than the merits. Many forms of payment now under attack do not constitute "bribery" under this definition.

For example, a certain amount of scoffing, much of it undoubtedly justified, has greeted the claims by some business executives that their payments to foreign officials were the result of extortion on the part of those officials, not bribery. But the courts do recognize the distinction between those payments which are voluntarily offered by someone who seeks an unlawful advantage and those which are extracted under genuine duress and coercion from an innocent victim seeking only the treatment to which he is lawfully entitled. A company which can demonstrate that it was truly confronted with an unmistakable choice between paying a corrupt foreign official, or seeing its entire investment in that country expropriated, is not paying a "bribe." (A recent U.S. Federal Court of Appeals decision reached a similar conclusion with respect to a hapless accountant indicted for having made payments to a group of threatening IRS agents.)

Nor does the above definition of bribery cover those payments, usually smaller, made by businessmen in a country where they are not prohibited, to facilitate, expedite or express appreciation for the normal, lawful performance of ministerial or procedural duties by a low-ranking government employee. "Grease" payments which help persuade the bureaucrat or functionary to do his job and continue the lawful flow of paper or goods should not be commended; but neither should they be confused with bribing that individual *not* to do his job.

Finally, there is a distinction not always easily determined, between a bribe and a relatively small sum of cash or other gift or service offered to an official by way of common courtesy or social amenity, a present put forward and accepted on the basis of amicable personal relations unconnected with the performance of his duty. Some of these payments are ethically questionable and of doubtful motivation as well; but there is a legal difference, however subtle, between the $20

bill you hand your local policeman on Christmas Eve and the $20 bill you hand him when he stops you for speeding (a difference recognized by a recent New Jersey Supreme Court decision involving a Christmas gift of cash from a builder to a municipal building inspector).

It is not easy, of course, to determine which foreign corporate political contributions, agents' fees, gifts, "grease" payments, and alleged extortion are in reality nothing more than indirect or camouflaged bribes or kickbacks. U.S. federal and state statutes frequently and justifiably prohibit or penalize these other forms of payment to public officials as well as bribes; and gray areas of interpretation will always remain. The size, form and timing of the payment, the adequacy of its disclosure, and other facts must bear on the conclusion in a doubtful case. Even then there will be countless situations in which a fair-minded investigator or judge will be hard-put to determine whether a particular payment or practice is a legitimate and permissible business activity or a means of improper influence:

Example 1. The best lawyer in a foreign town is the London-educated son of the Minister of Commerce. Should he be prevented from accepting clients who need permits from the Ministry? Should a U.S. corporation be prevented from retaining him? Would it make any difference if he were a consultant or agent instead of a lawyer? The opportunities for abuse here are undeniable but not inevitable.

Example 2. A U.S. corporation is asked by the Provincial Governor to contribute to the local Health and Welfare Fund, his favorite charity. Is this the obligation of a public-spirited company or an opportunity for covert graft?

Example 3. A U.S. corporation, already doing substantial business in a foreign country, wishes to invest as well in one of its local suppliers. The Prime Minister is the latter's principal stockholder. Would it make any difference if it were another U.S. company in which they would be investors together?

Example 4. A U.S. corporation's valuable inventory abroad is stored in a remote warehouse. The nearest police are willing to act as after-hours guards if they are paid by the corporation for their overtime services. Must a less effective and more expensive alternative be found?

Example 5. A U.S. corporation wishes to form a joint venture with a local firm owned by a member of the ruling family (not unusual or considered unethical in small countries with small elites). But see Example 1.

Example 6. A U.S. corporation, seeking to locate its plant in an impoverished land, invites the impoverished Minister of Environ-

mental Affairs to fly to the United States at its expense for a tour of its domestic installations, reportedly to demonstrate that its proposed plant will not pollute the local air and water. At what point does its hospitality become excessive; and should this expensive trip be more permissible than contributing the cash equivalent thereof?

Example 7. A U.S. corporation is informed that the government permit for which it was bidding has already been issued to a local corporation of unknown ownership which is willing to sell it to the U.S. bidder at the bid price. If no extra payment is thus involved, does the additional step render the transaction improper?

Reasonable men and even angels will differ on the answers to these and similar questions. At the very least such distinctions should make us less sweeping in our judgments and less confident of our solutions.

III

None of this, however, alters the basic parameters of the real problem:

It is illegal for a U.S. corporation to deduct as an ordinary business expense on its U.S. income tax return any bribes, payoffs, kickbacks or other improper payments to foreign government officials, whatever the label or justification, or any political contributions, whether lawful or not; for any corporation subject to the jurisdiction of the U.S. Securities Acts to fail to include and to describe accurately all such payments (assuming they are material to the company's finances or materially indicative of its management's integrity[1]) in its various statements and periodic reports to the SEC and shareholders required by those Acts; and for any such corporation to finance these payments through secret slush funds or phony offshore corporate entities outside the normal system of financial accountability prescribed by those Acts. Neither bribery of a foreign official outside the United States nor violation of a foreign law, however, appears to violate any U.S. law.

It is unethical for a corporation to pay bribes or kickbacks to foreign officials to induce them to violate their duty—a practice subversive of sound government, sound business and sound relations between the two, no matter how deeply entrenched it may have become in the host country; a costly, wasteful interference with the free competitive market system; and a cynical, shabby technique of getting business which usually rewards the richest, most reckless and ruthless while passing on the cost to those who can afford it least.

[1] The appropriate limits of "materiality," if any, under the Securities Acts in general and in cases of improper foreign payments in particular are being hotly debated as this goes to press and are beyond the scope of the article.

82-981 O - 77 - 9

It is unbusinesslike for a corporation to pay bribes and kickbacks, regardless of how routine a practice it may appear to be in the host country and regardless of competitive pressures. This conclusion, it should be acknowledged, is far from unanimous in the business community. (The legend persists that the Harvard Business School student who questioned the ethics of this practice was directed by his professor to enroll in the Harvard Divinity School.) Nevertheless, a large number of U.S. corporations successfully operating overseas have constantly faced and consistently resisted the pressures and temptations to make payments. Those not resisting appear in many cases to have been those too lazy to compete in honest salesmanship or too inefficient to compete on price, quality and service.

Some corporate executives have undoubtedly achieved substantial gains in the short run by these methods; some have obtained only marginal business; and some will never know if their payments were necessary or helpful or even reached the intended official's pocket. But all who paid thereby established their companies as easy marks for more demands and blackmail. All were immediately courting trouble if they reported these payments and more trouble if they did not. All were exposing their corporations and themselves to the possibility of stockholder suits, legal action by the U.S. government, the possible disclosure of proprietary information of value to their competitors as a consequence, and retaliation by the host country ranging from the cancellation of orders to the nationalization of assets. Moreover, just as a handful of dishonest door-to-door peddlers can turn an entire town against home solicitation, so the conduct of these corporations—at a time when the business community in general and multinational corporations in particular have been seeking to ward off unreasonable restrictions and suspicions—may have done a grave disservice to all who trade abroad. Surely, of all the hypocrites heard on this issue mentioned earlier, the greatest of all are those business executives who made such payments, whose corporations are now as a result in deep difficulty, but who insist they did it "for the good of the company."

This is not to deny the fact that, in far too many countries for far too many years, illicit inducements have been an accepted and customary way of doing business with the government, usually through agents whom virtually every visiting businessman is expected to retain. In still other countries, such payments, if not essential, are widely tolerated and expected.

But what is customary is not thereby ethical or even inevitable. In more than one American city widespread corruption in the police

department, long thought too deeply entrenched to be uprooted, has been effectively exposed and curbed. The fact that many U.S. companies have successfully avoided these activities in the very countries where it was most customary, and that others have given up business opportunities in those countries and moved elsewhere as a matter of sound business judgment, undermines the payor's usual justification that he had no alternative, that "everyone does it," and that if he didn't do it someone else would (the same excuse offered by heroin pushers). Moreover, the fact that the typical local official who takes a bribe wants it kept secret, fearing punishment in his own country if his corruption becomes known, casts doubt upon any payor's defense that he was merely playing according to "the rules of the game."

IV

All this is by way of background for a consideration of U.S. national interests in the current situation. Without a clear understanding of the scope and nature of the problem and its implications for American business, neither the desirability nor the feasibility of a workable solution can be accurately assessed.

This is particularly true in light of the presently ambivalent attitude of the federal government. While the SEC, Department of Justice and Congress rail against improper payments abroad, more mixed signals have emanated from elsewhere in the executive branch.

American Embassies around the world have long known of these practices but voiced no protests to host governments and offered no protection to honest American businessmen. Those U.S. exporters who thought they were serving their country's foreign policy interests by making under-the-table payments to friendly foreign officials and political parties were never told otherwise. Occasionally State Department officials have even offered guidance on the names and standard fees of those agents with the best connections.

The complicity of the Department of Defense in these practices appears even greater. In quadrupling over the last decade the sale of U.S. arms abroad, the Department approved contracts financed in whole or in part by military assistance funds without too close an examination of agents' fees and other contract terms, and it undertook to "educate" contractors on the necessity and implications of such fees. These sales helped maintain production capacity in this country which the Pentagon regarded as vital, helped achieve economies of scale for its own purchases from the same companies, and helped build closer technological and political ties with the military and governmental leaders of the recipient countries.

Now, with some present orders canceled as the result of current investigations and still others in doubt, the Pentagon is fearful of losing those advantages. Other agencies are similarly fearful that unilateral U.S. government restrictions on foreign bribery will make it more difficult for American corporations to compete for orders with any less scrupulous companies from Germany, Japan, France, Great Britain, and elsewhere, with adverse effects on U.S. exports, balance of payments and employment.

The State Department is, in addition, upset by the effect of the present investigations on several friendly governments. In Italy, Japan and elsewhere, governments in an already precarious position have been shaken by these revelations of corruption. Communist and other anti-U.S. forces have exploited this evidence of immorality in capitalism and pro-Western governments. Hostility to American interests has increased. More than one foreign official friendly to the United States is fearful of ouster and is resentful of America's role in exposing these traditional practices. More than one friendly foreign newspaper has chastised the United States for broadcasting its national self-flagellation to the detriment of the Western alliance.

But those who are angry at the revelation of bribes instead of at their payment (like those angry at Woodward and Bernstein instead of at Nixon) confuse the weatherman with the weather. Even before they were uncovered, these bribes—merely by being offered and accepted—had damaged American foreign policy and made it more vulnerable to its adversaries. By engaging in such debilitating practices, U.S. businessmen, who in most countries are more visible representatives of the American way of life than our diplomats, tarnished our country's image; subverted the lawful basis of friendly governments; aggravated the economic inequities and instability that inevitably accompany this subsidization and corruption of a power elite; and rendered both the host government and our own government more susceptible to an ultimate backlash.

I doubt that the messenger will in the end be condemned for bringing the bad news. Many foreigners, without ever fully understanding Watergate, came to admire the courage and independence of the American press, courts, prosecutors and legislative branch for exposing and cleaning up that mess. I believe the same will happen here. Certainly the Communists in Italy will now have difficulty maintaining that the multinational corporations and Wall Street dominate Washington, and equal difficulty denying that it was Washington's efforts instead of their own that helped expose this corruption in Italian politics.

To be sure, notwithstanding the virtues of disclosing and thus discouraging these practices, special care should be taken by both our executive and legislative branches not to publish the names of foreign officials accused only by unsubstantiated testimony, hearsay or rumor, and not to prejudice criminal proceedings in either our country or others by the premature publication or transmittal of such names. That is a legitimate concern of the President and the Department of State that must be respected. But even greater damage to America's reputation for justice and honor than has already been caused by the current revelations could result from any appearance of a cover-up—any suspicion on the part of the legislative branches or citizenries of other countries that the U.S. government is conspiring with their governments to delay indefinitely any disclosure affecting their incumbent officials or political parties.

Imagine the reaction of the American people had the Japanese government possessed vital information on Watergate and refused to transmit it to the House Judiciary Committee's impeachment proceeding, announcing instead that such information should go exclusively to our executive branch! Yet a similarly paternalistic decision has been made by our Department of State; and it is small wonder that this approach has caused the darkest suspicions in Japan about the possibilities of CIA and other U.S. government involvement in these overseas slush funds and bribes.

So let the information flow, with due respect for the rights of the accused. Little attention need be paid to complaints about damaged reputations from those foreign officials who have for years accepted bribes; or from those foreign governments that have long tolerated their receipt by their own officials or their payment by their own exporters; or from those foreign governments which are not now seriously investigating the clear evidence of such practices in their midst; or from those which are making a great show of cracking down on them with the full intention of permitting their resumption once the heat is off. Any pro-U.S. political party whose success has depended upon this kind of secret subsidy and corruption could not have been a very strong reed upon which our country could have leaned in any event.

The other principal concern of the Pentagon and other executive branch agencies is well-founded. Any unilateral U.S. restriction on foreign bribery by U.S. exporters undoubtedly will cause our arms merchants and others to lose substantial sales opportunities to their less-principled competitors, at least in the short run, particularly in some of our weaker industries. That unfortunate fact should be

acknowledged. A crackdown by the United States will not be cost free.

But surely these highly vulnerable and immoral arrangements between atypical U.S. businessmen and corrupt foreign officials provide a wholly untenable and shaky basis for building our military alliances. U.S. security and stature are not increased when foreign officials are improperly induced to ignore their countries' internal needs or to distort their defense priorities by spending their limited funds (or our limited military assistance grants) on what are frequently marginal weapons systems or a kind they do not need, cannot afford to maintain or will not be able to operate.

Moreover, there was no gain to our country's balance of payments or economy when U.S. companies paid bribes to win a contract that would otherwise have gone to another U.S. company. On the contrary, the added cost of these improper contracts to the host country further weakened the market for other U.S. exporters. The fact that some American companies have succeeded in these countries without the payment of bribes is an indication that U.S. exports will not suffer all that severely from an end to such payments. Those governments desirous of obtaining U.S. technology and quality will unquestionably learn to buy our goods without any special inducement.

In short, it is on balance in the long-run interest of the United States to halt these wasteful, corrosive and indefensible payments to foreign officials by U.S.-based corporations and their subsidiaries. Such action would enable this country once again to offer moral leadership to the world, demonstrating our concern not only for the defense of society but also for the kind of society we are defending, and practicing what we preach about the free market system. It would also provide a sounder basis for our alliances, increase respect for our values, enhance our standing with more progressive elements desirous of reform, and make those governments purchasing from us less vulnerable to future political attack.

Such action would not be, as often charged, an attempt by the United States to impose its puritanical standards on the rest of the world, disregarding the sovereignty of others and policing everyone else's ethics in a hopeless attempt to reform mankind. Not at all. It would instead simply require corporations based in our own country to adhere, wherever they operated, to a standard that served U.S. national interests. Our antitrust, Trading with the Enemy, and other statutes have long been held to have similar extraterritorial application. Setting a good example does not require any other government to follow it.

V

Of course, it would be preferable if every commercially important government in the world not only enacted but enforced tough and comprehensive laws against the payment and receipt of bribes. That would avoid any adverse competitive consequences of unilateral U.S. action. But awaiting development of an international code by the OECD, GATT, IMF or the United Nations is largely an excuse for delay and inaction. Most of the members of these organizations are not in agreement on what should be done, and many are not enthusiastic about doing anything. Such codes, if they were to be truly meaningful and enforced, would have to sink to the level of the lowest common denominator. Mild admonitions from the OECD and generalized resolutions from the United Nations are the best they are likely to produce.

The United States will be in a stronger position to call for action from other countries, and to embarrass or otherwise pressure any U.S. companies' competitors who are still paying bribes, after we have taken effective action against our own unethical corporations in this regard. Inasmuch as Congress is already past the halfway mark in an election-year session, enactment of new legislation may as well await a fuller determination this year of the entire range of the problem—lest American business be confronted with an incomplete statute constantly undergoing amendment. Nevertheless it should be already clear to our Congress that our present laws are not adequate, and that action should be taken next year before public interest in the problem flags.

Apart from the illegality of deducting such payments on U.S. tax returns, the principal statutory tool by which U.S. companies can currently be called to account is the variety of disclosure requirements in the Securities Acts. In addition, Congress has recently called for further disclosures with respect to military sales under the latest foreign aid legislation; and a similar emphasis on disclosure is contained in most of the other legislative proposals on overseas bribery.

This emphasis is well placed. Sunlight, in the memorable phrase of Justice Brandeis, is still the best disinfectant. A company legally required to expose its bribes—and thus face whatever stockholder suits, public embarrassment and government penalties may follow—is less likely to make these payments in the first place and their collaborators are less likely to demand them.

But our present disclosure laws must be strengthened: to impose more severe and certain criminal as well as civil penalties for those who fail to disclose to the appropriate U.S. government authorities

any payments abroad, including legitimate political contributions and agents' fees, of a significant amount; to cover privately owned companies as well as those subject to SEC jurisdiction (indeed the SEC may not be the appropriate enforcement agency); to cover exporters of civilian as well as military goods; to cover requests received (as is true of current U.S. Commerce Department regulations concerning the Arab boycott) as well as payments made; and to prohibit more precisely the many techniques used to conceal these practices from corporate and governmental accountability systems.

Disclosure, however, cannot carry the whole burden of law enforcement. It would be illogical to punish more severely than at present the nondisclosure of an activity not now illegal under U.S. law. Moreover, when the general or stockholding public proves to be indifferent to a company's disclosures of wrongdoing, as is often the case, no penalty and no reform may follow.

The more direct and traditional approach to law enforcement is simply to outlaw the payment of bribes and kickbacks to foreign officials by all U.S. corporations and their subsidiaries. Many corporate officials would actually be relieved by such legislation; for it would better enable them to resist all temptations and pressures and to hold both their subordinates and at least their U.S. competitors to a higher standard. It would also provide a stronger legal basis for independent auditors, directors and lawyers—as well as federal authorities—to insist in suspicious cases upon a closer look at the books. It would communicate to every company and government the clearest possible statement of our national integrity.

Such a law would have to be drawn and enforced with great care and precision, carefully setting forth the distinctions between bribery and the other forms of payments described above, and not undertaking to enforce what it cannot reach without placing numerous police agents in every U.S. Embassy. Unenforced and unenforceable laws only engender disrespect.

Nor should compliance with a host country's laws be available as a defense under this new statute. Too many of those laws are ambiguous, incomprehensible or unenforced, and the United States cannot undertake to enforce them. Nor, in some countries, is compliance with the law much proof of propriety.

No matter how carefully the new statute is drafted and implemented, however, some improper practices will escape and some new ones will be invented to circumvent it. A foreign agent who acts as an independent contractor for several companies will be able, on his own initiative and with his own funds, without the knowledge or reim-

bursement of a principal, to make improper payments on that principal's behalf that no outside law can reach. U.S. corporations wishing to avoid the law by selling to truly independent local distributors who in turn resell to the local government, complete with kickbacks, will no doubt be able to do so, at least diminishing the impact of their conduct on the United States. Extremely difficult problems of definition, fact-finding and interpretation, such as the seven examples earlier cited, will be frequent.

But the courts and Congress are not unaccustomed to drawing fine lines of distinction. Many another law now on the books is frequently violated but nevertheless desirable as a national standard, even if some violations go undetected. With a strengthened disclosure statute, whatever federal agency is enforcing the law will not be without tools to judge the legality of a suspect payment.

The new law could also regulate the use of agents. To prohibit their use would be outlandish, curbing many legitimate practices and merely causing those intent on paying bribes to conceal them elsewhere. To impose a maximum commission rate would only penalize "small-ticket" sales. But U.S.-based corporations could be required (1) to disclose to the U.S. enforcement agency not only every sizable fee or commission paid overseas but also the services for which it is paid and the recipient's qualifications therefor; (2) to instruct the agent by contract to make no payments to or for government officials and no political contributions on its behalf or with its funds; and (3) to obtain the explicit approval of the host government for that contract and for the agent's rate of compensation. Honest and qualified agents will, on the whole, accept such conditions; those intent on dishonesty will not.

Still other new legislative or executive measures could empower the executive branch to take supplementary action. Violators should be warned that the U.S. government would terminate their eligibility for government contracts and impose no obstacle to their extradition to any country possessing actual proof of their wrongdoing. Any U.S. business executive receiving from a foreign official a request or a demand for improper payments should be required to report it promptly to the U.S. Embassy, which should be required to protest vigorously to the host government. Foreign countries and companies persisting in such practices to the detriment of U.S. economic interests should be warned of the possibility of economic retaliation, ranging from termination of economic and military assistance to denial of access to our domestic markets or stock exchange listings.

Even though a strong international code is not in the offing, the

Department of State should undertake to obtain in advance the approval of all affected governments for each of the legislative measures proposed above. Whatever their real feelings, they would find it difficult to object; and such a step would both dampen the cries that such legislation was imposing our standards upon the rest of the world and improve the prospects for its general effectiveness.

It is to be hoped that such laws will also be accompanied by an increased demonstration of corporate self-regulation. In light of recent revelations, this will never be an acceptable substitute for government measures. But it will still be the most effective form of regulation, if enforced, because management can establish a system of clearances for "unusual" or "potentially embarrassing" payments out in the field that no law can adequately reach. Any new legislation and its administration should thus recognize and encourage company initiatives of this kind.

That will require, however, something more than the recent public relations announcements of companies rushing to "reemphasize longstanding policy" by the issuance of new corporate practice guidelines which are either too vague to be meaningful ("do nothing unlawful or improper"); carefully designed not to interfere with their particular practices ("do not violate local law, local custom or U.S. law; make no payments to the foreign government officials responsible for our industry"); or otherwise ineffective, by design or inadvertence.

Companies no more than governments should attempt to enforce what they cannot realistically reach. But a strict, comprehensive company code should be implemented by prompt disciplinary action, including dismissal at any level for violations; by annual sworn certifications of compliance by all responsible members of management; and by a system of full disclosure to counsel and auditors as well as superiors. Such measures, if accompanied by a reduction in pressure in the field to obtain contracts by whatever means necessary, would be far more effective than the recent proposal authorizing the government to remove the chief executive of an offending company.

In evaluating government as well as private regulation in this area, Americans should bear in mind a wise conclusion of John J. McCloy and his associates in their landmark investigation of the Gulf Oil Corporation's payments at home and abroad. "[I]t is not in the institution of rules and procedures," said that report, that the answer to this problem lies, "as much as it . . . is in the tone and purpose given to the Company by its top management."

The same is true of our country.

Mr. MURPHY. Thank you, Mr. Sorensen, for a very effective statement.

What effect do you anticipate the adoption of H.R. 15481 would have on our trading partners.

Mr. SORENSEN. I think it would embarrass our trading partners into taking more effective action themselves against their own enterprises which continue to pay bribes.

Mr. MURPHY. The administration bill would make the Commerce Department the reporting agency for the purposes of bribery disclosures.

Do you feel the Commerce Department is the appropriate agency to oversee this problem?

Mr. SORENSEN. No; I do not. The Commerce Department has a natural constituency among the American business community which has been reluctant to have any bold, new steps in this area. It is not a law enforcement agency. The problems of corruption and criminal behavior ought to be dealt with by the Department of Justice, a law enforcement agency.

Mr. MURPHY. In your testimony you make clear that disclosure requirements by themselves would be only minimally effective in dealing with the problem of foreign payments.

Do you see any advantage to incorporating disclosure requirements into the bill as an addition to the flat prohibition on bribes?

Mr. SORENSEN. Yes; I would. Frankly, I think that this is not a contest, as some have suggested, between disclosure and criminal proscription. The two can go hand in hand, and I think the bill would be strengthened if it contained disclosure requirements for those not subject to SEC jurisdiction.

Mr. MURPHY. You seem to be somewhat unimpressed with the administration's handling of this problem to date.

Mr. SORENSEN. You are right.

Mr. MURPHY. To what would you attribute their seeming laxness?

Mr. SORENSEN. They have not consulted me or disclosed their motives to me, Mr. Chairman. Judging by the press statement that was released by the White House at the time that the special Richardson task force was established, from which this recommendation emanated, I gather that the administration was concerned about adverse competitive effects if American exporters were denied the right to bribe while other exporters continued to bribe.

Mr. MURPHY. But as we have had testimony, it is American versus American.

Mr. SORENSEN. Exactly.

Mr. MURPHY. In so many instances.

Mr. SORENSEN. Exactly. And I cannot stress strongly enough, having done some writing and some speaking on this subject, the number of U.S. business executives who have said to me: "We would be greatly relieved if such legislation were enacted, because it would take the pressure off of us."

Mr. MURPHY. Counsel?

Mr. OPPER. No questions.

Mr. MURPHY. Mr. Sorensen, thank you very much.

The subcommittee will stand adiourned. We will meet again tomorrow morning in this same room at 9:30 a.m.

[Whereupon, at 11:30 a.m., the subcommittee adiourned to reconvene at 9:30 a.m., Wednesday, September 22, 1976.]

FOREIGN PAYMENTS DISCLOSURE

WEDNESDAY, SEPTEMBER 22, 1976

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE,
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE,
Washington, D.C.

The subcommittee met at 9:30 a.m., pursuant to notice, in room 2322, Rayburn House Office Building, Hon. W. S. Stuckey, Jr., presiding (Hon. John M. Murphy, chairman).

Mr. STUCKEY. The subcommittee will come to order.

Today the Subcommittee on Consumer Protection and Finance begins its second day of hearings on H.R. 15481 and other similar bills to amend the Securities Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of the act to maintain accurate records, and to prohibit bribes to foreign officials.

Yesterday's witnesses, which included Chairman Hills of the SEC, representatives from the Treasury, Commerce, and State Departments, and Theodore Sorensen, former Special Counsel to President Kennedy, were unanimous in their appraisal of the foreign bribery problem as having serious adverse consequences on this country's foreign policy, the business climate abroad for U.S. corporations, and on our own moral expectations, and requires, at the very least, firm remedial legislative action.

The Securities and Exchange Commission views the accounting standards in section 1 of the bill as the cornerstone of the legislation, since the more than 20 injunctive actions brought by the SEC to date have involved "slush funds" and questionable payments not recorded on the books and records of the company. He firmly defended the provisions of section 1 in light of rather recent comments of some members of the accounting profession.

The panel comprised of representatives of the Departments of Treasury, Commerce, and State clearly supported the objectives of H.R. 154841, but indicated a preference for disclosure standards as incorporated in legislation recently proposed by the administration, rather than the criminal sanctions which the bill before us today would impose on persons who engage in bribery of foreign officials.

Finally, Mr. Sorensen lent eloquent support to the provisions of H.R. 15481, indicating his clear preference for criminalization of foreign bribery activities as opposed to mere disclosure and suggesting that the scope of the present bill might well be expanded.

This morning our first witness will be Congressman Solarz, and we are delighted to have you with us this morning and look forward to your testimony.

STATEMENT OF HON. STEPHEN J. SOLARZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. SOLARZ. Thank you very much, Mr. Chairman. I very much appreciate the opportunity to testify this morning. I thought perhaps the most appropriate thing for me to do would be to ask for your permission to insert my statement into the record and then, in the interest of time, since I know you have other matters of equal concern and other witnesses to be heard from, I might briefly summarize some of the points contained in it.

Mr. STUCKEY. Without objection, your prepared statement will appear immediately following your oral presentation [see p. 140].

Mr. SOLARZ. I am delighted that your committee is holding hearings on this question because I think it is one of the more important issues to confront the Congress during the course of this session.

I speak also as the author of the only legislation to pass the House so far this session relating to the problem of the bribery of foreign officials, since about a month ago or so the House passed the bill I introduced requiring the Overseas Private Insurance Corporation to terminate investment insurance issued by OPIC in any case where the insured investor engages in the bribery of foreign officials. That bill passed under the suspension procedure by a voice vote.

Unfortunately, the bill hasn't yet come up for a vote in the Senate, although hearings are scheduled for late next week. Because of the Senate timetable, it appears at this point as if it is very doubtful that that will come up for a vote on the floor of the Senate, although, if it did, I have no doubt that it would easily pass. Senator Church is the main sponsor in the Senate, and he is actively supporting the bill in the Senate Foreign Relations Committee.

I mention all this because I would like to suggest the possibility, if your committee should actually mark this legislation up and proceed with an effort to report it out for consideration on the floor, that, if the germaneness problems can be solved, you might consider the possibility of attaching my bill on the Overseas Private Investment Corporation, which has already passed the House, as an amendment to the legislation before you.

The reason I suggest that is that, in the event that were done, I have no doubt it would be accepted on the floor of the House. It would mean that legislation incorporating my approach in the OPIC bill would reach conference, and there is reason to believe that the Senate conferees would accept that provision and we would have a chance ultimately to enact it into law.

If we have to wait for the Senate to pass my bill, given the fact that the first day the Foreign Relations Committee can schedule a hearing on it is September 28, it is more unlikely that it would come up for a vote in the Senate this year. This, of course, means that the bill will end up off the law books because, while it passed the House, it will not have passed the Senate.

I realize there may be a germaneness problem, but, if that parliamentary hurdle can be resolved, I certainly would appreciate it if you could consider adding this to the legislation before you. I think it is completely compatible with it in spirit. It deals essentially with the same kind of problem.

Basically, what it says is that an agency of the U.S. Government should not be insuring corporations that engage in the bribery of foreign officials. That is an inappropriate exercise for us to be engaged in. I think it would make sense as an addition to the Murphy legislation.

As the other witnesses, I gather, have indicated, the problem with corporate bribery overseas is that it poses very serious problems for our own foreign policy. I think it is probably fair to say that our relationship with Japan is the foundation of our whole foreign policy in the Far East, and yet we see the government of a valued ally being shaken as a result of the disclosures relating to the Lockheed scandal.

In Italy, a country which is essential to the viability of the southern plank of NATO, where a stable government committed to continued participation in NATO is essential for our own security interests and where the Italian Communist Party has made significant gains in the most recent elections, we find that the Government has been at least partially undermined as a result of allegations concerning the possible bribery of some of the highest officials of the Italian Government by American corporations. And, while those allegations have not yet been completely confirmed as to the identity of the alleged recipients, it clearly did have significant political repercussions in Italy.

So I would suggest that, whatever the commercial advantages to American corporations may be of the additional business which is brought in as a result of illegal payments—and there is some skepticism about how much extra business it does bring in—it seems to me that the damage that the exposure of these bribes results in to the foreign policy of our own country is something which ought to concern the Congress.

Now, a number of people have said that this approach is all well and good, but the problem with it is that it represents an effort to impose our own standards of morality on others and that we ought to concentrate on cleaning up our own house rather than on telling people how to do business in foreign countries.

The problem with this argument, Mr. Chairman, is that it is fundamentally unrelated to reality. While it has a seeming intellectual attractiveness, it is ultimately, I think, a facile argument. I say that because, in the course of doing research on the legislation I introduced concerning OPIC, we commissioned a study by the Library of Congress of the applicable laws on bribery of all of the countries in which OPIC has insured contracts. We discovered that in virtually all of them there were laws on the books prohibiting bribery.

What I would like to suggest, therefore, is that if we were to make the payment of bribes to foreign officials illegal in other countries than our own, in point of fact we would not be imposing our standards on others because I think research would indicate that virtually every country in the world already makes such payments illegal.

A number of other people have also suggested that it might be preferable to deal with this problem on a multilateral basis. I have no objection to that approach. Indeed, I think it is highly desirable, but, if we have to wait for the countries of the world through the U.N., through other mechanisms, to get together and to agree on an international code of corporate conduct prohibiting bribery, we might have to wait well into the 21st century. And I think in the

interim we ought to set an example for the world by moving forward and enacting the kind of legislation which we have before us.

Lastly, Mr. Chairman, may I say that, if one looks at the pattern of corporate bribery that has been exposed over the course of the last year through the very effective work of Senator Church's subcommitte in the Senate, the work of the SEC and the IRS, one discovers that, in many instances, what you really have is a situation where American corporations are competing for business not with the firms of other countries, but against other American firms, for the same share of the business of that country. And to permit American corporations to bribe foreign officials, thereby creating problems for our foreign policy, only to gain a competitive advantage against other American firms seems to me to be a ridiculous situation which we ought to prevent.

So I very much hope, Mr. Chairman, that, in the remaining days and hours of this session, realizing the parliamentary hurdles and political obstacles that lie ahead, that you will be able to effectively exercise some leadership in bringing this legislation to a vote. I rather doubt in this election year that there would be too many members of the House who would atempt to obstruct the passage of this motherhood legislation.

[Congressman Solarz's prepared statement follows:]

STATEMENT OF HON. STEPHEN J. SOLARZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. Chairman, it is a great privilege and pleasure to testify before this Subcommittee on one of the more important issues with which this Congress has had to deal this year. I am pleased that you have taken up the topic of bribery overseas by U.S. corporations, and only regret that the time is apparently too short to complete action in this Congress. I would hope that the 95th Congress makes the elimination of American corporation payments overseas one of its principal priorities next year.

I am speaking to you both because of my interest in the bill as well as the author of the only piece of legislation dealing with illegal overseas payments which has passed the House. Last month the House passed a bill which I introduced requiring the Overseas Private Insurance Corporation (OPIC) to terminate investment insurance issued by OPIC in any case where the insured investor engages in the bribery of foreign officials.

I was similarly delighted to see that Senator Proxmire's bill—upon which Chairman Murphy's bill is based—passed the Senate unanimously on an 86–0 vote on September 15. I particularly endorse the section of the bill which outlaws bribery by providing criminal penalties for payments overseas of up to two years imprisonment and a fine of up to $10,000. I believe that it is also useful to require companies registered with the Securities and Exchange Commission to maintain accurate books and records, to require internal accounting controls in order to insure corporate responsibility for all actions by employee or representatives of the company, and to extend the coverage of the anti-bribery laws to businesses other than those registered with the S.E.

In my testimony today, however, I first want to discuss the problem of American corporate bribery overseas, from my vantage point on the House International Relations Committee, in terms of its effect on the conduct of U.S. foreign relations. It is important to look at the problem of overseas payments in broader terms than simply a matter of economics or even morality.

It is clear that American companies have engaged in bribery on a grand and international scale to such an extent that the conduct of American foreign relations has been damaged. Headline after headline has appeared concerning some new American multinational company coming forward with an admission of corporate bribery or other payments to foreign officials. One day it is Lockheed. Another day it is Gulf. A third day it is General Tire. And the list goes on and on

to include a roster of some of the United States largest and most distinguished corporations.

I need not go into the wide variety of reasons that this bribery is both morally wrong as well as damaging to the free enterprise system. Even more directly a concern of my Committee are the deleterious effects on the conduct of American foreign relations. I need only to cite several recent examples.

In Japan, the present government of Takeo Miki is undergoing a severe strain due to its handling of the alleged Lockheed payoff scandal in that country. Japanese opponents of the present close ties between the United States and Japan have been handed a terribly effective weapon to drive a wedge between two close allies. At a time of uncertainty due to the shifting balances of power in Asia, our strongest and most stable ally in the region is undergoing unnecessary turbulence, and the relationship which is at the very heart of our foreign policy has been potentially jeopardized.

United States ties with another close ally, the Netherlands, have been similarly shaken by the allegations surrounding Prince Bernhard, husband of Queen Juliana and Inspector General of the Armed Forces, suggesting that he received $1.1 million in Lockheed payoffs. The Prince recently had to resign from his official posts as a consequence of an official inquiry into the allegations, a move which has shaken the royal house in the country.

Perhaps most serious is the delicate situation within Italy, one of the keys to the southern flank of NATO and a member in good standing of the European Economic Community. The power relationship between the Christian Democrats and the Communist Party is still very much in the balance since the June parliamentary elections in which the Communists picked up many votes and some important positions in the current Parliament. The Communist Party may yet formally enter the Italian government or even surpass the Christian Democrats to become Italy's largest party.

During the June elections, the Communists had a wide variety of issues to use against the recent ineffectual coalition governments, but the allegations of widespread payoffs to various Italian officials—up to and including a past Prime Minister—only provided an additional strong club to use against the government. It is not inconceivable that as a result of these disclosures, our whole foreign policy in both the Mediterranean as well as the southern flank of NATO has been very much undermined.

Thus what is at stake is much more than the individual interests of corporations which are competing for a share of foreign markets. What is in fact at stake is the foreign policy and national interest of the United States. It is clearly in our interest to put a stop to these pernicious practices. Leaving aside the question whether bribery is necessary to win contracts—and there is much evidence that it is not—there is much more involved than a few dollars. We simply cannot permit activity which so damages U.S. foreign policy.

There are some who have said that we ought not to impose our own moral standards of morality on others. This is a seemingly attractive if ultimately facile argument. The fact is that most of the countries in the world already have laws which make it illegal to bribe public officials.

In January of this year, I requested the Congressional Research Service to conduct a study of countries in which the Overseas Private Investment Corporation—over which my Committee maintains jurisdiction—insures investments to see which have laws dealing with bribery. The results of this investigation, which covered much of the developing world, indicate that almost all countries do have laws against bribery, with about half providing penalties of less than five years and half providing penalties of six-ten years.

Some people have said that bribery is not only a fact of life, but actually a necessity for doing business in the commercial life of the developing world—and even much of the developed world. I think that there is ample evidence to refute this point of view, including the statement earlier this year by the former Ambassador to Saudi Arabia James Akins that American companies did not have to make illegal payments in order to do business in the Middle East.

When Bob R. Dorsey, then the Chairman of Gulf Oil Corporation, testified before the Senate Subcommittee on Multinational Corporations, he pleaded for legislation to make it easier to resist demands for bribes:

"But you can help us, and many other multinational corporations which are confronted by this problem by enacting legislation which would outlaw any foreign contribution by an American company. Such a statute on our books would

82-981 O - 77 - 10

make it easier to resist the very intense pressures which are placed upon us from time to time."

Many people have put forth the pious claim that the problem of corruption in foreign countries is a multilateral one, not one to be solved by the United States alone. I note that the Ford Administration has on occasion taken a similiar approach. On March 5, 1976, Deputy Secretary of State Robert S. Ingersoll proposed an international pact to combat corporate bribery, including a multilateral agreement within the United Nations system to help deter and punish corporate bribary and a system for bilateral cooperation with foreign law-enforcement agencies. In addition, the OECD has attempted to set up a code of conduct for member nations.

While these proposals are laudable—and an international framework for dealing with bribery would be preferable—any truly effective international agreement which provided enforcement procedures and sanctions would be a long time coming—if ever. Even Mr. Ingersoll conceded that it would take years just to implement the information exchange. To wait until bribery is solved on a multilateral basis may well be to wait forever.

The New York Times in a February 21, 1976 editorial entitled "Corruption's Menace" stated the issue clearly: "The angry and deeply troubled reaction of responsible political leaders and of the public in the United States, Japan, the Netherlands and other free nations to the recent disclosures of corrupt business-government links—and their ugly relation to the arms race—is a warning to all corporate leaders, politicians and bureaucrats, whether they themselves have ever engaged in corrupt business practices or not." I believe that this bill will be a significant first step in implementing that warning by making it clear that the United States Government will no longer tolerate corporate bribery.

There are, to be sure, risks involved to American corporations if the Congress moves to stop their overseas bribery activity. But there are even greater risks to our own political standing if this activity is permitted to go on. Revelations of illegal payments have served to embarrass the United States as well as the recipient countries. And the Congress should act to discourage bribery before it creates additional problems for American foreign policy.

Mr. STUCKEY. I agree with you very much on your observations and analysis of the bill. I think we do need to have legislation of this nature. Whether we will be able to get it through this session or not, I don't know. I have some question about the parliamentary procedures, as to attaching it to H.R. 9860, although I also agree that it would be a faster and better way of doing it, working under the present time schedule limitations. However, we will just have to see what we can do. As far as the committee is concerned, I am sure, if time allows, we will try to get the bill through the subcommittee.

I have no questions. Mr. Eckhardt, do you have any questions?

Mr. ECKHARDT. I just wish, Mr. Chairman, to compliment our distinguished colleague for bringing a very important matter before this committee. I will say, however, that I am not altogether convinced that legislation which is so related to motherhood, home, and fireside is therefore necessarily legislation which should be hurriedly passed. There are many bad pieces of legislation that have passed in the waning days of a session on that very basis.

I am not saying here that this is not good. It appears to be a very competently prepared piece of legislation. But I am sure that the subcommittee will have a disposition to act with dispatch on it.

Mr. SOLARZ. I think no Member of the House has a greater reputation for carefully scrutinizing legislation which passes through the process than the distinguished gentleman from Texas, and I certainly would agree that we ought not in the closing days of the session try to

rush things through which otherwise would not be able to stand the kind of scrutiny which the process ordinarily permits.

I would simply point out, however—and I think this does have some relevance—that this is a matter which the Congress as a whole has been dealing with for about 1½ years now. It received very careful consideration in the Senate. It has been before the committee for quite some time. And I don't think that the technical problems posed by the legislation are so difficult that it would be impossible, if there were a will, for those Members of the House who are concerned about the integrity of the process to give this legislation the kind of careful consideration which it certainly is entitled to.

Mr. ECKHARDT. I was just looking at a provision. It says:

> It shall be unlawful for any person, directly or indirectly, to . . . omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made . . . not misleading to an accountant in connection with any examination or audit of an issuer. . . .

Let us see. That is, I assume, a criminal standard, isn't it? Isn't it a criminal standard for application of criminal penalties?

[Discussion off the record.]

Mr. ECKHARDT. There is some question in my mind as to whether that may be too vague a standard upon which to impose criminal penalties. Things like that, I think, need to be looked into, just by way of example. I don't think it is a matter that cannot be corrected.

Mr. SOLARZ. The only point I would make here—and I think the gentleman's observation and caution is a good one—is that, given the built-in problems of proof with respect to illegal payments made outside of the territorial jurisdiction of the United States, that one of the most effective ways of establishing the existence of such payments is through the corporate records of the firms involved, and——

Mr. ECKHARDT. Well, I don't have any objection to requiring that certain records be kept if they are in general described in such a way that a person knows what his duties are with sufficient certainty, but a standard of not omitting to state facts which, if not stated, might be misleading to an accountant—I don't exactly state the language, but that is a paraphrase of it—seems to me to give very little guidelines as to what constitutes a criminal activity.

Thank you, Mr. Chairman.

Mr. STUCKEY. Thank you.

Mr. SOLARZ. Thank you.

Mr. STUCKEY. Our next witness this morning is supposed to be Congressman Harrington. If you will bear with us for just a short moment, I would like to give Congressman Harrington a little time to get here this morning. I believe that he just has a statement that he would like to get in before that of Mr. Holton this morning. And I think that Mr. Holton's statement is somewhat lengthier than Mr. Harrington's; so, if you will just bear with us, we will hold on for just a few minutes.

[Off the record.]

Mr. STUCKEY. The next testimony that the committee will hear will be from Congressman Harrington of Massachusetts. Pleased to have you here this morning.

STATEMENT OF HON. MICHAEL HARRINGTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. HARRINGTON. My apologies, Mr. Chairman, to yourself, your staff, and Mr. Eckhardt, for keeping you. I appreciate your letting me testify. I have a brief prepared statement I would like to read, if I could, with your permission.

As I have indicated, I am grateful for the opportunity to testify today in favor of a long-overdue legislative response to the widespread practice of corporate bribery abroad. I support the enactment of criminal penalties to curb these illegal payments and would favor adding a strong disclosure requirement along the lines suggested by Senator Church on the Senate floor last week.

But my main reason for appearing today is to emphasize my misgivings about rushing through this kind of bill at the end of the session, as if it were a definitive solution and total absolution of American corporations and this Congress from any further responsibility for corrupt business practices.

Having watched the debate over the form of this legislation—the merits of disclosure requirements versus criminal sanctions or some combination—I have been distressed at how little attention has been paid to what lies at the heart of the entire issue: Public confidence in our national institutions.

Surely the members of this committee are aware of the numerous polls and studies conducted since the mid-1960's that document the American people's growing sense of alienation from, and distrust of, their Government. The increasingly large number of voters who choose not to exercise their franchise in Presidential, congressional, and local elections is one—but only one—concrete indicator of this trend. A recent study by pollster Peter Hart projects a record number of nonvoters in 1976, perhaps as much as half of the electorate.

Rather than running through a long list of the various reports documenting this dangerous loss of public faith in our country's institutions and principles, I prefer today to focus on a recent study conducted by the State Department, at Secretary of State Kissinger's request, in conjunction with "town meetings" his aides held in five U.S. cities.

The study was designed by the Department's Public Affairs Bureau to measure how the American people perceived our foreign policy. The striking results were only recently made known by New York Times reporter Leslie Gelb, who obtained a copy of the still-unreleased report.

As we sit here today to discuss how the Congress should deal with the problem of corporate bribery overseas, almost 3 years after the first corporation earned its place on what has become the "Bribery 40" list of the Fortune 500, I think it is essential to first understand, as the State Department now does, just how deeply the public's distrust on this and related issues runs.

I would like to quote briefly from three sections of the study, as reported in the September 16, 1976, New York Times. I am now quoting:

> There is a "longing for a national purpose beyond self-defense," as reflected in a belief that "we" in Washington simply have not appeared to be animated

in the last decade or so by the same root sense of right and wrong as "they" elsewhere in the country.

I am again quoting:

[W]e found distrust of this Government's effectiveness in carrying out policies intended to express the public's humanitarian concerns.

Finally:

We were struck by the extent to which the participants [in the town meetings], whatever their specific views on particular problems, felt that they and the Department responded to the beat of different drummers.

The article characterized the study's findings of the general attitude as—

Skepticism that the Government is heeding and serving the American public . . . coupled with a yearning to see the United States play a significant and benevolent role in world affairs.

It is not difficult to identify the roots of these feelings of alienation and self-doubt. Instead of a generation of peace, we have experienced in the very recent past a generation of Government deception, insensitivity, and short-run pragmatism.

The specific examples need not be restated to those of you who have participated in the difficult debates during the last decade. The corporate bribery matter that is now before this committee is but the most recent manifestation of a persistent national malaise: A government inclined to cover up or tacitly condone misdeeds both at home and abroad.

To date, we have had studies by a Presidential task force, hearings in the House and Senate, investigations by at least four agencies in the executive branch, and public "confessions," albeit induced by investigative pressures, by nearly 100 corporations. We have received assurances that past illegal payments are under investigation and that a recurrence is no longer possible. Just 2 weeks ago, the Emergency Loan Guarantee Board approved a refinancing of the Lockheed loan guarantee, replete with paper promises and token procedures that purport to prevent future bribery.

Yet, what message has the American people received regarding our response as a nation to this scandal? They have seen the Christian Democrats in Italy, the Liberal Democrats in Japan, and the royal family of the Netherlands rocked by scandal. They have seen former Japanese Prime Minister Tanaka imprisoned and released only after posting $680,000 bail.

At the same time, the response in this country can be charitably characterized as glacial at best. The corporations involved have been reluctant to reveal even the most general information about their illegal activities. Lockheed went so far as to reward the officers involved by voting its former president and vice president each $65,000 a year in pensions, while awaiting a board of directors' determination on reinstatement of a $100,000 per year consultancy arrangement initially contracted at the time of their departures.

The governmental response has been replete with decisions to limit the public disclosure of bribery information, most notably marked by Secretary Kissinger's unprecedented intervention in the SEC/Lockheed court case to see, successfully as it turns out, an injunction against

more than minimal disclosure. He has obtained the same kind of constraints on information flowing to foreign governments.

The image of governmental tolerance and lack of moral concern has been so etched on the American consciousness that no bill reported by this committee, especially one that appears as a token afterthought by a waning Congress, could erase it.

By our reluctance to act, particularly regarding Lockheed, which throughout this period has been propped financially by our Government's pledge of credit, we have only fueled the public's sense of alienation and low regard for the institution of government.

I realize that there is little that this committee can do at this juncture in its consideration of one particular bill to stem the drain on the public's faith in our national integrity; but, by acknowledging the problem and the role of Congress in it, we can at least begin to shift our vision in dealing with those issues toward the broader landscape of public consciousness.

Today I am submitting my concerns, as well as my frustrations, so that collectively we can reach for solutions to problems like corporate bribery that represent more than a rote exercise of token legislative action.

If I could, Mr. Chairman, just briefly continue, I had the experience—and one that I hope other Members of the Congress might share—of asking to be a participant in the recent hearings by the Emergency Loan Guarantee Board in deciding whether or not to approve a newly negotiated loan of some $500 million to the Lockheed Corp. After getting through the consternation caused by having a Member of Congress request participation and a suggestion that the size of the room limited staff availability to me, the hearings treated me to something that I could only describe as a broad philosophic, cultural, and political gap in terms of the presentations made by both the banks and by Lockheed itself; and—I might say not surprisingly—by the two remaining principals, Secretary Simon and Mr. Burns. Mr. Hills disqualified himself because of the SEC investigation.

What it did do is to serve to remind me of what I think is something we have failed to do well. This is something that I suggest Senator Ervin has done singularly in the course of the time he was in the Congress: Educate the American public to the magnitude and duration of practices of this kind. He refused to complacently or indifferently accept assurances from either the Executive or from the parties directly implicated that things will be better. Merely passing legislation, no matter how well intentioned is no substitute for that kind of a congressional stomach and will. A broader degree of knowledge in what the regulatory agencies have been doing to date as far as the activities of these corporations who dominate, at least at the top level, perhaps the great bulk of American enterprise both here and abroad is necessary to further conduct any investigation.

I think the bill is worthwhile, at least in focusing some attention on the problem. I think, however, it would be more worthwhile to put pressure on regulatory agencies—which your committee in part does deal with in an oversight way—to reveal to the Congress and to the public, as the singular disincentive, the kind of activities, which have become the kind of common practices rather than the exceptions, that we see on an almost daily basis on the front pages and financial sections of our papers.

I don't think this bill is adequate. I recognize the fact that it is in a sense governed by the constraints of an election year, and by the limitations imposed on a single committee and by the resources available; but, I think a great deal more could be done in the Ervin mold to begin to get broad public awareness through the educative process as to what we have really been able, perhaps most substantively, to glimpse from abroad.

So this morning, I suppose I come to urge you to act on the bill, as I suspect you will, in an attempt to get it before a reluctant President before the session ends. But more importantly I urge you not to allow either indifference or apparent lack of concern characterize the congressional response to this issue. Instead I stress the magnitude of the problem, and that it is not an aberration on the pattern which will be corrected if only we accept the assurances of those who are principals.

Mr. STUCKEY. Thank you, Mr. Harrington. Let me say—and I think I speak for the whole committee on this—that you have presented one of the most thought-provoking testimonies that I have heard, and it certainly gives us an unusual insight into the problem.

I tend to agree with most everything that the gentleman has said, but let me ask this. Do you feel that there is probably enough legislation already on the books now to handle the problem, if the various departments and independent agencies will just address themselves to the problem and further if the Congress will exercise whatever responsibilities it is charged with, and that includes the oversight, functions of Congress?

I know you feel that the legislation is inadequate, but is that mainly because of the reason previously outlined?

Mr. HARRINGTON. I feel very strongly that the existing legislation is adequate, Mr. Chairman. You certainly have had more experience than I in this particular committee; but the very reluctance of most committees even to issue subpenas for the basic information is often a clear signal to both the executive branch and to those who are involved of these committee's timidity. These investigations could take on these issues in a timely and serious fashion without new legislation at all—I think that pressure from the Congress on the SEC to make available to it the results of its investigations are of a comparatively greater resource. These types of actions would do wonders as far as precluding the same kind of activity from occurring in the future. In fact they may very well sensitize the American public to exactly what has been going on and deal with the other problem—the profound disbelief in ourselves. I think in most areas of activity described as institutional in this country, whatever our intentions, we have contributed to, by our apparent lack of concern, the cause of this alienation.

This isn't going to solve it, but I suggest it is a start.

Mr. STUCKEY. I agree with the gentleman that one of the problems—and not just in this area, but in many areas—has been that the Congress really has never in the past exercised its proper oversight role. But I will say this: I do feel that the Oversight and Investigations Subcommittee, that Congressman Moss chairs, is really starting to go into a number of these areas.

It is going to take some time, and a lot of it is really having to go back and make up for some of the lost opportunities of the past, but, as member of that subcommittee, I do feel that at least it is headed

in the right direction, and I am hopeful we will start seeing some results from these investigations. And notice has been served to the independent agencies that Congress is going to exercise its oversight role a little bit more frequently than it has in the past.

So I am in sympathy with you on that. I hope that we will start doing just that, and I certainly appreciate your testimony.

Mr. Eckhardt, do you have any questions?

Mr. ECKHARDT. Well, I want to compliment our distinguished colleague from Massachusetts for a very good statement on the point. And I also agree with him that merely to pass legislation, new legislation, to meet a problem which is probably governable by existing legislation, should not constitute a means of simply brushing the question under the rug without future oversight respecting the agencies that are called upon to enforce both existing legislation and the new legislation.

I had already said to the preceding witness that the fact this may be an extremely emergent problem should not cause us to fail to look at it with great care with respect to the effectiveness and the fairness of the legislation involved.

I thank you, Mr. Chairman. That is all I have.

Mr. STUCKEY. Does the staff have any questions?

Mr. OPPER. No. No questions.

Mr. HARRINGTON. If I may, let me just respond, since I don't want to engage an overuse of your time. When I look at the use of time the last 2 days that we have collectively spent with that witless exercise involving 20-odd rollcalls on Monday and the same thing on Tuesday and look at 800 of those over the course of the year, we are merely substituting illusion of activity for something that goes to issues. Whether it is the sort of thing we have experienced earlier in the 1970's or the 1960's where, in my committee, the war was never discussed or voted upon or even the subject of debate, doesn't really matter. We deal with the question of whether we will change the title to "A Light in Oklahoma," instead of whether or not we are going to sell $6.4 billion of arms in the last stages of the Congress without their being any debate on its implications. This type of action or inaction puts in perspective the sort of thing that I am most concerned about—getting to the essentials. Whether it is your committee or mine—and I am not here this morning obviously, Mr. Eckhardt, Mr. Stuckey, to suggest that the responsibility rests in a particular committee—is not important. The fault is, collective; we let the illusion of action substitute for dealing substantively with problems in a more meaningful way. I appreciate the chance to share that feeling with you.

Mr. ECKHARDT. Mr. Harrington, for instance, in the section on payment to officials, we make it unlawful for any domestic concern to give anything of value to any individual while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised directly or indirectly to any individual who is an official of a foreign government, for the purpose of inducing that individual, official, or party to influence a foreign government, et cetera.

Then we set a penalty: "Any person who willfully violates this section shall, upon conviction, be fined not more than $10,000, or imprisoned not more than 2 years, or both."

And the term "domestic concern" means either an individual who is a citizen of the United States or a corporation.

Now, I am only speaking tentatively here, but I can see situations in which an individual, an employee of a corporation, might be said to have reason to know that some foreign person might be corrupt, and its is conceivable that his activity would not be all that culpable. Of course, it does say "willfully violates this section."

I am a little concerned about whether or not a person who is doing that at the bidding of the corporation and that which is within the custom of the practice of business and who does not know the money will be used corruptly, but may have reason to know it might be, might be perhaps too severely punished with imprisonment of up to 2 years, whereas, on the other hand, I am inclined to think that $10,000 is not much punishment to a corporation that is going to make a billion.

Now, things like this, I think, need weighing and consideration, and I share your concern about what happened yesterday and the day before in which bills are presented on the suspension calendar with no opportunity for the whole House to examine them, perhaps amend them, debate them over 40 minutes. And I submit that even bills that are so related to what we consider mother, home, fireside—even bills like that have very difficult qustions involved, and I somewhat question whether or not the mere immediate action on such a bill is desirable.

I don't know whether that is a part of your concern. Perhaps I go too far——

Mr. HARRINGTON. The concern I have is that all of this frenetic activity, which has kept us in session from January until December in most of the years I have been here, has resulted in a net decline in public approbation of the Congress from the mid-20 percentile level to just under 10 percent. We don't fool anyone.

When we begin to deal—whether it is corporate bribery or it is domestic concern about the economy or it is arms sales—with something approaching relevance, I suspect that all of these things in terms of sheer numbers could drop by the wayside and be not dealt with at all. Then we might get some approbation and deal with some of these problems that are the pressing ones and the real ones that not only dissillusion, but make people more cynical. People are now saying we are a nonevent, and I think justifiably so.

That is what concerns me. We have substituted the kind of paced activity, which appears to create an illusion that we are here and working in some sort of sustained way for avoidance of basic things.

Why does it take a year to get revenue sharing? Why is it dealt with in the last week in the session? Revenue sharing is particularly fundamental to some of the economies in the area of the country that I come from.

Mr. STUCKY. If I thought it would do any good, I would ask the staff to make reprints of your testimony today and send it to "the leadership" in hopes that they might read it and that it might alleviate this problem in the future, but I doubt that very seriously——

Mr. HARRINGTON. You have heard this piece before. I am just interested in not looking for vengeance by repeating ground we have trod over, but I don't think we kid anyone, any way you want to measure it, by having this sort of thing suffice for something a lot more adequate.

Mr. STUCKEY. Being realistic, I think really what we are doing today is laying the groundwork for the next session on this legislation, if there is to be legislation. I just don't see from a practical standpoint—since we are scheduled to adjourn in 10 days whether the bill could get through this year. Even if it were attached onto existing legislation, I just don't see how it is possible. Bob, do you see any way?

Mr. ECKHARDT. That would be my concern. I think legislation like this is important. It needs consideration. And I think that to use a process which bypasses that consideration may be counterproductive in the long run.

Mr. STUCKEY. I agree with you, but I am saying that looking at it from a practical standpoint I just don't see that there is sufficient time to have the bill presented before the House for floor action.

Mr. ECKHARDT. Thank you, Mr. Chairman.

Mr. STUCKEY. Thank you.

Mr. HARRINGTON. Thank you.

Mr. STUCKEY. Without objection, the Chair wishes to place in the record as though read, a statement submitted by the Honorable John E. Moss of California. Congressman Moss is chairman of the Oversight and Investigations Subcommittee of our full committee.

STATEMENT OF HON. JOHN E. MOSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Moss. Mr. Chairman, members of the Consumer Protection and Finance Subcommittee: I accepted your invitation to testify on H.R. 15481 because the Subcommittee on Oversight and Investigations has developed a considerable record on corporate accountability in general and about illegal and questionable corporate payments in particular. The record demonstrates the need for enactment of H.R. 15481. Our hearings and studies indicate to me that a crisis of confidence in corporate accountability prevails in this country.

To date more than 200 corporations have disclosed illegal or questionable foreign or domestic payments to the Securities and Exchange Commission. In addition, the Commission has brought 20 enforcement actions. The first 89 corporations to make such disclosures are summarized in the SEC's report to the Senate Banking Committee.[1]

The subcommittee held 4 days of Securities and Exchange Commission oversight hearings,[2] A substantial portion of those hearings dealt with the symptoms and causes of the crisis of confidence in corporate accountability. The subcommittee conducted oversight of the SEC's enforcement of the disclosure requirements set forth in the Securities Act of 1933 and the Securities Exchange Act of 1934. Enforcement of these disclosure requirements is an essential element of corporate accountability.

During the hearings, the subcommittee voted to publish the staff's study of the SEC's voluntary compliance program,[3] an evaluation

---

[1] Securities and Exchange Commission, "Report on the SEC on Questionable and Illegal Corporate Payments and Practices", submitted to the Senate Banking, Housing and Urban Affairs Committee, March 12, 1976.

[2] House of Representatives, Subcommittee on Oversight and Investigations, Committee on Interstate and Foreign Commerce, Regulatory Reform—Securities and Exchange Commission, May 20, 21, 24, and June 1, 1976, 94th Cong., 2d sess. (subcommittee print).

[3] House of Representatives, Staff Study by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce, "SEC Voluntary Compliance Program on Corporate Disclosure", 94th Cong., 2d sess. (subcommittee print, June, 1976).

undertaken at the direction of the chairman. The subcommittee staff examined material filed by more than 60 corporations, analyses and recommendations of SEC staff, and the Commission's conclusions. Of the 60 corporations, eight are summarized in the Staff Study because, in the opinion of the staff, they point to serious shortcomings in the voluntary compliance program.

The staff study questions whether the SEC's action was sufficient in eliciting all the relevant facts because of the inadequacy of the enforcement staff to conduct follow-up investigations of the corporations which had disclosed voluntarily making illegal or questionable payments. Without thorough follow-up investigations by the SEC, the public cannot be confident that disclosure has clarified the full extent of illegal and questionable activities. Nor will the Commission know the degree to which the Federal securities laws have been violated. Morevore, the SEC's success in securing cessation and remedial action is doubtful.

The subcommittee staff study is also critical of the failure to require disclosure in some cases or to permit only generic disclosure in others. For example, the Commission did not require disclosure of $2.2 million in payments by the Celanese Corp., although senior management knew about the making of a large portion of those payments and although inhouse and outside accountants had known for at least 3 years that Celanese's internal controls had broken down. The SEC staff concluded that the payments were material. The Commission disagreed and required nonspecific disclosure.

In three other cases, Kraftco, Cities Service, and Gardner-Denver, names of corporate officers who had knowledge of illegal payments and therefore should have known that internal controls had broken down, were not required to be disclosed in proxies to shareholders even though those same officers were nominees for election to the board.

On one hand, the SEC recognizes the need for assuring the adequacy of internal controls, because it proposes legislative remedies similar to those contained in section 1 of H.R. 15481. On the other, the Commission has ruled that shareholders should not be informed before electing directors or giving proxies that nominees had knowledge that internal controls, which are supposed to protect shareholders' assets, had broken down.

In addition to the role of the SEC in the system of corporate accountability, there are other equally important stages in that system: Internal corporate conduct and financial controls; independent accountants, auditors, and counsel; and boards of directors. Disclosures required by the SEC and the Subcommittee's Staff Study show that the system also broke down at these stages.[4]

To provide a measure of the extent to which accounting or auditing problems were involved in the illegal or questionable corporate payments cases, the subcommittee staff undertook a second study. Twenty-five case histories were randomly selected and problems were separated into four categories: inaccurate accounting entries, off-the-book accounts, falsification of books and records, and knowledge by the independent accounting firm.

The subcommittee will vote shortly on recommendations to deal with the system of corporate accountability. At this time, I cannot

[4] See subcommittee hearings, notably testimony by Dr. Abraham J. Briloff, Emanuel Saxe, distinguished professor of accountancy at the Baruch College of the City University of New York, a CPA and an author of several books on accounting.

inform this subcommittee of the specifics of our forthcoming report; however, it will include an extensive discussion of the illegal corporate payments cases, inadequacies of disclosure, and the problems at the roots of these cases. I will be happy to transmit a copy of that report, after the oversight subcommittee has completed its deliberations.

Proceeding to the legislation before us this morning, H.R. 15481, first I commend you, Mr. Chairman, for its introduction. Also, I commend the chairman and the members of the subcommittee for convening these hearings to address a crisis of confidence very much in the public mind. The bill represents a sound approach to the problem of foreign bribery.

Section 2 of H.R. 15481 would prohibit publicly owned corporations whose securities are registered with the SEC from bribing officials of foreign governments. Business practices of these corporations abroad often impact directly on U.S. foreign policy. Disclosures have shown that United Brands dealings with a Honduran Government and Lockheed's relationship with the Dutch Crown, Italian political parties, and former key leaders of the ruling Japanese party had an impact as great as the Department of State might have had.

Surely the public expects more than to have foreign policy made in the board rooms of United Brands or Lockheed. Not only is a publicly owned corporation unaccountable to the public when it uses its assets to bribe foreign governmental officials, but also it is unaccountable to its shareholders, the ones to whom the assets belong.

Some argue that bribes or questionable payments are necessary to compete in many countries. Most, but not all, of the corporations disclosing illegal or questionable payments state that they intend to cease such payments and state further that cessation will have no material effect.

If a corporation must buy its customers, serious questions are raised about the business. Mr. David Lewis, Chairman of General Dynamics, said his company sold the F–16 to a consortium of NATO countries, including the Netherlands, without resorting to bribery:

> * * * General Dynamics and the F–16 won that large contract without resorting to the use of any agents, counselors, advisors or helpers and without making any payments in any form to anyone.

It may be that a contract will be lost on occasion, but no evidence has been advanced to support the contention that outlawing bribery of foreign governmental officials will cripple U.S. business abroad. Enactment of section 2 of H.R. 15481 will now extend to the foreign markets of our corporations what we require of them when they do business with the U.S. Government.

Outlawing bribery by U.S. corporations of foreign officials still leaves two nagging problems. First, what about a foreign official who extorts, blackmails, or otherwise attempts to induce U.S. corporate payments in exchange for favors. According to Gulf Oil's McCloy report, a prominent political party of one of our close allies forced Gulf Oil to pay about $4 million following a suggestion by that party which implied that a favorable business and political environment might not continue in the future should that party lose in the coming election.

Second, we are told of instances where foreign competitors of U.S. companies offer bribes or commissions and concern is expressed that U.S. businesses would not be able to compete when they are prohibited from offering such favors. Although this has not been proven, I am not insensitive to the situation.

Therefore, I would urge the subcommittee to recommend to the President that his Secretary of State negotiate suitable international accords, preferably through the United Nations, to relieve U.S. corporations and their foreign competitors of this kind of unfair pressure. Section 2 of H.R. 15481 will go far in solving the bribery problem, and I endorse it unequivocally. I would urge a vigorous international effort so that at least the governments of the world's other industrialized countries follow our lead. If after a good faith effort we cannot negotiate an end to bribery of governmental officials, we will have to look for other ways to solve these two nagging problems.

Section 1 of the bill essentially requires a corporation whose securities are registered with the SEC to keep accurate books and records which fairly reflect the company's transactions and assets and to maintain a system of internal controls in accordance with management's specific authorizations. Also, section 1 prohibits any person from falsifying such corporation's books or records. Finally, it would prohibit any person from deceiving such corporation's independent accountants.

Many corporations disclosing illegal or questionable foreign or domestic payments also disclosed that corporate books and records had been falsified; inappropriate accounting entries had disguised kickbacks, overbilling, or underinvoicing; or that payments had been kept secret by passing them through off-the-book slush funds or bank accounts or through an offshore or shell entity. In the *Gulf Oil* case, Bahamas Ex., a branch of Gulf's Explorations Division, was arranged in 1959 by then Chairman William K. Whiteford to serve as a conduit for illegal and questionable payments.

These accounting gimmicks point to part of the underlying problem, the ineffectiveness of internal corporate accounting and auditing controls. A system of internal controls enables a corporation to insure that its executives and other employees handle its business and finances in a way that protects shareholders' assets. In addition, an effective system of internal controls is essential to perform a valid independent audit.

At my request, the subcommittee staff undertook a second study of illegal or questionable corporate payment cases. They studied in detail 25 randomly selected companies which had discussed disclosure with SEC staff.

Of the sample, 96% had some kind of accounting or auditing problem. Forty-four percent had recorded payments in accounts which did not reflect the true nature of the payment; 20 percent maintained off-the-book accounts; and 12 percent showed that books and records had been falsified.

A corporation's internal controls also set standards for employee conduct. The illegal or questionable payments cases document the inadequacy of internal employee conduct controls. Exxon's Italian subsidiary made $27.9 million in political contributions from 1963 to 1971 at the direction of its managing director. Directors of Lockheed were

instrumental in that corporation's payoffs. A Gulf Oil executive vice president was aware that between 1972 and 1975 an off-the-book account was maintained for payments to certain foreign officials.

These are not isolated examples. In 36 of the first 89 companies to disclose illegal or questionable payments, top management had knowledge of such payments. In the subcommittee staff sample of 25 companies, corporate officers or senior management knew about the payments in 40 percent of the cases. In 12 percent of the 25 cases, outside auditors also had knowledge of the payments. On the other hand, independent accountants and auditors defend their profession by noting that in some cases they were deceived or defrauded by management. Where executives and other employees are misusing shareholders' assets, or where the firm's outside auditors knew of such misappropriations, conduct controls are ineffective.

Assuring investors that publicly owned corporations maintain adequate internal conduct and financial controls is essential to restore confidence in corporate accountability. Therefore, enactment of section 1 is essential in furthering the accomplishment of that purpose.

However, that purpose will not be achieved until shareholders' elected corporate representatives are held accountable for the protection of shareholders' assets. Nor will shareholders' be assured of the protection of their assets until they are told by those who must test the system of internal controls in order to perform a valid independent audit that the system is adequate.

Therefore, I recommend an amendment to provide that an indements. First, the board of directors must review and approve annually the corporation's code of conduct and internal accounting and auditing controls. In terms of section 1 paragraph (2), subparagraph (B) would be amended by requiring that the board review and approve management's, general authorization' referred to on lines 8 and 9 and on line 16.

The second amendment would add a new subparagraph (c) requiring management's independent accountant in certifying the financial statement to attest that management's internal controls are adequate to protect shareholders' assets.

Also, I urge consideration of an amendment to paragraph (2), subparagraph (b) clause (iv) (on page 2, line 20) of H.R. 15481 to require that uniform conduct and financial controls are applied throughout every department and operating division of the consolidated corporation, and complementary accounts among subsidiaries and between subsidiaries and the parent are reconciled regularly. This would address the *Esso Italiana* and *Gulf Bahamas Ex.* cases. Also, it would take care of the *Equity Funding* cases.

Section 1, paragraph (4) prohibits management from lying to or deceiving its independent public accountant. The illegal or questionable corporate payments record compiled by the SEC, IRS, and by the Oversight Subcommittee shows that in an alarming number of cases, the outside accountants were not so independent of management. Therefore, I recommended an amendment to provide that an independent public accountant who knowingly falsifies or contributes to the falsification of books and records or recklessly fails to ascertain all pertinent facts is suspended from practicing before the SEC for at least some period.

The Oversight Subcommittee's hearing record points to a dual system of disciplinary actions within the American Institute of Certified Public Accountants and at the SEC. Dr. Briloff perceives a pattern whereby smaller accounting firms are suspended while the big eight agree to go and sin no more. This third amendment would change that pattern.

These three amendments, taken together would asusre more fully that shareholders' assets are protected. There is still much that needs to be done if that objective is to be achieved fully. Additional proposals are probably best left to the next Congress, when we have time to consider a comprehensive approach to this complex problem.

Nevertheless, the three amendments I have proposed would lead us in the direction of assuring shareholders and public investors in general that independent public accountants work for shareholders, whose assets are at stake, not for management. All too often the public investor thinks the financial statement reflects truthfully the financial condition of the corporation. Financial statements today, however, are those of management not the independent public accountant. The three amendments would begin to reverse that.

Accountants argue that it is management who pays the costly auditing fees. However, it is not management's money; managers are agents of the shareholders appointed by the board. The money belongs to those who risk it by relying on the certified financial statement. Therefore, the loyalty of the accountant is first to the shareholder rather than to management.

The three amendments I propose are equally important to further the purposes of the underlying act: to protect the public interest and public investors and to maintain fair and orderly trading in securities.

The securities markets rely on the continuing generation and updating of relevant, accurate, and timely information as the basis for informed capital-raising and capital-allocating decisions. The independent public accountant's role, therefore, is fundamental to our free enterprise system. The accountant's responsibility for assuring corporate accountability and visibility goes beyond his loyalty to the shareholder and his role of maintaining the confidence of public investors in the securities markets. It goes to the heart of our economic system and the total society.

Although I think the record demonstrates that more is needed to accomplish our objective with regard to assuring shareholders that their assets will be safeguarded, H.R. 15481 is far superior to the administration's proposal. It would require U.S. businesses and their foreign subsidiaries and affiliates to report to the Secretary of Commerce all significant payments made in connection with business with foreign governments. The Oversight Subcommittee's Arab boycott investigation led it to conclude that the policies and practices of the Department of Commerce thwarted full implementation of the antiboycott provisions of the Export Administration Act (50 U.S.C. 2403).[5]

The subcommittee concluded: "Through a variety of practices, the Commerce Department actually served to encourage boycott practices,

[5] House of Representatives, report by the Subcommittee on Oversight and Investigations of the Committee on Interstate and Foreign Commerce, The Arab Boycott and American Business, 94th Cong., 2d sess. (subcommittee print, September 1976).

implicitly by condoning activity declared against national policy or simply by looking the other way while these practices grew." [6] Also the subcommittee found that "[t]he data reported quarterly and in special reports to Congress was generally meaningless and almost always inaccurate." [7] If the Commerce Department's exericse of its statutory authority with respect to the antiboycott provisions are the benchmark, the President's proposed legislation represents such an ineffective solution to the pay-off episodes.

The Oversight Subcommittee's work also indicates that the administration is proposing that Congress abdicate one of its constitutional powers, the right to conduct investigations to assure that the laws are faithfully executed. Section 8, subsection (a) provides that corporations shall report to the Secretary payments in connection with an official action, sale to, or contract with a foreign government for the commercial benefit of the corporation or its foreign affiliate. The Secretary shall transmit these reports to the Congress, and its committees and subcommittees, however, "subject to an appropriate arrangement to assure its confidentiality." I submit that this is executive privilege and cover-up of another type.

It was a former Commerce Department secretary, in fact, who haggled with the Oversight Subcommittee over transmittal of the data underlying its subsequent Arab Boycott report. It is no wonder, since the data showed that the Department of Commerce had done a substandard job in executing the Export Administration Act.[8] Mr. C. B. Rogers Morton argued that the terms of the Export Administration Act insulated the Secretary from Congress' need for the boycott reports. After the subcommittee found him in contempt, he supplied all the documents requested.

The requirement to condition transmittal of the illegal and questionable foreign payments reports to Congress set forth in the administration's proposal is unnecessary because the House of Representatives has a very adequate rule for receiving and deliberating upon confidential information. Rule XI(k)(7) provides: "No evidence or testimony taken in executive session may be released in public session without the consent of the committee."

I will not dwell at length on other deficiencies of the administration's proposal because the other body's unanimous vote in favor of outlawing bribery was a decisive vote for the Ford administration's position.

. Mr. STUCKEY. Our next testimony this morning is from the American Institute of Certified Public Accountants. Testifying for them this morning is Mr. Thomas L. Holton, and with him is Mr. Theodore Barreaux, vice president of the Institute's Washington office.

We are delighted to have both of you with us this morning. We welcome and look forward to your testimony.

---

[6] Ibid., p. VIII.
[7] Ibid., p. X.
[8] Ibid. See "Conclusions," pp. VIII–XII.

STATEMENT OF THOMAS L. HOLTON, CHAIRMAN, COMMITTEE ON SEC REGULATIONS, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, ACCOMPANIED BY THEODORE C. BARREAUX, VICE PRESIDENT, WASHINGTON OFFICE

Mr. HOLTON. Thank you, Mr. Chairman. I am Thomas L. Holton, a C.P.A. and partner in the firm of Peat, Marwick, Mitchell & Co. in New York. I also serve as chairman of the committee on SEC regulations of the American Institute of Certified Public Accountants.

As the chairman said, Mr. Barreaux is vice president of the Institute's Washington office and is with me.

I am speaking on behalf of the American Institute of Certified Public Accountants, which is the national professional organization representing more than 120,000 C.P.A.'s throughout the country. We welcome this opportuntiy to testify on the proposed legislation to amend the Securities Exchange Act of 1934 to strengthen corporate accountability and to prohibit certain questionable corporate payments.

In particular, we will direct our comments to section 1 of H.R. 15481, which would require every issuer having a class of securities registered under section 12 of the Securities Exchange Act of 1934 and every issuer which is required to file reports pursuant to section 15(d) of the 1934 Act to maintain its financial records accurately in order to fairly reflect transactions and dispositions of assets, as well as to devise and maintain an adequate system of internal accounting controls.

In addition, section 1 of H.R. 15481 would make it unlawful for any person, directly or indirectly, to falsify or cause ot be falsified any book or record made or required to be made for any accounting purpose. H.R. 15481 would also add a new section 13(b)4 making it unlawful for any person, directly or indirectly, to make or cause to be made a materially false or misleading statement to an accountant, or to omit to state any material fact to an accountant in connection with any examination or audit of a company.

We have no doubt that this is well-intentioned legislation and we are in agreement with what appear to be the objectives of section 1 of H.R. 15481 dealing with corporate records, internal control, and representations to auditors. The July 2, 1976 report, No. 94–1031, of the Senate Committee on Banking, Housing, and Urban Affairs that accompanied S. 3664 stated on page 8—and I quote:

> The committee expects that the requirement to maintain accurate books, records, and management controls and the prohibition against falsifying such records or deceiving an auditor, will go a long way towards eliminating improper payments, which—almost by definition—require concealment.

In some respects, we agree that this portion of the proposed legislation would help in attaining the stated objective, but in other respects we do not agree. Also, we find several deficiencies in section 1 in its present form that in our opinion can be remedied to make the legislation more effective.

INTERNAL ACCOUNTING CONTROL

Our first major area of concern relates to the requirement that certain publicly held companies be required to devise and maintain "adequate" systems of internal accounting controls which are sufficient to provide reasonable assurances with respect to certain management and accounting safeguards.

The drafter of this portion of the legislation was obviously under the impression that "inadequate" systems of internal accounting control have been a significant contributing factor in the more than 100 cases of varying types of illegal or questionable corporate payments that have received publicity because of SEC filings or otherwise. A careful analysis of those cases will show that this simply is not the case. All of those cases involved companies that had systems of internal accounting control. In fact, many people would say that most of them had very good systems. There is no indication that it was the lack of adequate systems of internal accounting controls of these companies that resulted in the abuses and prevented their detection and disclosure. Instead, the abuses usually involved circumvention of internal accounting controls.

The published reports of the incidents of illegal or questionable corporate payments in most instances make reference to "off-book" accounts or other techniques indicating that the internal accounting controls of the companies involved were circumvented. Adequacy of controls was not the issue. The May 12, 1976, "Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices," submitted to the Senate Banking, Housing, and Urban Affairs Committee, makes the following observation:

> Many of the defects and evasions of the system of financial accountability represented intentional attempts to conceal certain activities. Not surprisingly, corporate officials are unlikely to engage in questionable or illegal conduct and simultaneously reflect it accurately on corporate books and records.

We believe it is critically important to additionally recognize that illegal or improper corporate activities can and will occur regardless of the strength of internal accounting controls, because no system has yet been devised that can withstand collusive behavior or circumvention by corporate officials.

Accordingly, our first concern with the legislative mandate to have adequate systems of internal accounting controls is that such a requirement would not accomplish the objective sought. Furthermore, making it illegal not to have an adequate system would be counterproductive. There are no definitive standards against which to judge what is or is not an adequate system, and there are widely varying opinions among accountants, both accounting officers of companies and independent auditors, about what would constitute an "adequate" system. The term "adequate" as applied to systems of internal accounting control has not been defined.

"Adequacy" is much like "beauty"; for the most part, it is only in the eyes of the beholder. This fact of life raises two questions. First, would it be fair for anyone to be subject to conviction for a Federal offense dealing with something so highly judgmental? We think not. Second, would such a legislative mandate be counterproductive? We

believe it would. Because of the risks involved, it seems obvious that lawyers would advise their clients to discontinue or at least strictly curtail the normal practice of obtaining criticisms—that is, suggestions for improvement—from internal auditors, outside consultants, independent auditors, and others.

The Senate committee report that accompanied S. 3664 stated on page 12—I quote:

> The committee recognizes that no system of internal controls is perfect and that there will always be room for improvement. Auditors' comments and suggestions to management on possible improvements are to be encouraged.

We agree that such comments and suggestions should be encouraged, not only from independent auditors, but also from internal auditors and others. There can be little doubt, however, that the proposed legislation in its present form would in fact discourage such comments and suggestions.

The Senate committee report that accompanied S. 3664 commented that "requiring companies to devise, establish, and maintain an adequate system of internal accounting controls is not a panacea." We agree entirely, and, when this fact is considered along with the subjectivity and impracticability of enforcement of the related proposal in H.R. 15481, we reach an inescapable conclusion that the proposal does not belong in this very important piece of legislation.

It is our recommendation, then, that the intended purposes of H.R. 15481 will be better served by requiring that the books and records of a corporate issuer registered with the SEC appropriately reflect tansactions and by making it unlawful for officers, directors, and employees to falsify such records or to circumvent internal accounting controls.

FALSIFYING BOOKS AND RECORDS; REPRESENTATIONS TO AUDITORS

Our second major area of concern with the legislation relates to the prohibitions in subsections 13(b) 3 and 4 of "any person" from directly or indirectly causing any book, record, or document to be falsified and from making materially false or misleading statements or omitting to state material facts necessary to be stated to an accountant in connection with any audit or examination of an issuer. Although at first blush the thrust of these provisions appears to be desirable by protecting the integrity of books and records and by giving accountants greater assurance in relying on the statements made to them, there are some serious pitfalls that need to be examined most carefully.

First, we note the total absence from these subsections of any language such as "deceit" or "contrivance" as was used in section 10(b) of the Securities Exchange Act of 1934, from which the Supreme Court in *Ernst & Ernst* v. *Hochfelder* found a statutory requirement of an "intent to deceive" for even civil liability. Thus, as presently drafted, H.R. 15481 appears broad enough to permit a court to hold that a negligent mistake in a book or record or a negligently made misstatement is a criminal violation. Therefore, to put it as simply as we can, an honest mistake might land you in jail.

I also note that, whereas proposed subsection (b)(4) includes the concept of materiality, subsection (b)(3) applies to any book, record,

or document, no matter how insignificant. Because of the thousands of documents prepared by employees of a large corporation which are for an accounting purpose, it would be unwise to extend criminal liability to those which are not significant.

We also point out that auditors in the normal course of their audits discuss matters affecting clients' financial statements with many people of diverse backgrounds and training. Some of these individuals are very well informed and sophisticated, while others are not. By encouraging an attitude of free and candid discussion, the auditor is more likely to be able to ferret out information that is important to the audit. Improving the truthfulness and completeness of information received from client personnel and third parties clearly benefits the audit process.

However, situations may arise in which statements may later become the basis of criminal prosecution, and, as a result, people are going to be far more reluctant to discuss matters with an auditor if they believe their every statement will be judged within a framework of potential criminal liability.

Clearly, if this bill is passed in its present form, lawyers would advise corporate officials not to pursue conversations with an auditor without a lawyer monitoring what was being said. The stilted nature of such conversations would be detrimental to the audit process that relies in large measure on a candid give and take between the auditor and his client. The public would be the loser in such a process that results in less effective audits.

Undoubtedly, misunderstandings will occur, and imposing a concept of criminal responsibility relating to oral statements is not desirable and would be quite difficult to enforce. Such difficulties, though, would not nearly approach the same magnitude in the case of written representations. It should also be noted that in the audit process representations would normally be reduced to writing when the subject matter is of material consequence to the accountant's audit.

Therefore, we propose restricting the application of subsection (b)(4) to written representations where adequate attention can be devoted to reduce the risk of unintentional errors that could result in misleading the auditor.

Also, we suggest restricting liability in both subsections (b)(3) and (b)(4) to directors, officers, and employees of the company. Extending the liability under (b)(4) to third party respondents, who in most cases provide useful information on a voluntary basis, will in fact be counterproductive to the objectives of this legislation.

Bankers, customers, suppliers, and other third persons will be advised by their lawyers to simply refuse to respond to audit inquiries in the light of increased legal exposure. The same reasoning would apply to lawyers themselves, who are important sources of audit information in many cases.

Unquestionably, though, information from such third parties is useful to an auditor—and, indeed, is often required by professional standards—and any reduction in the willingness of such individuals to respond, although they are not required to do so, would adversely affect the current level of information available to an auditor and decrease the effectiveness of audits.

"ACCURATE" BOOKS AND RECORDS

We are also concerned about the requirement in H.R. 15481 that books and records "accurately and fairly" reflect transactions, et cetera. This connotes a concept of exactitude that is simply not obtainable, and there is no standard against which achievement of that precision can be measured. The Senate Committee report that accompanied S. 3664 stated on page 11:

"The term 'accurately' in the bill does not mean exact precision as measured by some abstract principle. Rather, it means that an issuer's records should reflect transactions in conformity with accepted methods of recording economic events."

We do not understand why the word "accurately" is used if, as the committee report suggests, that was not the intent of the committee. The intent would be far better expressed if the word "appropriately" were used instead of the words "accurately and fairly." As a minimum, the words "accurately and" should be deleted.

CONCLUSION

To assist the subcommittee, we will be preparing certain amendments to section 1 of H.R. 15481 incorporating our recommendations We urge the committee to study these proposals carefully, as we sincerely believe they will result in a more workable and effective law and enable us, as auditors, to assist in achieving the objectives of this legislation.

We believe this legislation, as it relates to corporate accountability, will be better served by requiring the maintenance of accounting records that appropriately reflect transactions and dispositions of assets and by prohibiting circumvention of internal accounting controls, falsification of the records, and written misrepresentations. We also hope that the subcommittee shares our enthusiasm for the many positive measures already underway in the business community today in this area. I would like to particularly make note of three such developments:

First, many companies have already developed or are in the process of developing strong and clear corporate policy statements to guide officers and employees in their business conduct in the future. These policies have been communicated to company employees at all levels, and monitoring and enforcement mechanisms are being established.

Second, a significant expansion is underway as to the responsibilities and functions of independent audit committees and outside directors. Increasingly included in these responsibilities are matters relating to establishment, monitoring, and enforcement of corporate policy statements, as well as matters relating to systems of internal accounting control.

Third, there has become an increased sensitivity to these problems by the accounting and legal professions. In that regard, we particularly call your attention to the recent efforts by the accounting profession to prepare auditors for circumstances in which illegal acts by clients or irregularities are involved. The Auditing Standards Division of the AICPA has exposed for public comment two drafts of statements on auditing standards entitled "the Independent Auditor's Respon-

sibility for the Detection of Errors or Irregularities" and another one entitled "Illegal Act by Clients."

We are most appreciative of the opportunity to present our views on this important legislation and are prepared to assist you in any way possible in your consideration of the significant issues involved.

Thank you very much.

Mr. STUCKEY. Thank you, Mr. Holton. I certainly appreciate your comments this morning and your statement. I don't think there is any question about it. The subject matter that we are dealing with is one of the more complex subject matters that the subcommittee has had to deal with, and I think that has been very well brought out this morning by Mr. Harrington and also as evidenced by Mr. Eckhardt's concern about speeding through legislation at this late date without taking the time to go into it as we should.

Also, I am pleased to see that the private sector of this country is very well represented by you and the American Institute of Certified Public Accountants this morning.

I think your comments, your observations, are very interesting and certainly valuable. I think they raise some interesting questions, and I have a couple that I would like to bring up. Also, if it is possible, I would like to have some questions submitted to you in writing and have them answered and submitted to the subcommittee, if there are no objections.

Mr. HOLTON. Fine.

Mr. BARREAUX. We would be happy to do that.

[The following letter was received for the record:]

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS,
Washington, D.C., November 16, 1976.

FRANZ F. OPPER, ESQ.,
Counsel, Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, U.S. House of Representatives, Washington, D.C.

H.R. 15481

DEAR MR. OPPER: On behalf of the American Institute of CPAs, I am pleased to provide the Subcommittee with responses to the questions contained in your letter of October 14, 1976.

QUESTION NO. 1

You indicate on page 4 that the internal accounting control provision could be counter-productive since lawyers would advise their clients not to seek suggestions from internal and outside auditors and others. Wouldn't this more likely place an extra incentive on the issuer to seek third party advice as to the adequacy of his controls?

RESPONSE

H.R. 15481 would require issuers to "devise and maintain an adequate system of internal accounting controls" sufficient to provide certain assurances as to management and accounting safeguards. The Institute's related testimony expressed our belief that the direction of this section was misplaced because the vast majority of illegal or questionable corporate payments problems have involved circumvention of internal control systems, not the inadequacy of the systems. We aso pointed out that the labeling of a system as "adequate" or "inadequate" is a highly judgmental issue, subject to widely varying opinions among accountants. Thirdly, we expressed our belief that a legislative requirement such as this would effectively terminate or severely limit the present practice of obtaining comments and suggestions from internal auditors, outside consultants, independent auditors and others.

In response to your question, I believe it is important to recognize, first, that letters to management on internal control customarily issued by auditors are by

their nature critical and negatively-oriented. The letters are designed to apprise corporate decision makers about what the auditor observed during his audit and his recommendations and suggestions for improvement. It is my experience that lengthy letters may be issued even for the very large entities with highly sophisticated systems of internal control because there can almost always be improvements made in *any* system. To one who is not highly knowledgeable as to the complexities of internal control systems for the many different types of business and operating environments, a letter suggesting the more ideal, precise refinements to a system may appear on its face to be just as critical as a letter on another entity pointing out more important weaknesses. (These less sophisticated persons, of course, are likely to comprise the jury that finally judges "adequacy" of the system if allegations are made under the proposed legislation.)

I would conjecture that issuers might well turn more to the legal profession than to the accounting profession for advice as to compliance with a legislative requirement calling for an "adequate" internal control system. The outgrowth of this might well involve a checklist-type approach to the problem, or a general standardization of systems characteristics, developed by the legal profession, to guide issuers in ascertaining compliance with the new law. Constructive criticism of those with real insight into the intricacies of internal controls would neither be solicited nor welcomed in such a legalistic approach. The result would be, unfortunately, an attempt by companies to attain a system that meets a minimal legal standard rather than to attain the best system suitable to the circumstances.

QUESTION NO. 2

On page 6 of your testimony, in criticizing the language of subsection 4, you indicate that the result may be "an honest mistake may land you in jail." Are you aware of any instances under the securities laws where the courts have applied criminal sanctions in the case of honest mistakes?

RESPONSE

The comment which you quote from my testimony refers to the criminal sanctions imposed by subsections 3 and 4 wherein any person may be held liable for indirectly causing any document to be falsified or for either making false or misleading statements to an accountant, or *failing to state a material fact* to an accountant in connection with the conduct of his audit. Auditors make a great many requests to third parties for information during the conduct of an audit. These include requests of banks to confirm balances and supply information as to debt and loan guarantees; they include confirmations of receivables and inventories; requests of legal counsel for information about pending litigation, and a wide variety of other matters. Responses to such requests are often prepared by employees other than management. Many requests are sent directly to individuals. It is possible that such responses can be returned incorrectly or omit material facts, solely due to oversight on the part of the person researching the details.

We believe this section sets a significant precedent in that, for the first time ever, criminal provisions of the Securities laws would apply to unrelated third parties, including individuals. We believe many companies will begin to deny auditors' rquests for information for fear that if they make an honest mistake, criminal sanctions could be applied to them. This would present significant impediments to independent accountants' efforts to conduct audits in accordance with generally accepted auditing standards, and may in some cases preclude an auditor from expressing an opinion on the financial statements.

While I am only familiar with criminal securities law cases involving accountants, of which there have been extremely few, and not with criminal cases generally, I do call to your attention the recent case of *U.S.* v. *Natelli*. In that case, even *if* Mr. Natelli made a "mistake" (which is the subject of much dispute), the indications are that such mistake was made without any evil intent. Indeed, immediately prior to imposing sentence upon Mr. Natelli, the trial judge stated "I think you are absolutely sincere when you say that you do not believe that you did anything wrong in this audit". In any event, I do not believe the presence or absence of past "honest mistake" convictions prior to passage of H.R. 15481 is determinative of what would happen under H.R. 15481 or, more importantly, of what would be the *perception* of lawyers, businessmen, bankers, etc., as to what would happen. The fact is that the Supreme Court in the *Hochfelder* case has

precluded "honest mistake" liability in civil cases and H.R. 15481 noticeably fails to do so with respect to criminal liability. As presently drafted, H.R. 15481 would permit a criminal conviction for a negligent mistake even though the same negligence would not permit recovery of civil damages.

QUESTION NO. 3

You indicate on page 8 that normally the accountant requires a written statement if the subject matter is of material consequence to his audit.

(a) Is there any requirement that the auditor obtain such statements in writing?

(b) Are you familiar as to whether ths procedure is generally followed by the smaller accounting firms?

RESPONSE

(a) The third standard of fieldwork, at Section 150.02 of *Statement on Auditing Standards No. 1* states:

"Sufficient, competent, evidential matter is to be obtained through inspection, observation, *inquiries*, and confirmation to afford a reasonable basis for an opinion regarding the financial statements under examination." (Italics added.)

The "inquiries" alternative applies in cases where the auditor believes procedures called for in the standard are not sufficient to give the auditor a reasonable basis upon which to reach a conclusion. Since evidential matter obtained through inquiry is not as well documented as that obtained by other means, precedent in professional practice has been to document such matters, where significant, by reducing them to writing with the signatures of senior management. It is standard practice, or firm policy, in all of the larger firms about which I have knowledge, for the auditor to obtain a representation letter from management which contains general and specific representations. The practice of obtaining this letter evolved as a precedent in the application of the third general standard of fieldwork, but it is not at this time an absolute requirement in the professional auditing literature.

The Auditing Standards Division of the Institute is currently drafting a new Statement on Auditing Standards which will set forth guidance as to the form and content of management representation letters. When this project is complete, I expect the obtaining of such letters will be a requirement, rather than just a common practice, in the application of the third general standard.

(b) I am not as familiar with the practices of the smaller accounting firms as I am with the larger ones. Over the years, however, in serving as a member and later as chairman of what is now the Auditing Standards Executive Committee and other committees of the AICPA and State Societies of CPAs, I have had occasion to talk about this procedure with many smaller practitioners around the country. I believe the vast majority of them do follow essentially the same practice as the larger firms in this regard.

I hope these responses will be helpful to the Subcommittee. I believe adoption of our suggestions will result in legislation that would do a much better job of accomplishing what we understand to be the objectives. Please contact me if the Subcommittee feels that the Institute can be of any further assistance in this matter.

Very truly yours,

THOMAS L. HOLTON,
Chairman, Committee on SEC Regulations.

Mr. STUCKEY. I think basically you were dealing with two concerns this morning, the first being the statutory requirement mandating establishment of internal accounting controls; the second limiting liability to written communications.

Let me just start with the first. You say that the way to correct the first concern is to make it illegal for corporations to circumvent the systems of internal accounting controls that are already in existence.

I have some question as to whether it is not already illegal for them to circumvent those existing internal accounting controls. Is that not so?

Mr. HOLTON. I am not a lawyer, but I believe, depending on how it is done, it very well might be. I really cannot answer that question.

Mr. BARREAUX. I would think that it might be illegal if the circumvention led to false statements being filed with a Federal agency such as the Securities and Exchange Commission, but I think the circumventions themselves wouldn't necessarily be illegal. I think that, if that circumvention led to an act where false documents or false statements were filed with a Federal agency, at that point I think the illegality might occur.

Mr. STUCKEY. I see what you are getting at in your testimony, and I agree with you. What has given me some concern is—I guess really the way that the statute would be worded, some type of suitable language. I wonder if it would be possible, along with the questions, for you to maybe submit some possible language that could be used in prospective legislation.

Mr. BARREAUX. We will be filing with you shortly, amendments that would incorporate the positions we have taken in this testimony, in the hope that they would be considered by you should this bill actually be marked up in the subcommittee this session.

[The following proposed amendments and explanation were received for the record:]

AICPA PROPOSED AMENDMENTS TO H.R. 15481

An Amendment to the Bill, H.R. 15481, a Bill to amend the Securities and Exchange Act of 1934 to require issuers of securities registered pursuant to section 12 of such Act to maintain accurate records, to prohibit certain bribes, and for other purposes. (Existing language in roman; [deleted words struck]; nw words italicized.

On the first page, beginning with line 6, strike all through line 17 on page 3, and insert in lieu thereof, the following:

"(b)(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to Section 15(d) of this title shall [(A)] make and keep books, records and accounts, which [accurately and fairly] *appropriately* reflect the transactions and dispositions of the assets of the issuer; [and]

[(B)](b)(3) *It shall be unlawful for any director, officer or other employee of an issuer which has a class of securities registered pursuant to Section 12 of this title or which is required to file reports pursuant to Section 15(d) of this title, directly or indirectly, deliberately to engage in any act, practice or course of conduct for the purpose of avoiding or circumventing* [devise and maintain an adequate system of] internal accounting controls [sufficient] *established by such issuer* to provide reasonable assurances that

(i) transactions are executed in accordance with management's general or specific authorization;

(ii) transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets;

(iii) access to assets is permitted only in accordance with management's authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

(b)[(3)](4)(1) It shall be unlawful for any [person] *director, officer or other employee of an issuer hereinafter described,* directly or indirectly, *with intent to deceive or defraud,* to falsify, or cause to be falsified, any *material,* book, record, account or document, [made or required to be made for any accounting purpose], of any issuer which [has] *was made or required to be made for an accounting purpose set forth in subsection (b)(2) or (b)(3) of this Section.*

(2) *This subsection does not apply to books, records, accounts and documents of any issuer which does not have* a class of securities registered pursuant to section 12 of this title [or] *and* which is *not* required to file reports pursuant to Section 15(d) of this title.

(b)[(4)](5) It shall be unlawful for any [person] *director, officer or other employee of an issuer hereinafter described,* directly or indirectly, *with intent to deceive or defraud, in any written communication*

(A) to make, or cause to be made, a material[ly false or misleading] statement *that is false or misleading,* or

(B) to omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading

to an accountant in connection with any [examination or] audit of *the financial statements of* an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to Section 15(d) of this title, or in connection with any [examination or] audit of *the financial statements of* an issuer with respect to an offering registered or to be registered under the Securities Act of 1933."

AICPA Memorandum and Explanation of Proposed Amendments to SEC Section of H.R. 15481

This memorandum is submitted by the American Institute of Certified Public Accountants in support of revisions to a proposed amendment to Section 13 of the Securities Exchange Act of 1934.

As formulated by the Securities and Exchange Commission, the bill would amend Section 13(b) of the Securities Exchange Act of 1934 by renumbering the present Seciton 13(b) to Section 13(b)1 and by adding three new subsections enumerated Sections 13(b)2, 13(b)3 and 13(b)4. The bill goes far beyond the problem of illegal corporate payments in establishing a required structure of corporate accountability and by making it illegal to distort proper record keeping. The proposed amendments would, for the first time, involve the SEC on a broad basis in corporate activities which do not involve filings with the Commission or transactions in securities.

Each of those subsections has been examined by the AICPA and it has prepared a revised bill making certain changes. Those changes are the subject of this memorandum.

Subsection 13(b)2

Subsection 13(b)2, as drafted by the Commission, provides that certain issuers of securities must maintain books and records which "accurately and fairly" reflect the transactions of the issuers and that they must devise and maintain "adequate" systems of internal accounting controls.

The AICPA proposes subsection 13(b)2(A) be revised by striking the words "accurately and fairly" and by substituting in lieu thereof the word "appropriately." Also subsection 13(b)2(B) should be renumbered to make it a new section 13(b)3.

The revision of 13(b)2(A) to delete "accurately and fairly" is required principally because the phrase includes a concept of exactitude that is simply not obtainable and affords no standard by which achievement of that precision can be measured.[1] The problem with the phrase is acute with respect to the proposed bill because, as it is formulated, it requires "accuracy" with respect to even the most complex of business transactions, not merely the disposition of cash. Since the purpose of the bill will be served by requiring that transactions be appropriately reflected and by expressly making it unlawful to falsify documents, we submit that "accurately and fairly" should be deleted.

If an accuracy concept is maintained, the absence of some legal standard or definition of the term would present registrants with a responsibility they could not be sure of satisfying. Auditors also would be faced with the same dilemma and would thus be placed in a position of uncertainty concerning their clients' compliance. This would require auditors to make essentially legal determinations.

---

[1] Webster's New Collegiate Dictionary defines "accurate" to mean: "In exact or careful conformity to truth, or to some standard, esp. as the result of care; exact.—Syn. See correct."

Changes are suggested to subsection 13(b)(2)(B), which requires issuers to devise and maintain an "adequate" system of internal accounting controls sufficient to provide reasonable assurances with respect to certain management and accounting safeguards.

The abuses which lead to the proposed Amendment involved either individual or group circumvention of established internal accounting control systems of the companies involved. To prevent to the extent possible a future occurrence, it should be unlawful for a director, officer or employee to circumvent a system of internal accounting control. Such a provision is contained in subsection 13(b)3 of the bill as revised by the AIPCA.

The bill should not be based on a requirement for an "adequate" system of internal accounting controls for the following additional reasons:

The concept of "adequate" internal controls is too judgmental to be required by law.

It cannot be determined what kind of system of internal accounting controls is being prescribed. The explanation provided by the Commission refers to a definition of the objectives of a system of accounting control contained in Statement on Auditing Standards No. 1—the profession's rule developed for the guidance of auditors, and it is unclear just how these objectives harmonize with the proposed statutory command required to be implemented by the registrant. It is an oversimplification to excerpt a particular audit concept and require that regisrtants adopt it. The Commission's proposed legislation does not indicate how to deal with the wide diversity of internal controls which might be appropriate for some issuers and not for others by reason of differences in type of businesses, size of issuer, methods of operation and other variables. Further study and consideration would be required before any meaningful statutory guidance could be proposed employing this concept.

If the unmodified proposal concerning internal accounting control became law. auditors would be faced with some serious, and we believe largely unintended, problems. As drafted, such a proposal will introduce a concept of legal interpretation into an essentially constructive and useful service now often a by-product of an audit. For example, would the comments made by an auditor to a client be interpreted as documentation that the client has failed to establish an "adequate" system of internal accounting control? As no materiality criteria are incorporated into the proposed legislation, how would a judgment be made as to the matters that would in effect be violations?

The unmodified proposal would be counterproductive, in that due to the risks involved lawyers would advise their clients to discontinue, or at least strictly curtail, the normal practice of obtaining criticisms of internal controls from internal and independent auditors, outside consultants and others. Comments and suggestions to companies on internal control should be encouraged, not inhibited by legislative mandate.

We believe that in the reported cases of questionable payments it was not the absence of a system of internal control, but rather a circumvention of the system that allowed abuses to occur and prevented their detection. The purposes of the bill are fully served by requiring, as proposed in the AICPA draft, that the books and records of the issuer appropriately reflect transactions and by making it unlawful to falsify such records or to circumvent internal controls.

SUBSECTION 13(b)3

This subsection (renumbered (b)4 in the AICPA draft) would make it unlawful to falsify accounting records. The AICPA revision suggests changes to enhance the consistency of these provisions with the other parts of the proposal, to avoid ambiguity, and to correct other deficiencies. The principal ambiguity is in determining what the words "of any issuer . . . "were intended to modify. It appears that the phrase was intended to modify "document". To make the revision we have broken the sentence into two parts.

Another revision proposed to clarify an ambiguity is to define the open ended "any accounting purpose" so as to tie it into the stated purposes of the bill. This is accomplished by making reference to sections (b)2 and (b)3 as revised. In addition, where as proposed subsection (b)(4) includes the concept of materiality, subsection (b)(3) applies to any book, record or document, no matter how insignificant. Because of the thousands of documents prepared by employees of

a large corporation which are for an accounting purpose, it would be unwise to extend criminal liability to those which are not material.

Absent from this subsection, as well as from subsection (b)4, is any language such as "deceit" and "contrivance" as used in Section 10(b) of the Securities Exchange Act of 1934 from which the Supreme Court in *Ernst & Ernst v. Hochfelder* found a statutory requirement of an "intent to deceive" for even civil liability. Thus, as presently drafted, H.R. 15481 appears broad enough to permit a court to hold that a negligent mistake in a book or record or a negligently made misstatement is a criminal violation.

Liability should be restricted to directors, officers and other employees of the company. Since the company is responsible for its books, records and documents as set forth in subsection (b)(2) of H.R. 15481, it is only the officers, directors and employees that can cause them to be falsified. To diffuse the liability under subsection (b)(3) to include outside third parties would have the adverse effect of diffusing the responsibility to keep appropriate records.

As to the two preceding paragraphs, we take guidance from Section 1005 of U.S. Code, Title 18, of the Federal law applicable to false entries in banking records, which applies to officers, directors, agents and employees and requires an "intent to injure or defraud."

SUBSECTION 13(b)4

This subsection, as proposed (renumbered (b)5 in the AICPA draft) prohibits "any person" from making materially false or misleading statements or omitting the state material facts necessary to be stated to an accountant in connection with any audit or examination of an issuer. Although the apparent thrust of this provision appears to be desirable by giving accountants greater assurance in relying on statements made to them, there are certain aspects that require revision.

As set forth in our comments relative to subsection (b)3, "intent to deceive" language should also be included in subsection (b)(4).

Auditors in the course of a year discuss matters with many people of diverse backgrounds and training. Some of these people are very well informed and sophisticated, others are not. To the extent that the auditor can encourage an attitude of free and candid discussion, the auditor is more likely to be able to ferret out information that is important to the audit. Improving the truthfulness and completeness of information received from client personnel and others clearly benefits the audit process. However, making it a crime to lie or to mislead an auditor, while laudatory in its own right, may not on closer inspection yield the desired result.

People would be far more reluctant to discuss matters with an auditor if they believe that their statements would be judged within a framework of legal liability. Is it reasonable to expect that most persons will be so precise and complete in their oral discussions with an auditor that no element that could be important would be omitted? Not all people either know or can so well remember or organize matters in an oral statement. Imposing a standard of legal liability on such a basis does not appear equitable. Misunderstanding can and will occur and imposing a concept of liability relating to oral statements would not on balance appear to be desirable.

However, the difficulties related to oral statements are not, in our judgment, present in a written representation. We propose restricting the application of this section to written representation where adequate attention can be devoted to reduce the risk of unintentional errors that could result in misleading the auditor. It is also recognized that in the audit process, representations would normally be reduced to writing when the subject matter is of material consequence to the audit.

Additionally, liability should be restricted to directors, officers and employees. Based on the voluntary nature of current representation made to auditors by many third parties it may be counterproductive to extend liability to these parties. Bankers, suppliers, lawyers and other third persons who currently respond to requests of auditors may in the light of increased legal exposure decide not to respond. As these communications provide useful information to the auditor (and, indeed, are often required by professional standards), any reduction in the willingness of such persons to respond, although such persons are not required to do so, would adversely affect the current level of information available to the auditor and decrease the effectiveness of audits.

We also recommend deleting the word "examination". We believe the word "audit" is more clearly understood in this context and is what is contemplated by the proposed legislation.

Mr. STUCKEY. It is already illegal for the accounting part to be purposely misleading or to use incorrect figures, so I don't think either one of us is having any problems with that.

The thing that I am having a problem with is: How would you word the language that would be used for the person who was willfully trying to circumvent that system of internal accounting controls? If you could, we would appreciate those being submitted.

Mr. HOLTON. That, of course, does get to one of our major points, that having an adequate system, as in the draft, would not stop those people from doing it. It just doesn't get at the problems that have been coming up in disclosures and the publicity that has been given. It doesn't deal at all with that, in our opinion.

Mr. BARREAUX. Of the many cases that have been uncovered by the Securities and Exchange Commission, both in their normal enforcement actions and also as part of the voluntary program, they have instituted through the Division of Corporation Finance, we are able to see that most of these companies had internal accounting controls. They just weren't utilized. They were purposefully circumvented.

And we just think that to strike at the heart of the problem would be to require that circumvention be the triggering device as far as the illegal act goes.

Having an adequate system certainly did not stop the bribery from taking place in the cases that have been uncovered by the SEC.

Mr. STUCKEY. Mr. Opper, do you have a question?

Mr. OPPER. Mr. Barreaux, are you aware whether in any or all—in all or in any of those cases, the existing accounting systems provided reasonable assurances of the items enumerated in 13(b), (2)(b) of the bill? In other words, you are indicating that the controls were adequate, but did they contain those specific items enumerated in this bill?

Mr. BARREAUX. I didn't say that they were adequate because we don't know what "adequate" means. We said that there was a system in existence.

Mr. OPPER. What would you suggest as an alternative to the characterization of "adequate"?

Mr. BARREAUX. The suggestion is that circumvention of internal accounting controls that are in existence be made illegal.

Mr. OPPER. Supposing the controls are entirely insufficient? Don't we all agree that some kind of controls that get to the root of the problem are necessary?

Mr. HOLTON. I would agree if that would get to the root of this problem, but I don't think it would.

Mr. OPPER. Would the situation be enhanced by lack of controls?

Mr. HOLTON. No, it would not.

Mr. STUCKEY. Excuse me. You are not arguing the issue of controls. In fact, my understanding is that what you are saying is that you possibly favor stronger controls. Your problem and my problem in asking for the appropriate language is the circumvention of those controls. Is that not really the key point that you are trying to make?

Mr. HOLTON. Yes. We have no problem with those general guidelines in the bill that describe certain aspects of internal control. Those are used by auditors in deciding on the extent and timing and nature of their auditing. In fact, they come out of the auditing literature to guide an auditor as to what he needs to do in reaching his conclusions. But I think you characterize—and maybe I misquote you—I think you characterize them as specific things which, in my opinion, they are far from specific criteria.

Mr. OPPER. Or we may characterize them as general, but clearly the focus of this section is to insure that there are internal accounting controls addressing themselves to each of those four areas.

Mr. HOLTON. Those are factors that the auditor takes into consideration when planning his audit.

Mr. OPPER. But you can't be sure that in those cases which the SEC has brought—that, despite the fact there have been in existence internal controls, that those controls address themselves to these specific areas.

Mr. HOLTON. To some extent—and obviously I am not familiar with all those cases, but I would hazard a very strong guess that, to some extent, a very large majority—probably all—the system directed itself to those aspects in one degree or another, and there would be wide differences of opinion, probably even on those, as to just whether they were super good or adequate or that sort of thing.

Mr. OPPER. I would only suggest that the SEC, which did draft this provision, as you are aware, feels very strongly that some of these areas in many or most of the cases in which they have brought injunctive action were not addressed by the internal accounting controls.

Mr. HOLTON. I really don't think that is the case, but obviously I cannot say for sure.

Mr. BARREAUX. Is it my correct understanding, Mr. Opper, that it is the position of the subcommittee that any set of internal accounting controls that had these four points in it would be adequate?

Mr. OPPER. I think that the position probably is that these controls are the very minimum, the bare bones of what is required as a prophylactic measure to help avoid the kinds of slush funds and foreign payments that we have become aware of. Certainly this is not to say that this system of controls or any system of internal controls could not be circumvented by someone who had intent to do so.

Mr. STUCKEY. Let me ask another question. I felt there were two points you were trying to bring out. At least it appeared that way to me. The second one you were discussing was limiting liability to written communications. Basically I think that makes sense, but in the normal course of an audit aren't the oral communications of that audit usually reduced to writing anyway?

Mr. HOLTON. The more significant oral communications that really have a significant bearing on the auditor's conclusion ordinarily are reduced to writing. Yes. In many cases.

Mr. STUCKEY. OK. I guess maybe I am trying to understand what you are saying. If the oral communications are reduced to writing, in a sense aren't you eliminating the problem? In other words, it is already reduced to writing, which is where the liability is currently placed. Is that not what you are saying it should be limited to?

Mr. HOLTON. As I see the problem, in visualizing an audit and people not wanting to communicate orally because of the consequences of this, then there would be much more difficulty in ferreting out information from all around, all people in the company, to finally get together really the important aspects thereof that would be reduced to writing. It just never would get to the auditor in the first place. At least it would be impeded.

Mr. STUCKEY. I am not that familiar with your auditing practices. What would be, say, a typical example of what you are trying to explain, where there would be a little hesitation to have that freedom of communication?

Mr. HOLTON. Well, I am trying to think of something that might be characterized as typical. In discussing with, say, an accounts receivable bookkeeper or someone in the credit department about how they had investigated the credit worthiness of debtors, if we weren't in a position to get free open communication about just what they had done themselves to be sure this is collectable, then it would be more difficult to get at our own conclusions or verify the company's conclusions about the adequacy of the reserve for bad debts, about which, in the final analysis, they would make written representations.

Mr. STUCKEY. If it appeared that there was anything wrong or illegal in that oral communication, then would not a CPA refuse to certify the statement? Is that not correct?

Mr. HOLTON. That is one of the questions that is being considered and reconsidered by the auditing standards division of the American Institute at this time. Our opinion on the financial statements runs to the fair presentation of the overall financial statements, including the notes thereto, in conformity to generally accepted accounting principles, and, if an ilegal act had an effect or a potential effect for the company losing a significant part of its assets, losing a significant part of its revenues, then in that case the auditor would conclude that it is a necessary disclosure in order to give an opinion on the financial statements.

Some small thing that involves a small piece of the assets, a small piece of the revenues—then you have got a different question, because the auditor does not purport to deal with immaterial things in the financial statements.

Mr. STUCKEY. Thank you. Mr. Barreaux?

Mr. BARREAUX. I would like to make one other point regarding the provision for making misrepresentations to auditors. Yesterday, one of the witnesses said that he had a difficult time understanding what the practical effect of limiting liability to written representations would be if they were preceded by an oral statement. In other words, if the auditor had the client put something in writing after the auditor was told it, would the written representation, the document, the piece of paper, be protected because it originated through an oral communication?

We would like to make it clear that it is certainly not the intention of the American Institute of CPA's to seek that sort of immunity through this provision, and we would expect that any oral communication that was then reduced to writing could be utilized in the prosecution of an individual who misrepresented something to the auditor in writing.

Mr. OPPER. I know you are referring to Chairman Hills' testimony yesterday in connection with oral statements. He indicated the lack of any penalties, of any clear penalties, for oral misstatements have led management to provide and would, in the future, lead management to provide auditors with vague or ambiguous written statements which they would then clarify with oral misrepresentations.

Do you have any comment on this?

Mr. BARREAUX. Mr. Holton can certainly comment for himself, but I think it is up to the accounting profession to make sure that vague statements are not accepted.

Mr. OPPER. You have also indicated the chilling effect that would be imposed on management/accountant communications as a result of the standard imposed on oral communications.

Section 12(2) of the Securities Act similarly makes it unlawful for persons to make misleading oral statements in connection with the offer and sale of securities. In 40-odd years of the existence of that provision, are you aware of any such adverse effect on the sale of securities or of any tradition of a securities salesman having to have a lawyer present when he makes his pitch?

Mr. BARREAUX. When I was on the staff of the Securities and Exchange Commission, my general understanding of how that was handled was when people were prosecuted, there was a string of victimized customers.

You were able to prove fraud with ease because people who made misrepresentations to customers did it to many, many people. So you had a string of evidence that might not be in existence if it is merely one person talking to an auditor—just one conversation.

Mr. OPPER. Do you really believe that bankers, customers, and suppliers and others who have nothing to hide will refuse to respond to auditors' questions on the basis of their increased exposure? Don't you think that the value of their relationship with the issuer and the reputation of the marketplace would really obviate such a reaction?

Mr. HOLTON. I think those relationships would have an effect to not get completely to the extremes, but, based on conversations with admittedly limited numbers of financial executives and others, but particularly with lawyers, lawyers have said that that would be the advice of many lawyers.

Mr. OPPER. You take exception to the provisions in subparagraph (b)(3) because they would apply to falsification of any book or document, no matter how insignificant.

If we agree that falsification of books and records is reprehensible, why should we make statutory exceptions relating to size? We make stealing a crime, but we don't make exceptions for little thefts.

Mr. HOLTON. Again, I am not a lawyer, but, as I recall what lawyers have told me, there are some differences between little thefts and big thefts.

Mr. OPPER. In degree, but not in the imposition of some penalties.

Mr. HOLTON. Particularly as it is drafted to make it apply, whether intentionally or not, that does make it even worse. Now, if you made the intentional—I forget the words we are suggesting, but, if you make it intentional versus inadvertent——

Mr. OPPER. Do you think there is such a thing as an inadvertent falsification of a record?

Mr. HOLTON. I think so.

Mr. OPPER. Don't you think it may be implicit in the definition of the word "falsification" that there is something particularly willful about it?

Mr. HOLTON. If there is, I would suggest——

Mr. ECKHARDT. May I interject here? The penalty applicable to this section is, I believe, section 32 of the Securities and Exchange Act. There is no specific penalty specified in this first portion of the bill, but specific penalty is provided in the second portion—but I think we fall back to section 32: "Any person who willfully violates any provision of this title is subject to a penalty." So the "willful" requirement is imposed upon the standard provided here, as I read it. Do you find it to be different?

Mr. BARREAUX. Well, I think that there is some concern that, because it is worded differently, even though it is an amendment to the 1934 act, that you could construe that the willfulness test is not applicable.

Mr. ECKHARDT. I couldn't possibly read it that way. When you have certain requirements and then when you write the penalty as being any person who willfully violates any provision of this title, it seems to me that you must both do one of these prohibited things and you must do it willfully, or else the penalty doesn't apply.

Now, if you did not do it willfully and the standard required that you do it, it might be that some injunctive relief would be available, but what is wrong with that? I mean the act ought to be enforced in accordance with its terms, whether the violation of it is willful or not. The only reason for the protection of the term "willful" is to provide a person with due process of law in his having to suffer a penalty for doing a wrongful act, but, if a person does a mistaken or a negligent act, there are certainly good public policy reasons why he should be prohibited from doing it in the future.

Mr. HOLTON. I certainly have no problem with that.

Mr. ECKHARDT. If we make it clear in that report, what objection would you have to the language here contained?

Mr. BARREAUX. I think our concern was again going toward clarifying the liability—the potential criminal liability.

Mr. ECKHARDT. Let me ask you this. I had, as you noted from my previous questions, serious questions about 4(B): No person shall "omit to state, or cause another person to omit to state, any material fact necessary", et cetera, et cetera, but it seems to me that that might well be embraced in the "make and keep books, records, and accounts, which accurately and fairly reflect the transactions."

The thing that troubled me about treating that separately and treating it with the specific term "unlawful" is what I think seems to trouble you. It seems to have some impact on what constitutes a willful violation. And I would suggest that that section (B) simply be omitted, because I think it is embraced in (2), and, if (2) were left as is, it would seem to me clear that it would require willful violation be a penalty.

I might suggest another thing and ask you what you think about it—and I also want to ask your information concerning the act. The act, of course, addresses itself largely to the securities business itself and not the internal operations of the corporation generally, whereas this

section deals with the corporation as its principal recipient or controlled entity.

The act, for instance, requires accounts and records of exchange members and others—and there, of course, it is addressing exchanges, brokers, dealers, and so forth, and it deals primarily with the operation of the securities industry, rather than the internal affairs of the corporation.

Is there any other provision in the securities act which deals directly with the accounting practices of the corporation, not a corporation involved in the securities operations?

Mr. BARREAUX. I think the SEC's primary responsibility regarding corporations and the accounting profession flows from the Securities Act of 1933.

Mr. ECKHARDT. That is right. But what I am asking you is: Is there any other authority that would permit the SEC to issue rules which would in effect require any corporation which is an issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(s) of this title to make and keep books, records, and accounts, and to devise and maintain an adequate system of internal accounting controls, et cetera? Is there present authority for the SEC to do that by rule, or do you know?

Mr. HOLTON. I do not know now. I believe the 1935 act dealing with public utility holding companies was when the SEC established a uniform system of accounts. I don't recall how detailed that is and whether that would flow over to authority to do something like this in the 1934 act. I really can't answer the question.

Mr. ECKHARDT. Well, the thing that has somewhat troubled me is, I think, what is troubling you, and that is that the provisions of the first—of (2) of this act are somewhat general, and, whether or not you comply with them may constitute a question which may be one of degree and of interpretation; and then you are concerned as to whether or not, having failed to comply with them, this would be a willful failure, and whether or not this specification in very general terms of what is wrong would affect the interpretation of "willful."

Now, let me ask you this. Suppose, instead of following this device of stating in very broad terms what is illegal—Suppose it were worded in terms of authority to the SEC to make rules? For instance, suppose it read:

> The SEC shall enact rules applicable to every issuer which has a class of securities registered pursuant, . . . reasonably necessary to assure that every such issuer: (A) make and keep books . . .; (B) devise and maintain an adequate system, . . .?

Now, what I am saying is we are not writing into the Act something that can be picked up by the penalty clause. The penalty clause says "Any person who willfully violates any provision of this title"—and, of course, this would be a provision of the title. The way I am specifying, it wouldn't be a provision of the title acting on you directly, but would authorize the SEC to make rules, and, of course, the SEC must make rules in accordance with the provisions of the Administrative

Procedures Act, with opportunity to be heard, et cetera, or at least to file a view.

What would be wrong with that?

Mr. BARREAUX. Well, Mr. Holton is chairman of the SEC Regulations Committee of the American Institute of CPA's and would be better able to answer that, but I would like to point out at the beginning that it is my understanding that there are those in the Securities and Exchange Commission who maintain they have the authority already.

Mr. ECKHARDT [presiding]. Well, I think they would so maintain, and nobody here is able to say whether they do or they don't. I wish I had had an opportunity to question them the other day. The thing is that I see some argument for fleshing out these general standards, but it does seem to me that it ought to be clear that the SEC has authority to insist on the keeping of books and records and accounts which accurately and fairly reflect the transactions and that do the other things specified here, because I think it seems plain that the keeping of reasonably good records, if not an absolute assurance that the records will not be falsified or avoided or so burdened as to make it difficult to see through them to the fraud which may occur—it seems to me to be absolutely plain that some requirement of some type of somewhat standardized records would make it more difficult to engage in such fraud, just as it is more difficult to avoid taxation if an income tax report requires some details. Is that not true? Do you not feel that such records would at least afford a tool for enforcement?

Mr. BARREAUX. I think they certainly would be a tool for enforcement.

Mr. ECKHARDT. And it would seem to me that persons concerned with accounting who frequently, I know, find themselves having to act on the conscience of their clients to record things accurately, would feel that such an approach was desirable.

Mr. BARREAUX. Well, as a person who does it all the time, Tom, how do you feel about that?

Mr. HOLTON. Well, none of these things are just completely black and white. One of the advantages of doing what you are suggesting for consideration is to establish some certainty as to what the rules are, what the requirements are, so that people know for sure how to comply with them. Of course, that does lead to cookbook technique sort of thing, that you go through the mechanics of complying with every one of these written rules that don't necessarily—quite often the tendency at least in those kinds of cases is to be sure you have complied with what the wording says, whether you really get at the substance of it or not. That is one objection to it.

As I said, on the plus side, you have some certainty of knowing what should be done, and I might say that one view of—well, first, you have to understand that a company, in order to have audited financial statements with the auditor's opinion thereon, of necessity has to have some system of internal control that the auditors can rely on. Now, one definition of what is adequate would be adequate to where the auditor can make an audit and express an opinion on the financial statement. Now, whether that is what is meant here, obviously, probably, it isn't.

Mr. ECKHARDT. What I am getting at is this. When we enact a statute, we have to act somewhat generally and then, if we apply a

penalty to these general standards which is in the nature of a criminal penalty, we either do one of two things. We act too severely without sufficient prior notice or, if we put in the term "willful" and we mean it, we probably don't do anything at all, because it is very difficult to prove that the failure to comply with a very general standard is a willful violation.

Now, what I am suggesting is to do this: To let the statute state what the SEC should do in general statutory terms, but not make the activity illegal until a rule is issued, just as would exist with respect to accounts and records, reports, examinations of exchanges, members, and others, where it says:

> Every national securities exchange, every member thereof, every broker or dealer who transacts a business in securities,

et cetera,

> shall keep or preserve for such a period such accounts, correspondence, memoranda, papers, and so forth, as the Commission by its rules and regulations may prescribe.

So it is not illegal not to keep those records until a rule is made, and I am suggesting that the rule could give the definitiveness that you are asking for.

Mr. HOLTON. Unless there is something I am not considering, I believe that would at least be a better approach. I had not considered that, and I don't know if it is possible for us to consider it with others and submit a memorandum.

Mr. ECKHARDT. Mr. Murphy?

Mr. MURPHY. I have no questions.

Mr. ECKHARDT. No further questions. Thank you very much.

Mr. Kennedy?

Mr. MURPHY. It is a pleasure to welcome Mr. Kennedy here. He is cochairman of the Special Committee on Foreign Payments of the Association of the Bar of New York City.

STATEMENT OF WILLIAM F. KENNEDY, COCHAIRMAN, SPECIAL COMMITTEE ON FOREIGN PAYMENTS, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

Mr. KENNEDY. I have a statement which I would ask the subcommittee to include in full in the record [see p. 186]. It was prepared hastily and I ought to say, like the Frenchman, that, if I had had more time, I would have written you a shorter letter.

Mr. MURPHY. It doesn't appear to have been written in haste.

Mr. KENNEDY. It does reflect several months long deliberations of our Special Committee on Foreign Payments of the Association of the Bar of the city of New York.

The special committee was established at the instance of Mr. Cyrus Vance, who was then the president of the association, and is composed of members of three regular committees of the association.

We have not had an opportunity to prepare a formal report, and, as a consequence, I cannot speak for the association as such, because their requirement is that, before you can do that, you must have a formal report which clears the executive committee.

However, the association has authorized this appearance today on behalf of the special committee.

We will make a formal report and we will make it available to the subcommittee and to others in the Congress.

In the formal statement, in the prepared statement, I have begun with a premise, which is that the practices—the serious practices which have been exposed over the last several years are clearly contrary to the national interest and that there have to be measures to prevent a recurrence of those practices. They have damaged our diplomatic relations in a number of critical situations.

Beyond that, I don't think anyone could contend that you can build the foreign trade and foreign investment of the United States in the long run on a foundation of bribery.

Perhaps as important as any other concern, these practices have impaired confidence in the business community and in the business enterprise system.

So we on the special committee can understand the message of the 86 to 0 vote in the Senate last week, the message that the Congress is determined to make it clear to the public and to the world that you will do something to prevent a recurrence of these very serious and unhappy events.

Now, the question, of course, Is what you should do? And, before I get to that, I should like to cover very briefly a number of the points I have made in the testimony.

Congressman Eckhardt has developed a little earlier this morning the point that there are laws on the books. I ought to say, for example, that the provisions of the Internal Revenue Code that prohibit a deduction of an improper payment abroad go back to 1958. They were incorporated in the Internal Revenue Code, if you look at the legislative history, at the instance of then Senator Williams of Delaware, who was, of course, a senior on the Senate Finance Committee.

Beyond that, there are provisions of the antitrust laws which, in our judgment, apply: Section 2(c) of the Clayton Act; section 1 of the Sherman Act; section 5 of the Federal Trade Commission Act. The False Claims Act applies in some cases and has been held to apply to bribery in connection with an AID financed transaction where there wasn't an adequate "disclosure."

In the tax area, if I may return to that for just a moment, your tax bill just passed by both Houses extends the principles of 162(c) of the Internal Revenue Code to improper payments by foreign subsidiaries controlled by U.S. companies.

There have been, of course, a number of shareholder suits, and it is clear that there is quite an array of legal sanctions in that situation.

Your arms export control legislation just passed in this Congress deals with the problem in that context.

Lastly, of course, there are the Federal securities laws. I think it is clear that those laws do apply where there is nondisclosure of bribery and the bribery is the basis of a significant part of an issuer's business. I think they probably apply in cases where a significant amount of corporate funds are handled outside the corporate system of accounting controls.

There are those of us who believe that the SEC, in going further than that, is pressing its jurisdiction beyond statutory bounds, but, in

any event, that is the situation that prevails. They have been enforcing their disclosure authorities very vigorously and very effectively and in the national interest, I might say.

Now, I go through this quickly to make one point. The point is this: There was never a lack of law applicable to the situation. What there was, was a lack of law enforcement. And I think this is the first point that the subcommittee should address itself to in its deliberations; namely, to look at the need for new law in the context of what is now on the books and what is now available.

This doesn't mean that you shouldn't have new law, but your new law should be tailored to the genuine problem and not to the optical one.

Now, another point I have made in the statement—and I will try to be very brief about this—is that, without in any way excusing the failures of U.S. business that have been exposed over the last 2 years—and I don't think they can be excused—the problem goes beyond those failures. It is not really addressing the whole problem to say that we need only look at the failures of U.S. business and not look at the context in which those failures occurred.

We know from the evidence that has been exposed so far that in many cases the bribes were solicited, not volunteered. We know that there were cases of extortion. We know that there are laws on the books in these foreign countries applicable to these practices and that, as in the case of the United States, these laws were not enforced and they are now being enforced, of course, in some cases very vigorously.

We know, beyond that, from some of the filings with the SEC and from other sources, that it wasn't just U.S. business that was involved, and we certainly have reason to say that perhaps these practices in other countries were tolerated there.

Now, your legislation, therefore, it seems to us, should address all of those concerns and not just the failures of U.S. business—and I say again I don't excuse those in any way.

Now, what is the most effective way to go at the problem? The Senate considered two approaches and even considered combining the two. They looked at criminalization and they looked at disclosure.

For whatever reasons, the Senate Banking Committee elected to drop the disclosure requirement and go the criminalization route. On the floor of the Senate, Senator Church offered disclosure proposals which, in the judgment of our special committee, the Senate very properly rejected, simply because, although we believe disclosure is the more effective of the two approaches, the proposals of Senator Church seemed to us not to be carefully tailored to what the genuine problems were and to go too far.

Now, let me back off to say, first, that I think—we think that the Senate Banking Committee and the Senate as a whole certainly made one very sound judgment, and that is that you cannot combine criminalization and disclosure. And the reason is very simple, and that is that they work at cross-purposes.

It is a very peculiar kind of jurisprudence to pass a law which says: "You shall not do this." That is crime 1. And then: "You have to confess it if you do do it." That is crime 2.

To pass a law that says you have two crimes out of one act, the crimes consisting of, one, you have done a certain thing, and, second,

you didn't go down and confess it, is, as I say, very peculiar jurisprudence.

Beyond that, I would say something else, and that is that it isn't going to work. Once the person determined to engage in this kind of conduct makes that determination, he is not going to go ahead and do it and then go around to the police station the next day and say: "I want to tell you just how I have violated the law the day before." So that the Senate, we think, was correct in rejecting the notion that it could combine criminalization and disclosure. We think the Senate was correct in rejecting the specific disclosure proposals advanced by Senator Church on the floor because those proposals were not, as we see it, tailored to the problem.

Now, what is wrong with criminalization? It seems to us there are several things wrong. First, criminalization puts on the prosecutor a burden of proof that in many cases is simply impossible to sustain because he isn't going to be able to get the evidence.

If you look at the Senate bill—and I might say, by the way, this is the advice—and it is in the record—that the Senate had from the Justice Department—if you look at the Senate bill, it has a requirement of three elements in order to prove the crime. First, you have to show the destination of the payment, where it was going to go. It has to go to a foreign official or a foreign political person. Second, you have to show the prohibited purpose of the transaction; namely, to influence foreign governmental action in an improper way.

Third, you have to show that this was done corruptly, and I think the "corruptly" is a meaningful requirement because it does address the situation that you were asking about earlier, Congressman Eckhardt. What about the fellow who is being pressured or where the situation is extortion or bordering on extortion? So I think the Senate, if it was going to go that way, had a proper requirement. But you have to say that the burden it puts on a prosecutor is so great as to make that provision meaningless in most cases.

Take the case where, however, they have enough evidence and they bring a prosecution. What is the situation of the accused? In order to show that he has not violated a law, he may have to bring in evidence in the form of both testimony from foreign persons and documents from foreign entities which may simply be beyond the compulsory process of our courts. And I think to enact a law which raises questions as to whether a person can fairly and effectively defend himself when he is accused of violation of that law is something you should consider very carefully in your subcommittee.

The next point: If you are going to do something about this internationally—and I won't elaborate on that here, but I have made some remarks about the need for an international approach in the prepared statement—you have to ask yourself what you would do. Any international agreement that was worth the paper it was written on would be a disclosure provision basically because anything in the way of universal criminalization would leave the American Government and American business in a situation where we wouldn't know whether we could rely on it.

It would mean that you were counting on every other foreign government of an industrialized country enforcing the criminalization provision against its own home enterprises in the way you would expect it

to be enforced here, and I would say that is not a very good agreement from the point of view of the national interest of the United States.

In other words, if you were to generalize or internationalize or universalize S. 3664, you would not have anything meaningful. What you really want in the way of international agreement is a requirement to report and to make publicly available the agreements and arrangements and devices—and I am talking now about third party arrangements—that can be used as a cover for improperity.

Next, let me raise the question whether, if you are going to do something like this, you should do what the Senate did and put it in the 1934 act, the Securities Exchange Act. That act, as Congressman Eckhardt has developed in his earlier colloquy, has certain purposes. The purposes are to prevent fraud in securities transactions, and to regulate securities markets. It does have a limited purpose in the strictly corporate area in assuring that shareholders have the right to exercise their vote on corporate affairs in a fair and effective way.

All of a sudden you introduce in S. 3664 an obligation for the SEC that seems to me just totally extraneous. Not totally, but certainly quite extraneous to the main purposes of the 1934 act. You say to the SEC: "We are going to put you in the general criminal law enforcement business; not the problem of enforcing the securities laws in their traditional form, but the general criminal law enforcement business. We are going to put you in charge of prohibiting foreign bribery." And you are not only going to do that, but, because about two-thirds of the companies that have to be covered are beyond the jurisdiction of the SEC: "You have got this piece of the problem with respect to your SEC regulated companies," and you say to the Justice Department: "You have got this piece of the problem with relation to the other two-thirds." And it seems to those of us on the special committee that this is simply not sound criminal law enforcement policy.

Next, let me speak briefly to the jurisprudential considerations. The United States has an international law concept and we have relied on it in a number of cases and developed some experience under it, that we can regulate the conduct of our own nationals abroad. This is a well accepted doctrine—our concept of international law, that broadly we can regulate the conduct of U.S. controlled enterprises, even though those enterprises are based abroad.

But we have learned some lessons the hard way in asserting that jurisdiction in the antitrust area and in the foreign assets control area, and that is that we run into political, diplomatic, and judicial problems with foreign governments and foreign courts.

I say to you not that the United States should never do that, but that you ought to look terribly carefully at each case where you are asked to do it and ask yourself whether this is the only way or the best way or whether there aren't better ways to do the same job.

Let me mention another joint about attempting to regulate conduct which occurs abroad, and that is: If you ask yourself what is the problem of foreign bribery, it is a problem which in the first instance involves conduct which takes place largely on a foreign territory. It may originate here, but it takes place on a foreign territory. It is an offense against the laws of that foreign country. It impairs, more than anything else, the interests of that foreign country. And is it sensible

to try to pass in the United States a law which displaces foreign law enforcement or tries to make up for its deficiencies?

I think we should ask ourselves whether we wouldn't be better off to try to develop a system which allowed or helped the foreigners to enforce their own laws more effectively and cooperated with them in doing it, rather than trying to displace them.

Take some other questions. Suppose there are diplomatic problems about getting the evidence and diplomatic problems about whether you bring one prosecution or another. How do you guarantee or assure yourself that these laws would be enforced fairly, when you know that these political, international, diplomatic considerations may affect the prosecution's judgment?

Beyond that, how do you determine who goes first in terms of making a prosecution? What do you do with the double jeopardy problem? That may not be a constitutional problem for the obvious reason you are talking about a foreign jurisdiction and our own, but you have got a double jeopardy situation. Will you subject a United States accused to two prosecutions, one in county x and one in the United States?

For all of these reasons, it seemed to our special committee that the disclosure approach was the more sensible one.

Mr. ECKHARDT. We have a vote on the floor at the present time and we will recess for a moment and be right back.

[Brief recess.]

Mr. MURPHY. Mr. Kennedy, if you will proceed.

Mr. KENNEDY. Thank you, sir. The first point about disclosure: It has been suggested that somehow, if all you do is disclosure, that would somehow be counteracting or even endorsing these unhappy practices, and I can't think of any argument that is more misplaced.

I noted yesterday that Chairman Hills said unequivocally in his appearance before you—and I checked his prepared statement, and he is just as unequivocal in his prepared statement—that disclosure is a sufficient deterrent. I don't know of anybody's view on this subject entitled to more credibility than that of Chairman Hills.

Beyond that, how could any responsible company think that somehow it could disclose improper conduct and, because you hadn't criminalized it in a bill like S. 3664, that it could get away with it?

First of all, there are already very serious sanctions available to penalize that kind of conduct, and how could a company live with the general U.S. public or the Congress or with anyone else if it were engaged in improper conduct and were reporting it?

So the notion that somehow disclosure is a permission or an endorsement or a countenancing—is, I think, a transparently wrong one.

Now, the thing that disclosure does and that is S. 3664 does not do is that it gets at what is the most serious problem, and that is the third party arrangements, the arrangements with agents or consultants or representatives who are used as a cover for the impropriety.

Mr. MURPHY. Before you go on to third party arrangements, 100 of the top 500 companies in this country have made disclosures of questionable foreign payments.

Mr. KENNEDY. Yes.

Mr. MURPHY. What sanctions have been imposed against them? What misfortunes have thereby befallen them?

Mr. KENNEDY. Well, let me say that there are several. First of all, as we know, several chief executives have been replaced. Some have not, but several have. Next, there have been shareholders——

Mr. MURPHY. In one case a corporation replaced its chief executive, and put a nun on the board. Is that going to correct the problem?

Mr. KENNEDY. No, I wouldn't say that at all, sir, but the shareholder suits—and we haven't seen the end of them—I think may be imposing some very serious sanctions indeed in terms of their ultimate consequences.

Chief executives have had to resign. Directors are subject to a possible monetary liability, which, I might say, tends to powerfully concentrate the mind.

Mr. MURPHY. Are you aware of the story which recently appeared in the newspapers concerning the chairman of Northrup at certain international meetings.

Mr. KENNEDY. Well, it seems to me that a number—I don't want to speak to individuals—a number of people have gone through some fairly traumatic experiences in the aftermath of this, and there is more to come.

Mr. MURPHY. But they were mostly connected with illegal political payments within the United States and not with the foreign payment problem we are here concerned with.

Mr. KENNEDY. That is true. I think the most serious legal sanctions have been imposed in connection with the violations of the Corrupt Practices Act. I think that is a fair statement, but I don't think that people who have been engaged in the foreign conduct have gotten off scot-free.

I observed earlier that there are very serious legal sanctions here, and I don't know how any responsible management could now believe that for the future this was a prudent course of conduct or how anybody could counsel that it was a prudent course of conduct. It is plainly one which is subject to the highest risks.

It seems to me that, if you have a requirement for disclosure, you have gotten at just about as much of the problem as you ever can. And I mean by that most of it or nearly all of it. Obviously there are going to be some residual hardcore situations, as there are in any other case. You have tax laws and criminal penalties, but there are still some tax abuses. And you have antitrust laws and abuse of those laws.

But I think, short of perfection, that, one, there have been radical improvements in the last couple of years, and I would say beyond that that with some modest additional measures you could be reasonably assured that there will be no large-scale recurrence of this.

I am not moralizing. I am saying I think the risks are too high.

Now, third parties. The problem for the future is: What kind of control do you put on these arrangements with intermediaries, agents, representatives, and consultants? You begin with the fact that almost all of them or nearly all of them are lawful and valid and for a proper purpose. But there are a few that are used as a cover for impropriety, and it is that kind of thing that you want to get at, and that is what disclosure deals with and that S. 3664 does not.

The Church proposals which the Senate properly rejected, and by a very considerable vote, seemed to me to go too far, because, in requiring

reporting, they required reporting of, I would suppose—There must be hundreds or thousands of perfectly lawful arrangements. You would have a regulatory agency flooded—I guess it would have been the SEC under Senator Church's proposal—flooded with these useless reports, and, because they would be published, you would have had some unhappy commercial consequences for the businesses involved.

These businesses would be telling their competitors the terms of their normal lawful arrangements. They would be telling an agent in country A what they were paying an agent in country B, which obviously is a commercial disadvantage. And all of this, it seems to me, to no good purpose in terms of law enforcement.

It is possible, it seems to our special committee, to draft a disclosure requirement which would call for disclosure of the arrangements which have a potential for abuse.

Now, in my prepared statement, I have suggested several criteria for that kind of disclosure system. First of all, it seems to us that it ought to be so framed that it could be fitted into an international agreemen on this. And, there is leverage that the United States has—and I have developed that in the prepared statement—to bring about such an agreement.

Secondly, it ought to be directed at substantial arrangements so that you leave out the minor facilitating payments which I think both the Senate bill would do and which the administration bill would do.

Third, you ought, in order to avoid loopholes, to require a reporting of any arrangement, regardless of whether it is otherwise covered, which was made with knowledge that the money would be passed on, so that you would draft a requirement that would prohibit the evasion of your general disclosure requirements.

Now, if you do that, it seems to us on the special committee, one, you will have given teeth—more teeth to your existing legal sanctions. You will have increased the likelihood that foreign laws will be more effectively enforced. You will have deterred a great deal of conduct in the first place. And you will have deterred solicitation of bribes and extortion, much more so than S. 3664 would do it.

If you have general So-and-so in country X and he is asking an American company to take a contribution of one kind or another, the American company says: "You know, we have a law which the Congress of the United States has just passed, H.R. 15481, which says, if I do this, I am a criminal under U.S. law." What does the general say to that? He says: "Well, you know, Mac, we all have our problems. Life is unfair. I still want that payment." But suppose you were to say to him instead: "You know, any payment I make, directly or indirectly, of a certain character, has to be a public record." It seems to me the deterrent effect of that is much greater.

Therefore, looking at it in terms of—that it is in the national interest to get this thing cleaned up, get it stopped, assure ourselves that there is no recurrence, assure ourselves that we have a domestic statute which will fit an international approach, that a carefully drafted disclosure provision will do the job and that criminalization will not do it.

Now, if I may, in the last part of my statement, I did deal with the SEC accounting proposals, and I won't try to duplicate the testimony of Mr. Holton on behalf of the AICPA, but I would like to address some points that Congressman Eckhardt raised a little earlier.

First, it isn't just that those provisions relating to misstatements to auditors apply to third persons, and it isn't just that they apply where the conversations are oral. And it isn't just that there is no requirement of specific intent to deceive. And I will come back to "willful" in just a moment.

But, beyond that, this statute would in its literal terms apply if you had an oral discussion with an auditor and you neglected to tell him something. It applies in the case of omissions. In theory, you would be opening to criminal prosecution a third person, not an officer or employee of the company, who, in the course of an oral conversation with an auditor did not give him the whole truth. Now, I realize no sensible prosecutor is going to prosecute many cases like that, but I don't think you ought to write laws on that premise.

And, beyond that, you are doing it on a basis where his only insulation is that there has to be a showing of willfulness. Let me make several observations about "willful." Any lawyer who has ever dealt with the subject knows that "willful" is a word of many meanings and varies with the context.

As you undoubtedly know, Mr. Eckhardt, Professor Loss in his revision of the securities laws now going on—the Federal Securities Code—drops that concept as not a sufficiently sophisticated concept for criminal sanctions, and he introduces concepts based on the thinking that was developed some years back in the Model Penal Code and elsewhere, with much more sophisticated and careful definitions of what kind of criminal intent would be required in order to criminalize conduct that might take place in some circumstances innocently.

So I don't think "willful" does much. I agree with your reading that, after all, the criminal provision is in section 32—and my statement makes the same reading of it, I might say. It does have a willfulness requirement, but that is a very spongy notion.

Mr. ECKHARDT. But you know I suggested we drop the language of (B) on page 3 of the act. That is, "to omit to state." I would suggest that that be dropped altogether.

Mr. KENNEDY. Yes; you did propose that, and I simply wanted to speak to the willfulness. You had a broader suggestion which was that you simply give the SEC rulemaking authority here, and, although I haven't dealt with this in the prepared statement, I would like to respond to that.

It seems to me, if you are asking what is the purpose of the recordkeeping requirements that are in S. 3664, you can posit three possibilities. One is that the SEC—and I think actually they have in mind several apparently, but one is that they would like a clarification of their authority to require certain kinds of recordkeeping and accounting in aid of their existing powers to assure adequate disclosure to investors and shareholders. I think most of us would be of the view—and I suggest in the testimony—that under their general rulemaking power they already can do that. They do have a very broad, very sweeping rulemaking authority in the 1934 act as it now stands, and, so long as they were seeking to require the keeping of records or the maintenance of accounting controls in aid of the disclosure authorities that they have under the 1934 act, which is, after all, the key concept of the 1934 act, they can do that under existing law in all probability.

Now, if you are talking about dealing with this precise problem that is before the subcommittee today—namely, foreign payments—the way you do that is with something much more modest, and, that is, if you have disclosure legislation, you say that people will keep the records that are required to make the reports. That is a perfectly conventional and traditional provision in regulations of various types. In fact, it is in the regulation that the State Department put out 2 days ago in connection with arms export sales. So, if you are concerned about records addressed to the foreign bribery problem, you can write a recordkeeping provision that deals with that.

That leads you to the third possibility. The third possibility—and I have dealt with this in the prepared statement—is, well, what this recent set of scandals shows is that there has been some manipulation of corporate books and you want to stop that, not just in that context, but generally. I would say several things about that.

One, you have got a number of State statutes on this. They are cited in a memorandum which I believe the American Bar Association's Federal Regulations of Securities Committee will supply to the subcommittee. But, if they are not available there, I will make them available by letter. But I can say to you, sir, that the leading States of incorporation in this country do have State provisions which make it a crime to falsify records. The line, by the way, which they draw between the trivial falsification and the serious one is that there is a crime of one grade to falsify in any circumstances and there is a crime of a more serious nature to falsify in a case where the purpose is to conceal another crime, which is the kind of distinction that you could look at here.

But, the next point—if you are concerned about the falsification of books because of general law violation, it seems to me you ought to look at section 10 of the Federal Trade Commission Act, which is within the jurisdiction of your parent committee, and which you amended only last year. That has a very sweeping provision which makes it a crime to falsify books. That is 15 U.S. Code, § 50.

I will say that there is not much case law under that. There is one district court case in Chicago from some years back which suggests that that applies only where there is a prior requirement to keep books under the FTC statutory authority. That seems to me a fairly narrow reading of a very broad provision. And you amended that in the warranty/guarantee amendments of last year to extend it beyond corporations.

In any case, there are a string of State statutes that apply. Let us suppose you conclude that that was inadequate, that you still wanted a general provision against falsification of records. Would you put it in the 1934 act? Is the 1934 act to be a basket for criminalization provisions of all kinds extraneous to the purpose of protecting security markets? It seems to me that it is not very sensible, and I suspect that Professor Loss, when he comes to you with his Federal Securities Code in a couple of years, will tell you that, if you did that in the 1934 act, you had better take it out and put it in the criminal code, at least for the future.

Next, all of these provisions are subject, if you are dealing only with falsification of records, to the point that was made in the Senate debates, and that is that they are limited to about a third of the companies that you should be concerned about.

There are roughly twice as many companies engaged in foreign trade and investment not subject to the 1934 act as are subject to it, and, using the 1934 act in this very artificial way, first of all, to expand it to criminal issues not normally related to the Exchange Act, and, second, to catch criminal violations by companies which are not in any other way subject to SEC regulations, seems to me to be—I will use the word carefully—incongruous.

That is all I have, Mr. Chairman.

[Mr. Kennedy's prepared statement follows:]

STATEMENT OF WILLIAM F. KENNEDY, CO-CHAIRMAN, SPECIAL COMMITTEE ON FOREIGN PAYMENTS, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

My name is William F. Kennedy. I am appearing on behalf of a Special Committee on Foreign Payments of the Association of the Bar of the City of New York. The Special Committee is chaired by Mr. Robert B. von Mehren who is unable to be here today.

The Special Committee was established by the then President of the New York City Bar Association, Mr. Cyrus Vance, and is composed of members of three regular Committees of the Association—the Committee on International Law, the Committee on Foreign and Comparative Law, and the Committee on Corporation Law. Our Special Committee has been working for several months and has now arrived at a substantial consensus which will be reflected in my statement today. However, we have not had an opportunity to prepare a formal report or to clear this report with the Executive Committee of the Association. Accordingly, I will be speaking for the Special Committee rather than for the Association as a whole. We plan to complete a formal report dealing comprehensively with the points covered in my testimony and to make this report available to you and to other interested members of the Congress.

The long-standing tradition of the New York City Bar Association is that lawyers participate in the work of its Committees in their own right as professionals and not as representatives of a client's interest or point of view. So, I should note that I am Counsel for General Electric Company, but am not appearing in that capacity, and am not speaking for that company.

I

The bill before you is H.R. 15481, the counterpart of S. 3664 passed by the Senate last week. My statement will focus on the particulars of that bill but I should open with a few broader observations.

Let me begin by stating that no responsible person either in the Bar or in the business community can argue for a return to the serious practices which have been exposed over the last two years—largely through the efforts of the Securities and Exchange Commission. In some cases, these practices have been harmful to the foreign relations of the United States and in other cases, they have adveresely affected U.S. competitors. Even in the coldest practical terms, no one can rationally contend that U.S. foreign trade and U.S. foreign investment will, in the long run, prosper on a foundation of bribery. Moreover, as SEC Chairman Hills has pointed out, the disclosures to date raise questions of corporate stewardship. Perhaps most fundamentally these disclosures have impaired public confidence in corporate management and in the business enterprise system. The question is not whether the serious practices exposed are defensible, but how best to assure that they will not recur.

This leads us to ask what the evidence shows as to why these practices developed in the first place. Clearly there have been gross failures on the part of some elements of U.S. business. Without in any way excusing these failures, it is important for the Congress to recognize that this wasn't the sole problem. There are at least four other factors which contributed.

First, contrary to the folklore, there were substantial U.S. legal sanctions applicable to foreign bribery, a point which I will elaborate in a moment. Moreover, the practices went on for a very long time and were not isolated. There are even public indications that in some cases they were known, not perhaps in detail, but in general outline to some elements of the U.S. Government. The problem in a word was not law, but law enforcement.

Second, the evidence shows that foreign competitors were engaged in similar practices, that this was perhaps tolerated by their own governments, and that this was part of the climate in which U.S. business had to compete in foreign markets. To this day, no foreign government has shown a zeal in any way comparable to that shown here about imposing constraints on the foreign activities of its home enterprises.

Third, the evidence suggests that in some countries, not all, bribery in dealing with the government was pervasive, that in some cases bribes were solicited not volunteered, and that there were some cases of plain extortion.

Fourth, it appears that almost all foreign countries have laws against bribery. There were to put it plainly failures not only of U.S. law enforcement, but failures of foreign law enforcement as well.

It is the view of our Special Committee that if Congress wishes to enact legislation which will provide additional assurances against recurrence of foreign bribery by U.S. business—and that is certainly the message of the 86–0 vote in the Senate last week—then Congress should enact a bill addressed to all these elements of the problem and not to just one of them.

II

Before turning to what such a bill might contain and to why S. 3664 would be both ineffective and counterproductive, I should mention the U.S. criminal and civil sanctions already applicable. Our Special Committee report will treat this in some detail, and here I will only summarize.

First, section 162(c) of the Internal Revenue Code makes it a criminal offense to take as a business deduction, foreign payments which would be illegal under U.S. law if made in the United States. The pending tax bill will extend this principle to payments by foreign companies controlled by U.S. parents. The bill will make a bribe paid by a foreign subsidiary, income currently taxable to a U.S. parent. It will exclude the bribe from the calculation of the foreign tax credit. It will make it clear that a bribe cannot be taken as a deduction in computing the income of a DISC.

Second, section 2(c) of the Clayton Act prohibits payments to customers or agents of customers except for services rendered. This provision affords a triple damage remedy to adversely affected competitors, and there are lower court cases holding that it applies to export sales and bribery. Section 1 of the Sherman Act is also probably applicable in some cases, and violation of that section would be subject to criminal penalties and civil injunctive relief, as well as triple damages. Section 5 of the Federal Trade Commission Act prohibiting unfair methods of competition is probably also applicable. The FTC can bring a proceeding for a cease and desist order under section 5.

Third, section 1001 of the U.S. Criminal Code, prohibiting false statements to Government agencies has been held to apply to failure to disclose bribery in connection with AID-financed transactions, and would also apply where there are clear disclosure requirements applicable to other Government-financed activities.

Fourth, the recent legislation governing arms exports provides for disclosure of questionable payments in connection with those transactions.

Fifth, a number of state statutes make it a crime to falsify corporate books and records. Section 10 of the Federal Trade Commission Act contains a similar broad prohibition against record falsification, although this has been held in one District Court case to apply only with respect to records required to be kept pursuant to the FTC's statutory authority.

Sixth, foreign bribery may subject the involved corporate management to a shareholders' derivative suit under state and Federal law. There have been a number of such lawsuits.

Seventh, the SEC has an array of civil and criminal sanctions under the '33 and '34 Acts to cover non-disclosure of bribery at least in cases where a significant portion of a company's business or income is dependent on the bribery, and probably in cases where a significant amount of corporate funds are handled outside of a company's regular system of accounts. The SEC takes the position in its May 12, 1976 Report to the Senate Banking Committee that its jurisdiction extends substantially beyond that—a point which many of us would debate—but in any event the SEC's enforcement proceedings and its more or less "voluntary" disclosure program have operated to bring to light what one can assume to be most of the questionable foreign practices of the last few years.

The problems which have been exposed arose therefore not out of lack of statutory authority, but out of a failure of law enforcement. The laws are now being enforced and with great vigor.

One could argue from all this that the prime need is not for new Federal law, but for international agreements to protect U.S. business against extortion, to subject foreign competitors of U.S. companies to the same constraints as those properly imposed on U.S. business, and to assure impartial law enforcement by foreign governments. But the 86–0 vote in the Senate last week, as well as the scheduling of these hearings, evidence a strong belief that there is a need for additional legislation to respond to public concern and to provide a signal to the world that foreign bribery is not consistent with our national ideals or our national policy.

III

The Senate, before adopting S. 3664, considered two approaches—disclosure and criminalization. There were those who advocated combining the two and it is the view of our Special Committee that the Senate acted correctly in rejecting any such combination. It is very questionable jurisprudence to make two crimes out of one by first prohibiting foreign bribery and then making it a second crime to fail to confess the first. Moreover, the criminalization approach is obviously at cross-purposes with a disclosure approach since hardly anyone having determined to violate the law will show up the next day at the police station and report the violation.

Next, our Special Committee believes that the Senate acted correctly in rejecting the specific disclosure proposals before it. These proposals had three major deficiencies:

They called for a great deal of detail about lawful business arrangements, detail which was unnecessary as well as burdensome and which subjected U.S. business to substantial commercial disadvantages;

They were limited to companies subject tot he 1934 Act, only about a third of the U.S. companies engaged in foreign trade and investment; and

They involved the SEC in the job of criminal enforcement with foreign policy implications—a job inconsistent with its present very demanding statutory responsibilities.

Having said all this our Special Committee is strongly of the view that there is no merit in the criminalization approach that the Senate did adopt in S. 3664. In our judgment, criminalization won't add significantly to the deterrent effect of existing law and will impair the ability of the U.S. to negotiate effective international arrangements. Let me develop these points in more detail.

First, in many cases the evidence necessary to prove that a payment made in a foreign country—probably through intermediaries—(i) was intended for a foreign official or politician, (ii) was made corruptly and (iii) was for a prohibited purpose, will simply be beyond the reach of U.S. investigators and U.S. enforcement authorities.

Second, an effective defense by a U.S. citizen accused of the Federal crime of foreign bribery might well depend on being able to call foreign witnesses and to obtain foreign documents beyond the compulsory process of the United States courts. This raises fundamental questions of due process of law.

Third, one should ask whether criminalization will deter foreign officials and foreign politicians from soliciting bribes and from engaging in extortion. It is plain on the face of it that an official or politician determined to violate the law of his own country, will not be restrained by concern that the U.S. company making the payment may be violating U.S. law. He can simply tell the U.S. company to use an intermediary—that's all the books will show, and nothing will have to be reported to either government.

Fourth, one has to ask whether criminalization is consistent with the U.S. interest in negotiating an effective international arrangement. Suppose a number of foreign countries agreed to enact laws along the lines of S. 3664, prohibiting their home enterprises from engaging in foreign bribery. What meaningful assurance would the U.S. Government and U.S. business have that these laws would be effectively enforced? Clearly an effective international agreement requires disclosure by enterprises of the industrialized countries of substantial third-party arrangements. As we have seen, criminalization is inconsistent with this approach.

Fifth, it should be noted that this Subcommittee is one of the Congressional custodians of the Federal securities laws. The purposes of those laws are to prohibit fraud in securities transactions, to regulate securities markets, and

to protect corporate shareholders in exercising their right to vote on corporate affairs. More broadly, the present SEC responsibility in protecting the process by which private savings are made available for business investment is a critical and consuming one. Is it good administration or good sense to add to this responsibility the very difficult role of enforcing a general criminal statute, particularly a statute involving U.S. diplomatic relations?

Moreover, the Senate bill provides for dual enforcement of the criminalization provisions. The SEC would have the primary role in investigating violations by companies subject to the '34 Act. The Justice Department would have the primary role in investigating violations by all other companies. Again, is this sound criminal law enforcement policy? The opportunities for inconsistent or inequitable enforcement are obvious. Also there can be overlapping enforcement authority where two U.S. companies are involved—one subject to the 1934 Act, and one not subject to it.

Sixth, we should mention one broad jurisprudential consideration. The conduct addressed in S. 3664, bribery of a foreign official or politician, is conduct which takes place abroad, involves in the first instance the interests of the foreign country, and violates the law of the foreign country. The United States adheres to the view that, as a matter of international law, it can impose criminal sanctions on the conduct of its nationals abroad, including conduct of foreign-based companies controlled by U. S. nationals, and sometimes on conduct by others affecting vital interests of the United States.

It is obvious from our experience in applying the antitrust laws to foreign commerce, and in the area of foreign assets control, that the potential for conflict with other nations requires that this position of the United States should be asserted only with the greatest caution, only when vital interests of the United States are concerned, and only where other measures are not available to do the same job.

Bribery abroad represents in the first instance a failure of foreign law enforcement. Is it sound policy for the United States to try to displace such enforcement or to make up for its failures? Shouldn't our primary efforts instead be directed to helping foreign countries do their own enforcement job?

Let me add some considerations which give these observations even greater force. Where foreign officials or politicians are involved, a decision by the United States Government either to prosecute or not to prosecute may involve diplomatic problems. The use of certain evidence either by the Government or a defendant, may also present diplomatic problems. Where these foreign relations elements are involved, how can we be assured of an impartial exercise of enforcement discretion? How does the U.S. Government work out an agreement with the host country government, as to which will have priority in undertaking prosecution? Will an accused be subject to double jeopardy for the same basic conduct?

IV

All of this leads to the view that if this Subcommittee believes that new legislation is appropriate, it should reject the criminalization provisions of S. 3664 and should try to develop a disclosure system which would not be subject to the failings of the disclosure proposals properly rejected by the Senate. Before discussing the criteria for such a system, I should address one argument which has been made by some proponents of criminalization.

This argument is that disclosure without criminalization would somehow countenance or endorse unethical practices by U.S. business. To the contrary, it is clear that disclosure would be more effective than criminalization in stopping these practices.

The notion that any U.S. company would believe that it could publicly report a foreign bribe with impunity is nonsensical on the face of it. The company reporting it would be subject to criminal sanctions in the foreign country concerned. It could lose not only the sale or investment involved in the bribe, but other investments and business opportunities as well. It could be subject in some cases to suits by competitors and its management would be subject to suits by share owners. There would be substantial tax sanctions. Disclosure might have to be made in documents filed or circulated under the Federal securities laws. Finally, the company's public reputation in this country would be intolerably damaged.

It is plain from all the published reports to date, and it is recognized in the Senate debate last week, that very frequently improper payments have been made through middlemen. Requiring reporting of agency, consultant, and representa-

tion arrangements where the amounts involved are substantial, and the services ill-defined, will clearly act to deter entering into such arrangements for an improper purpose. Under the Senate approach, on the other hand, a management determined to avoid the law might well enter into a questionable representation arrangement relying on the fact that it did not have to be reported, and on the difficulty that the Justice Department would have in proving that part of the money was intended for payoffs to foreign officials or politicians.

In a criminal prosecution under a disclosure statute, all a prosecutor would have to prove would be the making of the payments and the failure to report it. In a criminalization statute, there would be a much different burden of proof; it would be necessary to show the ultimate destination of the payment, a corrupt motive, and a prohibited purpose.

All of this suggests that any new legislation should call for a disclosure system focusing on large payments to intermediaries—agents, consultants and representatives—which have a potential for abuse. One might propose the following criteria for such a system.

First, it should be so framed that it can be utilized as a basis for negotiating an international agreement calling for comparable disclosure by enterprises of other industrialized countries.

Second, it should not apply to arrangements in the normal course of business which cover substantial identified services on a continuing basis at regular rates. A great of deal of business abroad is done on this lawful and often necessary basis. Reporting of these arrangements would be unduly burdensome and would flood the enforcing agency with a mass of useless paper. Moreover, public disclosure of an arrangement with one sales agent could put a company at a commercial disadvantage in negotiating an arrangement with another agent. Beyond that it could put a company at a disadvantage vis-a-vis its competitors.

Third, to assure that the disclosure system does not contain gaps or loopholes, there should be a requirement for a reporting of direct payments to foreign officials or politicians and a requirement to report any payment to an intermediary made with knowledge that all or part of it will be passed on to foreign officials or politicians.

Fourth, the reporting should not apply to minor so-called facilitating payments.

Fifth, the SEC should receive copies of any reports by 1934 Act companies but should not have primary enforcement authority.

I have referred repeatedly to the desirability of an international agreement to deal with the problem of bribery in international trade and investment. There is a facile cynicism about this in some quarters in this country to the general effect that—"We'll live so long"!

In the view of our Special Committee, the national interest requires that the U.S. stop foreign bribery by its own enterprises. But there is another national interest and that lies in assuring that this country's foreign trade and investment are not unfairly penalized by unfair practices of foreign competitors, tolerated by their own governments, or by foreign extortion, or by discriminatory foreign law enforcement.

It would be naive to say that it will be easy to reach an effective international agreement meeting these objectives. But the United States has to try, and for a good reason, and that is that the very effort to reach such an agreement will put the emphasis where it belongs and will have beneficial effects. For in the course of these efforts, the United States will be making four critical points:

One, the problem in the first instance is one of better home country law enforcement;

Two, the problem is not confined to American-based enterprises;

Three, part of the problem of improper payments is not bribery, but extortion; and

Four, we look to foreign governments to enforce their laws impartially, penalizing not only payors but recipients, and penalizing not only American enterprises but other foreign enterprises, and local enterprises.

It is disappointing that thus far the Congress has placed so little emphasis on this approach and is now actively considering legislation like S. 3664 which is squarely inconsistent with it. This country has to stop foreign bribery by our own nationals because we have learned the hard way in recent years that things go wrong when we don't live up to our best traditions. But being true to itself doesn't mean the United States has to be a patsy.

This brings me to the second point about international efforts. The Congress should reexamine the provisions of section 301 of the Trade Act of 1974 relating

to retaliatory measures against unfair practices by foreign governments and, if necessary, clarify that authority to apply to cases where foreign governments fail to proceed against their own enterprises which use bribery as a method of competition in international commerce. This clarification of section 301 on retaliatory authority would give a greater credibility to our negotiators seeking an international agreement addressed to the bribery problem.

VI

Section 1 of S. 3664 contains the proposals of the SEC relating to keeping of corporate accounting records, maintenance of a system of internal accounting controls, falsification of records, and misstatements to auditors. The Senate debate points out that the Senate Banking Committee heard no witnesses on these proposals except those from the SEC. This is most unfortunate because the SEC recommendations have been subject to specific, forceful and very persuasive criticism by the American Institute of Certified Public Accountants, by the Committee on Securities Regulation of the New York City Bar Association, and by the Federal Regulation of Securities Committee of the American Bar Association.

Our own Special Committee shares and endorses these analyses. Rather than repeat them at length, I will confine this closing portion of the testimony to a few main points:

First, the prohibition against misstatements to auditors goes way beyond reasonable bounds. There must be very few laws which make it a crime to make a false statement to a private person, as distinct from a governmental agency with law enforcement, regulatory or procurement responsibilities.

Again the prohibition applies to oral misstatements. The notion that one might be accused and convicted of a crime because of what he said or didn't say in the course of a conversation wtih an auditor is, to put it mildly, unusual.

Also as I have implied, the SEC proposals are not limited to affirmative misstatements. You can be convicted of a crime under these proposals if you omit to state something in an oral conversation and the omission is material and misleading.

Next, the SEC proposals are not limited to misstatements by corporate officers or employees. If an auditor seeks out a third person in order to make a confirmatory check in the course of an audit, that third person is subject to criminal risks under S. 3664. If he makes the mistake of talking to the auditor, he can be guilty of a crime if, in the course of an oral discussion, he fails to tell the auditor something and the omission is found in hindsight to be material and misleadng.

Of course, all ths is a crime only if the misstatement is willful. But willful is a word of many meanings, and no one is ever quite sure of its application in a particular case. The SEC proposals do not contain any requirement of a specific intent to deceive.

If S. 3664 is enacted, one has to ask would any careful person ever respond to an auditor's inquiries except where it is absolutely necessary? Would any careful person ever engage in an oral exchange with an auditor? Wouldn't he insist that both questions and response be in writing? I close this part of the discussion by suggesting, that what these provisions could well do, if enacted, is impair the effectiveness of corporate audits.

Second, the SEC proposals for keeping corporate records contain a requirement that these records be kept "accurately"—a requirement that the AICPA points out does not meet the realities of accounting practice. Many perfectly proper and honest corporate records are not in fact "accurate", if the word means precise or exact. Again one asks why a requirement like this in a statute which imposes criminal sanctions?

Third, the SEC proposals contain a requirement for a system of internal accounting controls meeting certain standards. But the AICPA has pointed out that these standards were developed as general guides, are susceptible of different interpretations in particular context, and are therefore not appropriate as statutory rules, subject to civil remedies and criminal penalties.

All of this leaves essentially the thought that the SEC proposals have as their one legitimate aspect, the suggestion that perhaps it ought to be a Federal crime to falsify corporate records, or to circumvent an existing system of internal accounting controls, provided that the bill specified, as S. 3664 does not, that falsification or circumvention was accompanied by an intent to deceive and provided that the falsification or circumvention was material.

Even here one has to ask whether this is necessary and whether in any event, it is appropriate in the 1934 Act. The focus of that Act is on preventing fraud by assuring that shareholders and investors receive adequate financial information about the corporation. The regulatory scheme is addressed to financial statements filed or circulated, and not to the underlying records on which the statements are based. If what is needed is better record-keeping to assure the adequacy of financial statements, the Commission probably has that authority under its existing rule-making powers.

If the purpose of section 1 of S. 3664, is simply to assure that proper records are kept in order to deter foreign bribery, it should be noted that S. 3664 goes way beyond that purpose. It is not limited to records relating to payments to foreign officials or politicians or to payments to possible intermediaries. It is limited to the 1934 Act companies which, as we have seen, are only one third of the U.S. companies engaged in international trade. A record-keeping requirement for this purpose belongs in general disclosure legislation, not in the 1934 Act.

Finally, if the purpose of S. 3664 is to deter corporate law violations generally one has to ask why include it in the '34 Act and why duplicate state law?

All of this suggests that section 1 of S. 3664 ought to be carefully reviewed by this Subcommittee and either dropped or substantially revised.

I should close by thanking the Subcommittee and its staff, on behalf of the Special Committee for the invitation to appear and present our views. I hope that whatever action the Subcommittee takes, it will find our formal report helpful in its further review of this problem.

Thank you.

Mr. ECKHARDT. How would you list those companies that should be subject to certain reporting requirements? How would you describe them?

Mr. KENNEDY. It seems to me——

Mr. ECKHARDT. So as to cover all of them instead of about a third.

Mr. KENNEDY. I think you would say any company which had a volume of export sales beyond some cutoff and—or any other company which had investments outside the United States beyond some cutoff, and you could set the cutoff almost anywhere you wanted it.

Mr. MURPHY. As long as you are on cutoffs, where does a "grease" payment end and a bribe start? At what level?

Mr. KENNEDY. Well, this is a very difficult question to answer because, if you answer it with a particular number—and I am going to talk around this, if I may, a minute, Mr. Chairman. I will be candid. I am going to talk around it.

First of all, if you come in wtih a particular number, you are subject to the reproach that you have already conceded on the principle, and I would say this, that the point is not that grease is right or that it is good or that you would countenance it in this country. The point is a different one, namely, that there are things that the United States cannot control such as the $15 tip to the customs agent because he is holding up your clearance certificate on some equipment you need in a local plant. The United States cannot get at the fact that, if you are visiting a foreign country and you haven't paid $10 to somebody or other, you are going to be held up on your routine clearances just to get in. And it is not a matter of the morality of it. It is a matter of what the United States can effectively do.

Clearly, the $10, $15, $20, $100 things, I think, are so trivial that you write them out on the basis that they are not reachable by the United States. We make ourselves look foolish when we try. We impair our effectiveness on the big things if we fool around with the trivial ones.

I said in a speech a while ago that the perfect is the enemy of the good. What Senator Proxmire had in his earlier bill was $1,000, and that is as good a number as any. I don't hold any brief for any particular number.

Mr. MURPHY. You don't underestimate the ambition of some of the customs people in other countries.

Mr. KENNEDY. I recognize it is a difficult problem. Of course, you know what you have done in the tax bill. You have said that any payment which is illegal by U.S. standards—that would be illegal if made in the United States—is currently taxable income. And, of course, it cannot go into the computation of earnings and profits for the foreign tax credit. And, if it involves a DISC, it is not available as a deduction against the income of the DISC. And your real control on that getting out of hand is—if that got out of hand and got to be significant amounts, you would pick it up through the tax route, and that is going to keep it down, and nobody can fool around with their tax returns on this because this gets you into the much more serious crime of tax fraud.

Mr. MURPHY. Mr. Eckhardt?

Mr. ECKHARDT. What would you think about this in the disclosure bill? Suppose we should provide in this bill that companies of the nature you described—that is, companies having foreign sales in excess of such-and-such or foreign investments in excess of such-and-such—shall keep records reasonably necessary to disclose or aid in the disclosure of bribery of foreign officials, more adequately described, and that the SEC shall have authority to require such records including—and then list this group of situations contained in the first section of this bill: Make and keep books, records, et cetera, et cetera.

What I am getting at is—you first define the scope of the records as having to do with the subject matter. You second define those who are required to do it as those who are likely to be in the class that are subject to such events. And you delegate to the SEC authority to specify in particularity what kind of records must be kept.

Now, I know you have said: What is the point of having this a function of the SEC? And this is not its usual function. I agree with you on that with respect to enforcement activity, but, with respect to rulemaking and with respect to what kind of records tend to reflect or result—I think they probably have the highest degree of expertise of any other governmental agency. And that is the reason I would apply it to the SEC. Not because the particular corporations are generally under their jurisdiction and not because I think the SEC is the proper enforcement agency, but merely because they are the agency with the greatest expertise with respect to devising the rules which will have the effect of disclosing. I know of no other agency—possibly the Federal Trade Commission in its function under the antitrust laws. But I don't want to quarrel about those two agencies. You have got to give it to somebody and you have got to give it to somebody with some degree of expertise.

Mr. KENNEDY. Well——

Mr. ECKHARDT. What would be wrong with that kind of approach?

Mr. KENNEDY. Well, first of all, the first two parts of your approach—namely, to have a provision which applied to anybody who

was in any substantial way engaged in foreign trade or investment—makes sense, rather than have the criterion whether you are an issuer subject to the 1934 act. That is point 1.

Second, it is obviously sensible to say that, if your problem was the inadequacy or the absence of records on this payments problem, what we ought to do is get records addressed to that. I would go more broadly than you and say we ought to have records on payments to intermediaries. I think some of the arguments that have made against public reporting don't apply.

Mr. ECKHARDT. I would not exclude that. As a matter of fact, in the second portion there is a reference to the use of intermediaries, I think. Of course, this is a criminal sanction, but you could easily use the same type of structure. A payment to any individual, while knowing or having reason to know that all or a portion of such money is to go to foreign agents.

Mr. KENNEDY. As to giving it to the SEC, first of all, the SEC has done a very good job here, and it is perhaps as logical as any other for that limited assignment. I do think you have this, sir. This subcommittee is one of the two congressional custodians of the Federal securities laws. I think you have got a policy question you should look at over a period of time. And that is, because the SEC does such a superbly good job, are you going to constantly enlarge its role, particularly because it has such great public and congressional credibility? Are you going to constantly enlarge its role so that what started in as an agency with fairly well-defined functions becomes an agency with a miscellany of functions? I think that is a very difficult question for you, and I would say you ought to be careful about enlarging their role, the reason being that they have an enormously consuming role right now and a very critical one.

One of the things that is at the heart of this economic system is the regulation of the mechanism by which private savings are made available for business investment.

Mr. ECKHARDT. May I interject here? Why not then the Federal Trade Commission?

Mr. KENNEDY. The Federal Trade Commission seems to me a little bit more logical.

Mr. ECKHARDT. It already has an extremely broad role and there is indeed a relationship, as you pointed out before, between this kind of activity and antitrust violation.

Mr. KENNEDY. Oh, yes.

Mr. SCHEUER. Also unfair competition.

Mr. KENNEDY. I think you are just absolutely right, Congressman Scheuer. I think it is reasonably clear that these activities in certain cases are unfair methods of competition in commerce, certainly in any case where there was an impact on a U.S. competitor.

Mr. ECKHARDT. There is just one other question I would like to ask, and that is with respect to criminality. I share your concern about this point, if I understand it. It seems to me you are saying that either the act is too oppressive if the question "willful" is too lightly construed or else it is unenforceable if "willful" is too strictly construed. I think this latter situation is certainly true with respect to the intermediary situation because it says, if a concern—and that means either an individual or a corporation—gives any individual money

while having reason to know that a part of that money may indirectly go, say, to an official of a party and then the party may influence the government to buy its goods, that person is guilty of a crime. If "willful" is construed very lightly or very permissively, it seems to me that is too much, because it is very difficult for a subsidiary or an employee of a company, a person with the responsibility of trying to sell its goods, not to have some knowledge of the very likely, practical possibility of some of those funds going into what you might call a kind of a—not hardcore bribe. And that would be too complicated to anticipate.

It strikes me that imprisonment with respect to such a person may be very oppressive, especially in view of the fact of the difficulty of getting evidence in defense, as you also pointed out.

On the other hand, it strikes me that, with respect to section 1 of the earlier provisions about an intentional bribe, that $10,000 is the lightest slap on the wrist with respect to the corporation. I imagine they would pay 10 fines of $10,000 or 100 in order to get the benefits of a $1 billion contract.

Mr. KENNEDY. My memory fails me a little bit on this, but I think one thing they missed—they have increased the penalties in the 1934 act.

Mr. ECKHARDT. But this is a special penalty. This is in this act itself.

Mr. SCHEUER. Is there also a criminal penalty? That has a tendency——

Mr. ECKHARDT. $10,000 generally, but it has a $500,000 penalty with respect to exchanges. However, that $500,000 penalty would not be applicable here, either under the terms of that act and also because the penalty is specifically provided in this act. But $10,000 seems to me to be virtually nothing.

Mr. KENNEDY. I agree with that.

Mr. ECKHARDT. The publicity would be much more costly to a corporation than the $10,000 penalty.

Mr. KENNEDY. Exactly. And I would say it seems to me one more case where attempting to fit this whole thing into the structure of the 1934 act has produced some artificial results.

Mr. ECKHARDT. Thank you, Mr. Chairman.

Mr. MURPHY. Mr. Scheuer?

Mr. SCHEUER. Mr. Kennedy, it is a pleasure to have you here. I have to state that we have a possibility of a conflict of interest here because I worked for Mr. Kennedy 24 years ago as a young lawyer in the Office of Price Stabilization when Mr. Kennedy was counsel to the meat branch, as I recall.

Mr. MURPHY. He looks better than you do.

Mr. SCHEUER. Time has treated him much better than me.

Mr. KENNEDY. I wouldn't accept that, Congressman. I will say that we were associated with some very good people.

Mr. SCHEUER. We were indeed. So I have an enormous respect for your legal acumen and your scholarship, as well as your tremendous capacity as a first rate human being, which probably is more important than anything else.

You have suggested that an alternative route would be an international treaty.

Mr. KENNEDY. Well, I had earlier been of the view as an individual that we should first attempt to develop an international treaty, and I am not as pessimistic on that as some others, because I think, as I say, we have some leverage.

Mr. SCHEUER. Do you have any idea what the timeframe would be?

Mr. KENNEDY. No. I think it is at least a 2-year exercise, but this statement which reflects the unanimous view of our special committee says in effect that Congress should not wait for a treaty. But we do think the Congress should write legislation which would fit a treaty, and that the criminalization provisions don't fit. In fact, they are counterproductive. They work against an effective treaty—and disclosure would fit an international approach.

I ought to say one thing more about this. It is in the statement, and I recognize it is beyond the jurisdiction of the subcommittee, but, when the Trade Act of 1974 was passed by the Congress, a couple of years ago, there was a broadening in a number of ways of the power of the President to retaliate against unfair methods of competition by foreign governments.

There are some nice questions as to whether or not in the new phraseology you have adopted, which is broader than the old Kennedy Trade Expansion Act of 1962, you didn't perhaps narrow it in terms of its potential application in this case. Some of us would say you did not, that section 301 of the Trade Act can be used for this purpose, but, in any case, it seems to us on the special committee that the Congress should clarify 301 of the Trade Act and give the President retaliatory authority. I thoroughly recognize that that is an authority which he would use only very rarely. There are a lot of difficult implications, but the availability of that authority, the power of the United States to proceed where foreign governments were countenancing this kind of behavior on the part of enterprises which compete with U.S. enterprises, would give our efforts in the international arena a great deal of credibility.

I think we have other leverage. Obviously, the United States has such a large role in the world economy that we have, I think, a fair amount of influence with our friends in the OECD orbit, that we do have a basis, it seems to us, for getting a treaty.

I would not argue at this stage that the Congress should wait for that. I think the Congress should act, but I think they should act in the light of what would make sense if we can get a treaty and in light of what would make sense in seeking a treaty.

Mr. SCHEUER. And that would be the disclosure route?

Mr. KENNEDY. Disclosure seems to us to be more sensible. I said before you came in, Congressman, that—suppose you had a treaty along the line of the Senate bill where everybody said: "All right. We will put in the S. 3664 criminalization provisions." Would the U.S. Government be happy with such a treaty or should it be? Would U.S. business think that that treaty was very reliable? And the answer is that it would be just as reliable as the enforcement policies of all other foreign governments that adhered to the treaty, and no more so.

On the other hand, disclosure and reporting requirements would be much more easily enforceable and much more meaningful.

Let me say one other thing. It is perfectly true, as has been said time and again, beginning with Chairman Hills and others, that in a num-

ber of the cases what the U.S. companies that were engaged in this were doing was hurting other U.S. companies. There was no foreign competition in the picture in a number of those cases. But it is also true that in many areas of world trade U.S. companies are head to head with major companies of other industrialized countries, and I don't think we should deprecate that problem. I think it is a serious one.

Mr. SCHEUER. Thank you very much.

Mr. MURPHY. Thank you, Mr. Kennedy. We really appreciate your testimony.

The concluding witness is Mr. Leonard C. Meeker, who is an attorney with the Center for Law and Social Policy.

STATEMENT OF LEONARD C. MEEKER, ATTORNEY, CENTER FOR LAW AND SOCIAL POLICY

Mr. MEEKER. Mr. Chairman, I appreciate the opportunity to appear here this morning. I have prepared a statement and have filed it with the subcommittee, which I would request be incorporated in the record.

Mr. MURPHY. Without objection, it will be included in the record in its entirety (see p. 200) and you may proceed to paraphrase your statement.

Mr. MEEKER. What I would like to do now is just to emphasize a few points and considerations which seem to me to have special importance.

The practices of foreign bribery and improper payments are of such proportions and are so noxious that effective action really ought to be taken to stop them. Such bribes and payments are just not a legitimate part of the free enterprise system. They, of course, harm the business prospects of all American firms, not just those who pay the bribes, and the damage extends to our Nation as a whole. It diminishes our standing, our ability to conduct foreign relations effectively.

Most of all, I think that the continuation of such practices and effective condoning of them by the Government as a whole has highly corrupting effects on all of American society.

The comments this morning of Congressman Harrington were particularly apt in regard to this fundamental aspect of the bribery problem.

Now that it has been brought to light by numerous extensive, notorious disclosures during the last 2 years, it does seem time for some definitive national action to be taken. Of course, there is a responsibility on the executive branch and there is responsibility on regulatory agencies, and hopefully in the future they will discharge those responsibilities and do so vigorously to the extent of their authority.

But I think also there is a role for Congress to play at this stage. References have been made to statutes, laws, already on the books. There indeed are some. They are scattered. Some of them are criminal. Some are statutes providing civil remedies. They tend to deal, each one, with a small segment of the problem. It might be a tax aspect. It might be an antitrust aspect. There is no existing Federal law which deals with this problem in general.

Reference has been made to the arms control legislation recently enacted. This is indeed a model for disclosure legislation, but it applies only in one class of cases. I would think that there ought to be enacted a comprehensive statute that would declare U.S. national policy in

this area and accompany the statement of policy with appropriate sanctions to back it up, and at the same time, because this is an international problem and not one limited at all to a single country, we should pursue vigorously some negotiations that have already been undertaken to produce a worthwhile international agreement.

In regard to the legislation that has been passed by the Senate and is now pending before the subcommittee in the form of H.R. 15481, I think it is, so far as it goes, a realistic and constructive legislative measure.

I would like to make a few suggestions about H.R. 155481, and mostly they are for the purpose of clarifying and strengthening the measure. First, it seems to me that a prohibition on political contributions by corporations to foreign political parties, officials, and candidates might as well be an unqualified prohibition. There is no reason that we should have one standard in the United States where the prohibition is complete and another standard with respect to contributions—political contributions abroad. I think it would be a wise change to make the ban on political contributions by corporations a complete one in the case of this legislation.

Reference has been made this morning to the appearance of the word "corruptly" in the legislation, and I would raise the question whether that particular term should be retained, because in the bill there is a very clear description, both in section 2 and in section 3, of the purposes of payments that are being made and which are known to the corporation or to the individual who is responsible, and I would think that the proof of the making of the payment and that it was made for one of the purposes defined in the legislation would be quite sufficient and an appropriate statement of the situation to which the criminal sanction would apply.

I think to add as a third requirement proof that the payment had been made or offered corruptly puts a great obstacle in the way of any effective prosecution because it requires proof perhaps of a subjective state of mind, which is just about impossible.

It seems to me that what is involved here is not the state of mind of any corporation or the people who are running it, but rather proper conduct by the corporation in an area which the Nation thinks is important to be kept clean.

So I would urge that the term "corruptly" really ought to be dropped.

In the legislation as it now stands, in defining its field of application, the expression "any means or instrumentality of interstate commerce" is used. I think here it might be appropriate to broaden that to say "interstate or foreign commerce," particularly where the subject matter of this legislation is commerce with foreign countries.

The argument has been made against criminal sanctions that they would be unfair in requiring a special standard of ethics, business ethics, for U.S. companies which may not be required by other countries of their corporations operating abroad.

This argument, it seems to me, is really not a persuasive contention. Ever so many U.S. companies—undoubtedly the majority—haven't been paying bribes at all. They have relied on what American industry has relied on from the beginning, and that is quality products, efficient marketing, modern technology. Their business and their business suc-

cess have depended not on sleazy corruption, but on effective performance.

Many times, as has been pointed out, bribes have been paid not in order to best a foreign competitor, but to get an advantage over another American firm.

As for the oft-repeated statement that bribes and payoffs are not only customary in foreign countries but are not a violation of the laws abroad, this seems to me an entire misunderstanding of foreign legal systems.

Mr. MURPHY. Mr. Meeker, you were formerly ambassador to Romania.

Mr. MEEKER. Yes; I was.

Mr. MURPHY. In reference to what you just stated, would you say that bribery by U.S. firms is an old practice?

Mr. MEEKER. Certainly—are you speaking now in regard to Romania or——

Mr. MURPHY. Generally.

Mr. MEEKER. Unfortunately, in looking through the evidence that has been turned up in the last 2 years, it appears that the practice goes back about 20 years at least. I think that when this became more prevalent was in the great expansion of our foreign trade after World War II. During the 1950's, the practice seems to have taken hold more widely; not that it was totally nonexistent before, but I would say there was a great increase during the last 20 years.

There really is no country I know of where bribery is permitted, where it is not against the law and the subject of criminal sanctions. There are some countries where contributions by corporations to political parties are not only legal, but rather expected, but that is a separate question.

I believe that the legislation would be strengthened if it were to include also some provisions requiring disclosure. It seems to me that the criminal sanctions are worthwhile and are appropriate and that the bill in that respect would be strengthened if there were provisions requiring disclosure not directed at criminal activity, but disclosure of payments by corporations that were made in order to get business, payments to government officials abroad, payments to agents of governments, payments to agents of companies who would be receiving commissions. It should be required that all such payments, their amounts and purposes, ought to be disclosed. In this way, I think that information would become available to make it possible to determine in what cases there had been criminal violations. But, beyond that, the purpose of disclosure is a broader one, just as Mr. Kennedy has said here this morning.

Mr. SCHEUER. Excuse me. Would you accept disclosure as an alternative to criminal violations, which is what Mr. Kennedy urges?

Mr. MEEKER. I would not think so. It seems to me that both approaches ought to be taken in the legislation, both criminal sanctions to cover certain actions and also disclosure, which would have a wider area of applicability.

Now, at the same time, it seems to me that we should clearly be expecting the executive branch to pursue vigorously international negotiations. In this regard, it seems to me that the enactment of legislation now by the United States, both with respect to criminal

penalties and disclosure, would in no sense interfere with or discourage the progress of international negotiations. Quite the contrary, I think that such action on the part of Congress would make it clear that the United States is serious about this and intends to take effective measures. It would strengthen the hands of the American negotiators to have a good new law on the books in this country.

Those are my thoughts on this legislation, and I would be happy to try to respond to any questions.

[Mr. Meeker's prepared statement follows:]

STATEMENT OF LEONARD C. MEEKER, ATTORNEY, CENTER FOR LAW AND SOCIAL POLICY

Mr. Chairman, members of the Subcommittee:

I am Leonard Meeker, an attorney with the Center for Law and Social Policy, a public-interest law firm in Washington. In 1975, I represented a number of organizations in filing with the Securities and Exchange Commission a Petition asking the Commission to hold a rulemaking proceeding on requirements for disclosure of foreign bribes and political payments by corporations subject to that Commission's jurisdiction. During the current year, I have represented other groups in a proceeding before the Federal Communications Commission where one of the issues was the eligibility for television station license renewal of corporations having a long history of bribery, fraud, and improper transactions in their international operations.

The views expressed in this statement are entirely my own, and should not be taken as reflecting positions of the Center for Law and Social Policy or of any of the organizations I have represented.

Americans have traditionally taken pride in the advanced technology of our industry, in the efficiency of its organization, and in the energy and resourcefulness of its marketing. We have long held the idea that these elements brought prosperity and expansion to the American economy. We have considered them also the accepted principles of our foreign trade, which expanded rapidly in the 20th Century, particularly in the years since World War II.

Thus, it has been with dismay that the country has learned, last year and this, that a large number of companies—some of them leaders in their sectors of industry—have for several years been giving bribes and making other pay-offs in connection with foreign sales of their products. The disclosures have resulted from investigations conducted by the Securities and Exchange Commission, from hearings held by Congressional committees, and from a series of stockholder suits against companies and their top management officers.

Among government agencies, the Securities and Exchange Commission took the lead in ferreting out the facts. The Commission commenced court proceedings against a series of major corporations to challenge their accounting practices which had failed to disclose and frequently were designed to conceal foreign bribes and pay-offs. In a number of instances, these lawsuits brought about thorough investigations of corporate affairs under the mandate of outside directors. In addition, the Commission invited companies subject to its supervision to come forward with information on bribes and pay-offs, and a substantial number have done so.

Unfortunately, the facts do not permit the conclusion that foreign bribes and pay-offs have occurred only in isolated instances. So far, it appears that perhaps 200 corporations have engaged in such practices, and new disclosures have been appearing every week. This is not to say that corruption pervades all or most of United States foreign trade. Many companies have firm policies against bribes and pay-offs and carry out the policies in practice. There seems to have been a concentration of foreign bribes and pay-offs in particular industry groups: first of all, aerospace and defense companies; next, the oil and gas industry; and then the drug industry. A number of other sectors have been involved as well.

Damage from corrupt trade practices

Payments to government officials or agents, and contributions to political parties, in order to obtain sales abroad are not a legitimate activity in the free enterprise system. Such payments to influence business decisions corrode free enterprise. They tend to direct business not to the most efficient producer of the

best quality manufacturers but to the most corrupt. Bribes paid by corrupt firms tend to put pressure on honest firms to follow suit.

Bribes and pay-offs impair trade opportunities abroad for American business. Not only are such practices likely to result in cancellation of contracts and denial of future business to firms that have engaged in them, but a foreign government's distrust of an American company that has been caught in bribery can spill over all too easily into suspicion of other firms that may be quite innocent. Thus, although only some and not all American firms have engaged in bribery and pay-offs, these practices give American business generally a bad name.

The damage caused by foreign bribes and pay-offs does not stop with reduced foreign trade opportunities for U.S. industry. These corrupt practices reflect on the United States as a nation. They diminish our standing before the world. The American reputation for quality, competence, and honesty is tarnished and eroded by them. In ways that are intangible and cannot be exactly measured, such practices make us a less influential and significant nation.

Corporate bribes and pay-offs abroad can embarrass and endanger the survival of friendly governments. They lend credence to the suspicions cultivated by extremists in other countries that American business has a corrupting influence.

But, most of all, we should be concerned about the corrupting effects on our own society of large business organizations delivering bribes and making illegal payments, and the effect of U.S. government acquiescence in such practices if that should be the official treatment of them. We cannot afford to settle for the proposition that corruption is a way of life that must be accepted. We do not want to be such a country, and we do not want to be branded as one through continued illegal practices abroad by some of our corporations.

Now that the problem has been brought to light in extensive disclosures during 1975 and 1976, it is time for effective national action to deal with it. Two lines of action should be pursued:

(1) A clear and definite national policy should be set forth in legislation, with appropriate sanctions to back it up; and

(2) Negotiations should be pursued with other countries with a view to concluding one or more international agreements in support of our national policy of honesty in foreign trade.

Criminal penalties

The legislation contained in H.R. 15481 constitutes an appropriate measure for dealing with the problems of foreign bribes and pay-offs. It is realistic in requiring the keeping of full and accurate books and records by corporations subject to the jurisdiction of the Securities and Exchange Commission. It also imposes a flat prohibition on bribes or political pay-offs by such corporations to secure business in foreign countries. In addition, it prohibits other domestic concerns from making use of the mails or of interstate commerce to engage in such bribery or pay-offs. Thus, the coverage of the bill is appropriately broad. The definitions of prohibited offers and payments seem well calculated to end the illegal practices to which the legislation is addressed.

So far as concerns contributions by corporations to political parties, their officials, and candidates, I would think the statutory prohibition might properly be made unqualified. Such treatment would accord with the existing United States statutory prohibition on political contributions by corporations.

On one matter of drafting, I would raise a question about inclusion of the word "corruptly" in Sections 2 and 3 of the bill. Is this adverb meant to require proof of an element in the offense beyond the elements set forth in subparagraphs (1), (2), and (3) of these two sections of H.R. 15481? If this is not the intention, then the word should be omitted or, in the alternative, the reports on the legislation should state that inclusion of the term "corruptly" is intended only to emphasize the nature of the actions described in subparagraphs (1), (2), and (3) and does not add the requirement of any proof other than what would be required in the absence of this term.

On another point of drafting, I would suggest that the expression "any means or instrumentality of interstate commerce" be broadened to include "foreign" commerce as well.

Various objections have been raised at different times against the enactment of legislation to prohibit foreign bribery and illegal pay-offs. Those objections are not convincing.

One argument sometimes advanced is that U.S. companies must pay bribes in order to compete with less scrupulous foreign firms. Many American companies doing business abroad have never resorted to bribery. Chairman Roderick Hills of the Securities and Exchange Commission told a Senate committee in testimony on May 18: "We find in every industry where bribes have been revealed that companies of equal size are proclaiming that they have no need to engage in such policies."

Secretary of Commerce Richardson stated in a letter to the same Senate committee on June 11, 1976: "In a number of questionable payments cases—especially those involving sales of military and commercial aircrafts—payments have been made *not* to 'out-compete' foreign competitors, but rather to gain an edge over other U.S. manufacturers."

If the Federal Government sets a uniform standard for American companies to follow and takes appropriate steps to see that the standard is enforced, a company doing business abroad will not have to fear that its American competitor may obtain unfair advantage through bribes and pay-offs. Executives of a number of firms have said that they would welcome the setting of a standard to outlaw such payments for all. The existence of a standard would give an American firm a solid basis for refusing bribes and pay-offs in situations where they might previously have been solicited or at least expected.

The promulgation of an American standard does not solve the problem of the third-country competitor that may hope to clinch a foreign contract through money under the table. But an American standard can, nevertheless, exert a considerable influence on the practices of firms based in other countries. Those firms may well decide that, if their American counterparts are going to refuse the payment of bribes, they might as well do so too. I will want to discuss later the steps that the U.S. Government should undertake in conjunction with other governments to prohibit bribery and illegal pay-offs. Here I would simply note that firm and decisive action by the United States Congress will create a solid and persuasive basis on which to begin those negotiations. National legislation will show that we are serious and mean business.

Moreover, foreign firms may be deterred by the prospect of disclosure, in an atmosphere where attention has become focused on bribes in connection with international sales and where competitors will be alert to find them out and publicize them. Still another factor may be the deterrent effect of disclosure on the readiness of foreign officials to accept or solicit bribes. In Japan, Iran and elsewhere, revelations of bribery have produced strong public and governmental reactions. Heavy consequences may be visited upon bribe seekers and takers. Criminal and other sanctions are bound to operate as a deterrent.

It has sometimes been said that bribes and pay-offs in a foreign country are not only customary there but also are not in violation of the country's laws. While the laws of some countries—unlike those of the United States—permit contributions to political parties and candidates, I know of no country where bribery of a public official in order to gain favorable government action on a contract is anything but illegal.

Another argument raised against United States legislation is that other countries would resent American attempts to impose our standards and morality on them. Such a contention is misleading and lacks substance. In the first place, legislation such as H.R. 15481 is addressed to American citizens, not to government officials or nationals in any other country. It is by no means unprecedented or unusual for United States legislation to regulate the activities of American citizens abroad. The tax and anti-trust laws are familiar examples. On the question of foreign government reaction to U.S. legislation such as H.R. 15481, the comments of the Attorney General of the Republic of Botswana are instructive:

"Certainly, no self-respecting African nation would consider U.S. legislation aimed at curbing corrupt practices of American transnational enterprises in their foreign host states to be 'presumptous' or in any way 'an interference'. On the contrary, most Third World nations would appreciate such legislation. You see, developing countries have difficulties in discovering offenses committed by U.S. corporations insofar as their bribing and corrupting of local government officials . . . Why do you think all of these disclosures are coming out of Washington and not out of the host countries? On this particular issue, most Third World countries would want to cooperate to the fullest extent possible, with the U.S. and other home countries to make sure that the offending transactional enterprise is punished. Another result of the U.S. adopting such legislation is that the Third World will acquire a healthier respect for the United States and its transnational enterprises."

Still another argument put forward against legislation is that criminal sanctions against bribery or illegal pay-offs abroad would turn out to be unenforceable. There may, of course, be instances in which prosecution for an offense would be made more difficult by the fact that it was committed abroad and that important witnesses reside outside the United States. However, as Senator Proxmire has said on the floor of the Senate in support of a bill paralleling H.R. 15481,

"The committee also notes that in most cases investigated by the SEC to date, investigators were able to uncover adequate evidence of overseas payments by subpenaing records, and/or interviewing witnesses with knowledge of such payments, available in the United States. Furthermore, ethical employees or competitors are often a source of information on bribes paid overseas. All of these sources will continue to be available in the prosecution of bribery cases."

In connection with enforcement, it is important that both the Securities and Exchange Commission and the Department of Justice have adequate funding and staff to do the job needed. The committee reports on the legislation might appropriately urge both agencies to review their needs under the new legislation and to present to Congress the budgetary requests that are indicated.

A further element in the area of enforcement that would be useful in the government's efforts to clean up U.S. foreign trade would be a clear and uniform policy on the part of government agencies that they will not contract with firms that have not effectively forsworn the corrupt practices covered by H.R. 15481.

Disclosure requirements

The measure now before the Subcommittee would be substantially strengthened if there were added to it provisions requiring reporting by U.S. firms of payments, gifts, commissions, and contributions along the lines of provisions already incorporated in the Arms Export Control Act of 1976. In the Senate, Senator Church proposed just such an amendment. The basic provision of the amendment would require that firms subject to the jurisdiction of the Securities and Exchange Commission file with the Commission "a complete accounting of any contribution, payment, gift, commission, or thing of value"—

"(A) to any agent, consultant or like individual retained by the issuer to perform services outside the United States on behalf of the issuer in promoting, selling, or soliciting or securing indications of interest in any product or service produced, sold, distributed, or performed by the issuer;

"(B) in connection with any direct or indirect political contribution by that issuer to any foreign government; and

"(C) in connection with any direct or indirect payment or gift by the issuer to an official or employee of a foreign government."

The Church amendment specifies that the filings are to include the names and addresses of each person who made or received a payment, the date and amount of it, and a description of the purpose for which it was made. The purpose in requiring such reporting is to assist in identifying payments made illegal by sections 2 and 3 of H.R. 15481. The investigations of overseas corporate bribery have disclosed that often bribes and other illegal payments have been made in the form of fees and commissions paid in the first instance to agents, consultants, or other intermediaries. Reporting requirements will help in the effective enforcement of the criminal sanctions set forth in sections 2 and 3 of the bill.

The Church amendment could usefully be broadened to include disclosure of payments made in connection with foreign commerce by domestic concerns other than issuers subject to the jurisdiction of the Securities and Exchange Commission.

Here it might be noted that the inclusion in legislation of both criminal prohibitions and disclosure requirements would not raise a problem with respect to the Constitutional privilege against self-incrimination contained in the Fifth Amendment. Long ago, the Supreme Court decided, in *United States* v. *White*, 332 U.S. 1248 (1944), that the privilege is available only to individuals in their private capacity and does not shield organizations from disclosures required by government in the exercise of its regulatory functions.

H.R. 15481, supplemented by appropriate reporting requirements such as I have outlined, would constitute important and valuable legislation to bring under firm control the problem of bribes and illegal pay-offs by American firms abroad. Even in the wake of the investigations and disclosures of the last 15 months, uncertainties remain in American industry as to what practices are permissible and what accepted patterns of action will be in the future. That uncertainty should be ended at once with the enactment of clear and adequate legislation.

International cooperation

The area we are discussing is one of international concern, in which many countries are involved. The United States Government has been participating in various international discussions designed to cope with corporate bribes and illegal payments. One negotiation has taken place within the OECD in Paris, the Organization for Economic Cooperation and Development, made up of industrialized nations. Other negotiations are going forward in United Nations bodies. It should be the aim of these negotiations to obtain international agreements on the establishment of standards and codes of conduct for the operation of business firms. Such agreements should also establish international rules regulating international procurement and sales by governments. A fully effective set of measures for eliminating bribery and illegal pay-offs in international business transactions will require the cooperation of many nations. Common standards will need to be agreed. Cooperation in enforcement of them will also be called for.

Accomplishment of these larger purposes on the international negotiating scene will doubtless take time. Experience shows that quite clearly. Efforts at obtaining international agreements will surely be speeded if the United States, which is one of the largest and most important trading countries in the world, moves promptly to take effective action that lies within this country's legislative and regulatory power. The enactment of appropriate legislation will demonstrate that this country is serious. It will serve as a spur to other countries to enact comparable legislation, and it should serve as an important catalyst in moving the international negotiations forward.

Mr. MURPHY. Mr. Meeker, I am afraid we are on the second bell for a rollcall vote on the Legislative Branch Appropriations Act, and we are going to have to go back to the floor to vote and adjourn for the day.

We certainly appreciate your testimony and the input that you have given us in this very serious area. Thank you very much.

The subcommittee will stand adjourned.

[The following statement and letter were receieved for the record:]

STATEMENT OF THE UNITED STATES COUNCIL OF THE INTERNATIONAL CHAMBER OF COMMERCE

This statement has been prepared in response to the Subcommittee's request to Mr. Ian MacGregor, Chairman of the Board of Directors of AMAX Inc. and Chairman of the U.S. Council of the International Chamber of Commerce to testify before the Subcommittee on the provisions of H.R. 15481, which has been prepared on behalf of the U.S. Council of the International Chamber of Commerce. It is requested that this testimony be included in the record of the Subcommittee's proceeding.

The U.S. Council is comprised of several hundred leading industrial companies, bank, law firms, public accounting firms, international engineering and construction organizations, advertising agencies and other businesses all of whom are heavily involved in international operations. The U.S. Council has frequently testified before Committees of the House and Senate on matters bearing on international business activities.

When revelations concerning irregular payments to government officials abroad in connection with commercial transactions burst upon the public in 1975, the U.S. Council was quick to take action in this regard. Consequently, the Council urged the International Chamber of Commerce to internationalize the approach to the problem immediately. In response to this, the International Chamber established its Commission on Unethical Practices in December 1975.

Early in 1976, the Rt. Hon. Lord Shawcross, P.C., G.B.E., Q.C., Chairman of the City of London Board on Take-overs and Mergers; Chairman, British Press Council; former President of the Board of Trade of the United Kingdom, accepted the Chairmanship. Other members of similar stature were named to the new Commission. Members have been drawn from the United States, Germany, United Kingdom, Sweden, Japan, Belgium, India, Brazil, and Sudan. A list of the members of the Commission is contained in an annex to this statement.

The terms of reference of this Commission on Unethical Practices include: (1) Case studies throughout the world whereby improper payments or inducements of a corrupt nature are solicited or made in the course of commercial

transactions involving either private or public enterprises or both; (2) studies of the extent to which improper payments are solicited by political parties or offered to them by business with a view to securing unethical advantages; (3) studies of the problems relating to the payment of normal business commissions; (4) studies of existing laws and the extent and method of enforcement regarding these matters; (5) suggested remedial action to promote correct conduct, including the establishment of relevant guidelines for adoption by international business; (6) recommended legal measures to be taken by governments and inter-governmental agencies, and (7) an expression of the views of the international business community on intergovernmental projects on this subject.

The Commission has held several meetings and is now hard at work drafting guidelines. Three additional meetings are scheduled for the Autumn of 1976. The most important aspect of its work is the creation and elaboration of an International Code of good business behavior which will be of a self-regulatory nature. The broad framework of the code is well along. It is hoped early next year to reach a consensus within the 53 National Councils which comprise the International Chamber of Commerce as to the content of these rules of fair conduct.

In addition to the voluntary code of conduct envisaged by this Commission of the International Chamber as a self-policing action by the International business community, the International Chamber and its United States Council also have given full support to initiatives for effective international action concerning extortion, bribery or corruption under consideration in intergovernmental bodies.

Most recently an executive of the ICC, addressing the U.N. Economic and Social Council (ECOSOC) meeting in Geneva on July 27, 1976, supported the proposal for an International Convention, under which each signatory state would be obligated to take steps to eradicate extortion and corrupt practices, including the establishment of effective enforcement machinery. The ICC support stems from the conviction that remedial action is required not only at the national level, but also, by multilateral government action.

The type of international convention the International Chamber supports would make disclosure of all political contributions mandatory; would prohibit companies from making political contributions outside their home country, and would provide for the Secretary General of the United Nations to submit an annual report on results achieved through its application.

It will be recalled that the ECOSOC decided in August 1976 to set up an 18 member intergovernmental working group to prepare an accord designed to prevent bribery and other corrupt practices by multinational companies or government officials. ECOSOC meets later this week to select the members of the working group; the first meeting is planned for October of this year. This ECO SOC initiative provides further opportunity for the U.S. Council and the International Chamber of Commerce to present their recommendations on the content of any agreement on unethical business practices which might be agreed.

Therefore, in view of the vigorous action being taken within the International Chamber of Commerce to ensure the international treatment of the problem of unethical business practices, coupled with intergovernmental action in the United Nations for the eradication of corrupt practices through the establishment of adequate enforcement machinery, the U.S. Council urges the Committee not to act on H.R. 15481 at this time, but to continue its consideration of these problems in the light of discriminating unnecessarily against the various initiatives now under way in international organs. This will give the initiatives a chance to evolve and to provide universal international solutions to a universal problem, without discriminating unnecessarily against other U.S. interests.

MEMBERSHIP OF ICC COMMISSION ON UNETHICAL PRACTICES

Chairman.—Lord Shawcross, G.B.E., Q.C. (United Kingdom). Chairman of the City of London Board on Takeovers and Mergers, Chairman of the British Press Council, Former Attorney General and President of the Board of Trade.

Members:

Subramanya Bhoothalingam (India). Former Secretary of the Indian Ministries of Commerce, Industry, Steel, and Finance. Former Director General of the Indian National Council of Applied Economic Research.

Arthur von Bulow (Federal Republic of Germany). Former Secretary General of the Federal Ministry of Justice.

Giulite Coutinho (Brazil). President, Associacao de Exportadores Brasileiros.

William H. Franklin (United States), Chairman of the Board of Trustees of the Committee for Economic Development. Former Chairman of the Board of Caterpillar Tractor Co.

Zaki Mustafa (Sudan). Secretary General of the Joint Commission Sudan/Saudi Arabia for the Mineral Development of the Red Sea. Former Attorney General.

Rudolph A. Peterson (United States). Former President of Bank of America. Former Administrator of the United Nations Development Program.

Jean Jay (Belgium). Former Chairman of the Commision of the European Communities and Minister of State.

Genzo Suzuki (Japan). Chairman, Associated Japanese Bank International, Ltd.

Erland Waldenstrom (Sweden). Chairman of the Board of Granges AB.

Legal Advisor.—John Blair (United Kingdom). Shell International Petroleum Co.

Rapporteurs.—John F. Crawford (United States). Surrey, Karasik, Morse and Goekjian.

Dr. Sten Tengelin (Sweden). Director, The Trade and Industry Committee on Marketing Law Policy.

AMERICAN BAR ASSOCIATION,
FEDERAL REGULATION OF SECURITIES COMMITTEE,
SECTION OF CORPORATION BANKING AND BUSINESS LAW,
September 22, 1976.

Hon. JOHN M. MURPHY,
Chairman, Subcommittee on Consumer Protection and Finance, Committee on Interstate and Foreign Commerce, U.S. House of Representatives, Washington, D.C.

DEAR CONGRESSMAN MURPHY: This letter is submitted by members of the Federal Regulation of Securities Committee ("Committee") of the Section of Corporation Banking and Business Law ("Section") of the American Bar Association ("ABA"). The need to submit these comments promptly has prevented the observance of the normal processes of clearing such comments with all members of the Committee, the Section and the leadership of the ABA. Accordingly, these comments do not represent the official position of the Committee, Section or ABA, nor do they purport to reflect the varying views of individual Committee members, some of whom disagree with these comments. Nevertheless, these comments do reflect the substance of a consensus of the views of Committee members as expressed at its meeting held on August 9, 1976 in Atlanta, Georgia. In addition, a draft of this letter has been submitted to each of the 19 chairmen of the subcommittees of our Committee, the officers and members of the Council of the Section and the chairmen of various other committees of the Section having an interest in this subject. The great majority of the persons thus far responding to the earlier version of this letter join in the substance of these comments.

We have grave concern about H.R. 15481 as presently drafted and respectfully request that these comments be considered by the Subcommittee on Consumer Protection and Finance.

This letter is divided into two main sections. Section I contains comments on H.R. 15481. Unless the context indicates otherwise, references herein to H.R. 15481 include S. 3664. Section II contains comments on S. 3741 introduced in the Senate on August 6, 1976, and H.R. 15149 introduced in the House of Representatives on August 10, 1976, both on behalf of the Administration. This proposed legislation is referred to as the proposed Foreign Payments Disclosure Act. Since the Administration's proposal has been stated to be a supplement to the proposal incorporated in H.R. 15481, we concluded it would be desirable to provide our comments on that proposal as well. In addition, there is an appendix which contains comments on an earlier proposal relating to competitor's rights of action.

In summary, the Committee supports a legislative effort to address the foreign payments problem. Our primary recommendations are:

The adoption of the alternative to Section 1, Subsection (2) of H.R. 15481 set forth in I.C. hereof.

The deletion of Section 1, Subsection (3) from H.R. 15481 the reasons set forth in I.D. hereof.

The inclusion of Section 1, Subsection (4) of H.R. 15481 in Title 18 of the United States Code for the reasons set forth in I.E. hereof.

The adoption of the Administration's proposal, with certain minor changes, in lien of Sections 2 and 3 of H.R. 15481 for the reasons set forth in H.B. hereof.

To provide further assistance to you with regard to a proposed legislative approach to the foreign payments problem, we have included herein in addition to the foregoing recommendations alternative recommendations for your consideration.

I. H.R. 15481

A. Introduction

H.R. 15481 would amend the Securities Exchange Act of 1934 ("Exchange Act") to require issuers of securities registered pursuant to Section 12, and issuers required to file reports pursuant to Section 15(d), of the Exchange Act to keep accurate books and records and to devise an adequate system of internal accounting controls. This bill also makes it unlawful to falsify accounting books and records or to deceive an accountant in connection with an audit or examination of such issuers. It also provides criminal penalties for foreign bribery by United States business concerns.

The Senate Committee on Banking. Housing and Urban Affairs ("Banking Committee") held several days of hearings on the subject of improper overseas payments in April and May of 1976. It considered several proposals: S. 3133 introduced by Senator Proxmire on March 11, 1976; S. 3379 introduced by Senators Church, Clark and Pearson on May 5, 1976; and S. 3418 introduced by Senator Proxmire at the request of the Securities and Exchange Commission ("SEC") on May 12, 1976.

Then, in July 1976, the Banking Committee favorably reported a composite bill. S. 3664, incorporating verbatim all of the SEC's legislative proposal and including a direct criminal prohibition against foreign bribery. S. 3664 was passed by the Senate on September 15, 1976.

H.R. 15481, which corresponds to S. 3664, was introduced by you on September 8, 1976 and hearings are being held on September 21–22, 1976.

B. General Comments

The Senate Report on S. 3664 [No. 94–1031, 94th Cong., 2d Sess. (1976)] ("Senate Report") includes a discussion of the need for the proposed legislation. It notes that bribery is unethical and that severe foreign policy problems are created where United States corporations bribe foreign officials. The Senate Report also states:

"[T]he payment of bribes to influence business decisions corrodes the free-enterprise system. Bribery short-circuits the marketplace. Where bribes are paid, business is directed not to the most efficient producer, but to the most corrupt. This misallocates resources and reduces economic efficiency. Senate Report 3."

The Committee agrees with these conclusions and supports the effort to address the foreign payments problem. With that end in mind, we have prepared these comments.

One general comment seems appropriate at the outset. We note that the problem of foreign bribery has generated a great deal of activity at United States governmental agencies, in the Congress and in international bodies. Secretary Richardson, in his address at the ABA Annual Meeting in August 1976, stated:

"It is undeniable that existing securities laws and the Internal Revenue Code have important bearing upon the questionable payments problem—the former by requiring disclosure of "material" improper payments, and the latter by denying tax deduction of illegal payments. In addition, vigorous application of securities and tax standards is prompting increased internal corporate accountability."

More recently, the Federal Trade Commission has taken action in this area on the basis that the Federal Trade Commission Act bars corporate bribery as a form of unfair competition.

In the Congress, much legislation has been introduced to stem questionable foreign payments. In addition to the legislation which is the subject of this letter, there are changes in the Internal Revenue Code relating to foreign bribes; amendments to the Foreign Military Sales Act requiring additional reporting of fees paid to military sales agents and others of defense articles to or for the armed forces of a foreign country or international organization and providing that no payment may be included in the amount paid under any procurement contract unless the amount of the payment is reasonable, allocable to such contract, and not made to a person to exercise "improper influence" with respect to the transaction; H.R. 11987 introduced by Congressman Mottl on February 19, 1976 which would amend Title 18 of the United States Code to provide criminal

penalties for payments to foreign officials made to influence official acts; H.R. 9860 introduced by Congressman Solarz on September 25, 1975 which would require the termination of investmnet insurance issued by the Overseas Private Investment Corporation in any case in which the insured investor engaged in bribery of a foreign official; H.R. 7539 introduced by Congressman Solarz on June 3, 1975 which would amend Title 18 of the United States Code to provide criminal penalties for payments to a foreign government official or political organization made with an intent to influence any official act affecting the company involved; H.R. 11532 introduced by Congressman Solarz on January 27, 1976 which would amend the Foreign Assistance Act by directing the Overseas Private Investment Corporation to automatically terminate insurance in a relevant project if it becomes known that, in conjunction with such project, the investor has made any significant payment to any foreign official in a manner which violates the applicable laws of the country in which the project is located.

Regarding action by international bodies, the Organization for Economic Cooperation and Development has adopted voluntary guidelines on corrupt practices, the United States has proposed negotiations of an international agreement, and the General Assembly of the United Nations adopted Resolution 3514 (XXX) on December 15, 1975 condemning corrupt practices, including bribery, by transnational and other corporations and calling upon governments to take specified measures to address the problem.

The foregoing list is not complete. It serves to illustrate, however, the scope and intensity of the activities being pursued to prevent questionable foreign payments. In light of the extensiveness of these activities, and in recognition of the fact that some of the measures proposed, in and of themselves, may individually provide a complete deterrent to these foreign payments, we trust that the legislative approaches of the House Committee on Interstate and Foreign Commerce and the Senate Committees on Commerce and Banking willl be closely coordinated and that the approaches of other committees of Congress presently dealing with this problem will be taken into account. Unless this is done, we fear that there will be duplicative and excessive regulation which may be particularly inappropriate now when there has been increasing concern expressed at all levels of government and by the public over unduly burdensome governmental regulation and the resultant detrimental effect on business. Surely it would be desirable to avoid a situation where, when looking at the regulatory and legislative developments in this area with the increased perspective of hindsight, reasonable men would conclude that the collective cures were worse than the disease. No doubt the Congress is sensitive to the frustrations which are prompting increased interest in Sunset Laws and to the sentiments which underlie observations such as those recently expressed by Hugh Sidey:

"It is evident that in many areas of American life we have reached the threshold of tolerance for Government interference. It is not a matter of ideology. It is plain human protest against inconvenience, burden and limitation." Time Magazine, p. 20 (Aug. 16, 1976).

Again, we note our agreement that a legislative approach to the problem of overseas bribery is desirable. We think that approach should be measured (recognizing that existing laws are being aggressively enforced at this time) and coordinated and synchronized in order to avoid duplication, redundancy and criminal and other consequences which collectively would represent inordinate, excessive punishment.

Turning our focus to H.R. 15481 as such, we believe that the bill covers several situations unrelated to its expressed objectives in a manner which creates serious potential problems for covered companies as well as their directors, officers, employees, lawyers and public accountants. In addition, the bill is in significant respects unnecessarily duplicative of existing Federal and state laws. On the other side of the coin, we note that the bill does not deal with the broader question of domestic bribery.

C. Comments on section 1, subsection (2)

This Subsection would require issuers of securities registered under Section 12 of the Exchange Act and issuers required to file reports pursuant to Section 15(d) of the Exchange Act (herein sometimes collectively referred to simply as "Reporting Companies") to create and maintain books and records which accurately and fairly reflect the position of the issuer. This Subsection would also require Reporting Companies to devise and maintain internal accounting controls sufficient to provide reasonable assurance that transactions will be

executed and access to assets will be permitted only in accordance with management's authorization, that transactions will be properly recorded, and that assets reflected on the books of account will be compared at reasonable intervals with actual assets.

As already noted, the substantive thrust of the bill is the prevention of certain foreign payments. The proposed additions to Section 13(b) of the Exchange Act incorporated in Subsection (2) are ancillary. The SEC, in its "Report on Questionable and Illegal Corporate Payments and Practices" dated May 12, 1976 ("SEC Report") notes that reviews of the Staff, and action taken by the SEC itself—

". . . have been significantly influenced by the fact that virtually all questionable payment matters have involved the deliberate falsification of corporate books and records, or the maintenance of inaccurate or inadequate books and records which . . . prevent these practices from coming to the attention of the company's auditors, outside directors and shareholders." SEC Report 13.

The SEC concluded that—

". . . the falsification of corporate books and records and the accumulation of funds outside the system of corporate accountability—problems presented in most instances of questionable or illegal activity considered by the Commission to date—is of paramount concern to investors and cannot be ignored." SEC Report 22.

It is important to note, however, that neither the Banking Committee nor the SEC presented a factual record in support of the proposition that the quality of accounting and recordkeeping on the part of Reporting Companies should be generally criticized or condemned. Indeed, the Senate Report, quoting SEC Chairman Hills, indicates that "the most universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability." Senate Report 11.

Accordingly, we suggest that a legislative solution focus on the observed evil. Creation of slush funds from which bribes are paid and the mislabeling (and therefore concealing) of foreign bribes are necessarily the consequence of intentional acts. The language suggested below as an alternative to Subsection (2) will adequately define, in our judgment, the class of persons who could undertake such schemes and create a statutory prohibition on the conduct which has given rise to concern on the part of the Congress and the SEC, without imposing on Reporting Companies the requirements included in Subsection (2) which are in part not clearly defined and redundant. For example, Paragraph (B)(iii) of Subsection (2) [providing that access to assets, however insignificant, shall be permitted only in accordance with management's authorization] is at once impossible of performance as a practical matter and redundant in light of Paragraph (B)(i) [providing that transactions shall be executed in accordance with management's general or specific authorization]. Similarly, the requirement of Paragraph (B)(iv) [providing that "the recorded accountability for assets [shall be] compared with the existing assets at reasonable intervals and appropriate action [shall be] taken with respect to any differences"] is upon analysis unclear and, depending upon its meaning, probably redundant in light of Paragraphs (B)(i) and (ii). In raising these points we do so with full understanding that the language comes from existing auditing guidelines. It is perhaps unnecessary to say that language which may be appropriate and adequate to serve as guidelines for accountants is not necessarily appropriate for inclusion in a statute, the violation of which carries civil and criminal penalties.

Subsection (2) requires an issuer to maintain "an adequate system of internal accounting controls" or be in violation of the securities law. While we agree that every issuer should maintain an adequate system of internal accounting controls, we have great difficulty in seeing how the failure to do so can be made the subject of Federal civil and criminal penalties in the absence of some legislation containing clearly articulated standards of conduct. The problem lies in the lack of such standards as to what would constitute "an adequate system."

It has been contended that the components of such a system are contained in the accounting literature published by the American Institute of Certified Public Accountants ("AICPA"), see Statement of Auditing Standards No. 1, Section 320, entitled "The Auditors Study and Evaluation of Internal Controls." The AICPA standards require auditors to study and evaluate existing internal controls "as a basis for reliance thereon and for the determination of the resultant extent of the tests to which auditing procedures are to be restricted." (SAS 1, Section 320.01.) The auditor is required to evaluate such controls in order to determine

the extent to which he is willing to rely thereon in his examination of financial statements. The auditing guidelines speak of internal accounting controls designed to provide reasonable assurances of the nature specified in the bill (SAS 1, Section 320.28).

However, the auditor's role is not to evaluate the adequacy of such accounting controls for the purpose of compliance by the issuer with legal standards, but rather to permit the auditor to form judgments relative to the scope of the audit. It is still possible to complete an audit in the absence of a complete system of internal controls, but alternative vertification or other extended procedures may be necessary. The auditing standards provide no basis to judge the legality of such systems. An examination of the published accounting standards in this area leads us to conclude that adoption of this portion of the bill in its present form would provide inadequate guidelines to issuers as to when they are operating unlawfully by reason of inadequate controls. Moreover, judicial standards for the determination of the adequacies of such controls may be uncommonly difficult to formulate as they will vary depending upon the nature, size and business activities of the enterprise involved. The Senate Report recognizes this problem. It notes that the requirement of an adequate system of internal accounting controls "is not a requirement that is intended to be enforced without regard to the point at which the costs associated with a particular corporate system of internal accounting controls exceeds the benefits that flow from that system." Senate Report 12.

Given the difficulty inherent in establishing and defining an adequate system, we do not understand the pressing need to legislate this aspect of public accounting particularly where the foreign payment cases disclosed to date have had, in the SEC's observation, almost the universal characteristic of circumvention of apparently adequate internal accounting systems. It must be borne in mind that there is no such system that could prevent all attempts at circumvention even if it could withstand a cost-versus-benefit analysis. It seems to us that a far better approach would be to deal with attempts at circumvention of an internal system of accounting controls.

In view of the foregoing, we suggest as an alternative to Subsection (2) the following language:

"(2) It shall be unlawful for an officer, director or employee of an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to furnish reports pursuant to section 15(d) of this title to circumvent, with intent to deceive as to a matter involving $1,000 or more, the system of accounting records and internal accounting controls maintained by such issuer to record its transactions and account for its assets."

It is hard to imagine how such circumvention could be accomplished without also falsifying books or records, a subject discussed below.

D. Comments on section 1, subsection (3)

This Subsection would make it unlawful for any person to falsify any book, record, account or document of a Reporting Company made or required to be made for any accounting purpose. It does not require any intent to do an improper act, it does not make any exception for immaterial inaccuracies and it is not limited in its scope to persons having a management or employment relationship with the issuer. Thus, the effect of this Subsection would be to make almost every mistake in the books and records of a Reporting Company a possible subject of the jurisdiction of the Federal courts. Items as trivial as a mild exaggeration of an expense voucher presumably would be included. The Senate Report states that this Subsection would cover acts of omission as well as acts of commission, so the failure to make a record of a trivial transaction also presumably would be a civil or criminal violation of Federal law.

According to the Senate Report, traditional concepts of aiding and abetting and joint participation in a violation would apply. If this provision is not limited to persons connected with the issuer, we believe that this would result in a dangerously broad area of potential liability with undefined boundaries that would serve no commensurate useful purpose.

It appears that the potential consequences of Subsection (3) on the civil and criminal case loads of the Federal courts may not have been fully appreciated. In this regard, we think that Subsection (4) of Section 1 (discussed below) also could have a very substantial impact on the case loads in the Federal courts. The foregoing suggests the appropriateness of seeking a Judicial Impact Statement from the Administrative Office of the United States Court System.

We wish to call attention to the fact that state statutes providing *criminal* penalties for falsifying corporate records are widespread. Such statutes exist, for example, in California, Cal. Corp. Code § 3020 (West 1955); Delaware, Del. Code Ann. tit. 11 § (1974); Florida, Fla. Stat. § 817.15 (1976); Massachusetts, Mass. Gen. Laws ch. 266, § 67 (1968); Michigan, Mich. Comp. Laws Ann. § 450.1932 (1973); New Jersey, N.J. Stat. Ann. § 2A:111-9 (1969); New York, N.Y. Penal Law §§ 175.05, 175.10 (1975); Ohio, Ohio Rev. Code Ann. § 2913.42 (Baldwin 1971); Pennsylvania, Pa. Stat. Ann. tit. 18, § 4104 (1973); and Wisconsin, Wis. Stat. Ann. § 943.39 (Supp. 1975).

Supplementing state law, there are of course the Federal securities laws which presently provide the basis for the extensive and vigorous SEC enforcement activities recognized in the Senate Report. In view of the foregoing, while we do not condone the falsification of books and records, and agree that such conduct should be unlawful, we believe that Subsection (3) of Section 1 is overly broad and redundant of certain state legislation.

Assuming the Congress determines to adopt the substance of Subsection (3), we submit that such a provision should be included in Title 18 of the United States Code rather than in the Exchange Act, for the reasons set forth in the next part of this letter. If, however, the Congress were to determine that the Subsection should be adopted as part of the Exchange Act, we suggest that it read as follows in order to avoid the negative consequences identified above which we believe were not intended:

"(3) It shall be unlawful for any officer, director, employee or agent of any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15(d) of this title, directly or indirectly, to falsify, or cause to be falsified, with intent to deceive as to a matter involving $1,000 or more, any book, record, account or document of such issuer made or required to be made for any accounting purpose."

E. Comments on section 1, subsection (4)

This Subsection would make it unlawful for any person to make false or incomplete statements to an accountant in connection with any audit of a Reporting Company. According to the Senate Report, this provision "is designed to encourage careful communications between auditors and persons from whom the auditors seek information in the audit process." Senate Report 12.

We believe that such a provision will have the opposite effect in many cases. As in the case of proposed Subsection (3), this Subsection does not require any intent to do an improper act nor does it make any exception for immaterial inaccuracies. For these reasons, persons such as banks, suppliers and customers from whom auditors normally seek information in connection with an audit but who have no obligation to furnish it might well refuse to furnish any information at all to the auditors rather than run the risk of an inadvertent violation of a civil and criminal statute. The problem would be particularly acute if the Subsection were to be construed to apply to misstatements or omissions made negligently but without fraudulent intent, which the Senate Report indicates is a purpose of the proposed legislation. Given the evidence to date in this area which indicates that the problems have been created by intentional conduct, we must question the need or desirability of an overly broad approach which carries the possible counterproductive effects noted above.

The proposed Subsection would apply to any misstatement or omission, whether oral or written. In connection with their audit work, accountants must communicate with a number of people over a relatively long period of time and the nature of the communications varies from casual conversation to carefully prepared written statements. It seems inadvisable to impose potential civil and criminal liability on any person who even inadvertently might make what after the event would turn out to have been a false or incomplete statement to an accountant which at the time might have been thought by both parties to the conversation to have been true and complete and not related to the audit. For these reasons, we believe Subsection (4) should be limited to written communications, to such communications by persons connected with the issuer, and to those situations where there is an intent to deceive.

Subsection (4) would apply to immaterial inaccuracies. In this respect it represents a dramatic departure from the fundamental structure of the liability provisions of the Exchange Act for which no justification has been provided in the Senate Report or the SEC Report. We believe that Subsection (4), for sound

policy reasons, should be consistent with the basic structure of the Exchange Act and apply only to material inaccuracies.

As in the case of Subsection (3), the Committee is of the view that a statutory provision such as that proposed, if adopted at all, should be included in Title 18 of the United States Code and not added to the Exchange Act. If, however, the Subsection is to be adopted as part of the Exchange Act, in order to reflect our comments above and for increased clarity of expression in certain other respects which do not involve any change of substance, we suggest that Subsection (4) read as follows:

"(4) It shall be unlawful for any officer, director, employee or agent of any issuer hereinafter described, with intent to deceive, directly or indirectly—

(a) to make, or cause to be made, in writing an untrue statement of a material fact, or

(b) to omit to state, or cause another person to omit to state, any material fact neceessary in order to make statements made in writing by such officer, director, employee or agent, in the light of the circumstances under which they were made, not misleading,

to an accountant in connection with any audit of the financial statements of an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to section 15(d) of this title, or in connection with any audit of the financial statements of an issuer with respect to an offering registered or to be registered under the Securities Act of 1933."

As noted above, we believe that the subjects of Subsections (3) and (4) would be more appropriately covered, if they are to be covered at all, in Title 18 of the United States Code rather than in the Exchange Act. Also, since the main thrust of the bill is against improper overseas payments, it seems to us that the application of the two subsections should be limited accordingly. On the other hand, we believe that in one respect the purpose of the proposed legislation would be better served by making these provisions applicable to all persons to whom the restrictions on overseas payments are applicable and not merely to issuers subject to the reporting requirements of the Exchange Act.

To achieve the foregoing results, we suggest the substitution of the following for Subsections (3) and (4):

"Title 18 of the United States Code is amended by adding a new Section 1028 as follows:

"*1028. Falsification of books, records, etc.*

"Whoever, being an officer, director, employee or agent of a domestic concern, and who, for the purpose of concealing from such domestic concern or its accountants, any payment to any official of any foreign government or instrumentality thereof or to any foreign political party or official thereof or any candidate for foreign political office, where the amount involved exceeds $1,000, directly or indirectly falsifies, or causes to be falsified, any book, record, account or document made or required to be made for any accounting purpose of such domestic concern shall be fined not more than $———— or imprisoned for not more than — years, or both. For purposes of this section, "domestic concern" shall mean any individual or entity included in the definition of that term in —— U.S.C. Sec. ——."

It should be noted that the foregoing proposal would apply to all foreign payments of the type covered, whether or not prohibited. We note the narrow approach of the bill to foreign payments, as distinguished from unlawful domestic conduct. This dichotomy, as proposed in the bill and as reflected in the language suggested above, and its implications, suggest the need for further study by Congress.

F. Comments on sections 2 and 3

Section 2 would prohibit a Reporting Company from "corruptly" offering, paying or promising to pay money or anything of value (i) to an official of a foreign government or instrumentality, (ii) to a foreign political party, official or candidate, or (iii) to a known intermediary. The existence of a corrupt purpose turns on whether the payment is made for the purpose of inducing the recipient of the payment to use his influence with the foreign government or instrumentality or to fail to perform his official functions in order to assist the issuer in obtaining or retaining business or in influencing legislation or regulations. The above prohibition would be achieved by amending the Exchange Act to add a

new Section 30A applicable to Reporting Companies which would then subject them to the existing penalties. Willful violations of the Exchange Act are punishable, under Section 32, by up to five years imprisonment and a fine of up to $10,000. Violations of Section 2 normally would be investigated initially by the SEC and, if criminal prosecution were warranted, referred to the Justice Department.

Section 3 of the bill would apply the identical prohibitions to any domestic busines concern not covered by Section 2. Violations of Section 2 would be investigated and prosecuted by the Justice Department.

The Committee believes that if a direct criminal prohibition on foreign payments is considered by Congress as the best approach, such prohibition should be included in Title 18 of the United States Code for the reasons indicated below. However, we think the Administration's proposed Foreign Payments Disclosure Act has much to be said in its favor (see Section II. hereof) and is deserving of due consideration by Congress as an alternative to Sections 2 and 3 of the bill.

1. *An Anti-Bribery Law Would Be More Appropriate in U.S. Criminal Code.*— The Committee's threshold comment on Sections 2 and 3 is that a legisiative prohibition against foreign bribery would be more appropriate for inclusion in Title 18 of the United States Code. First, Sections 2 and 3 would tie in with Sections 201–224 of that Title which represent a comprehensive attempt to deal with domestic bribery and related practices. Second, the inclusion of unrelated substantive criminal provisions in the Exchange Act would constitute an unjustified departure from the concept, structure and purposes of that Act. The major purposes of the Exchange Act, as set forth in its preamble, are:

". . . [t]o provide for the regulation of securities exchanges and of over-the-counter markets operating in interstate and foreign commerce and through the mails, to prevent inequitable and unfair practices on such exchanges and markets, and for other purposes."

Section 2 of the Exchange Act states:

". . . [f]or the reasons hereinafter enumerated, transactions in securities as commonly conducted upon securities exchanges and over-the-counter markets are affected with a national public interest which makes it necessary . . . to require appropriate reports . . . ."

An additional objective of the Exchange Act is to provide a fair opportunity for the operation of corporate suffrage.

The Exchange Act, as well as the Securities Act of 1933, reflect a policy of requiring disclosure of information material to investment decisions. This policy is implemented by disclosure requirements in the Securities Act covering public offerings and by disclosure requirements in the Exchange Act covering proxy statements and SEC reports. The common thread and touchstone in this scheme has been materiality. Sections 2 and 3 as drafted contain no concept of materality. Their approach reflects an unjustified assumption that the sorts of foreign payments covered by the bill are material and disclosable under the Exchange Act irrespective of amount, irrespective of whether the questionable payments indicate that the accounting controls of the issuer were inadequate, and irrespective of the knowledge and involvement of management.

To date, neither the SEC, nor the courts, nor the securities bar has operated under the assumption that any illegal or questionable conduct by an employee of an issuer is *per se* material to investors so that disclosure would be required. Yet, by reason of the approach reflected in Sections 2 and 3 of the bill, a novel and possibly disrupting concept would be forced into the Exchange Act. Specified conduct not directly related to the purposes of the Exchange Act would be made criminal. Prohibited payments automatically would become a violation of the Exchange Act, thus being distinguished from other types of unlawful conduct. It is not unreasonable to suppose that the SEC would find such a violation a cause for disclosure irrespective of the traditional definitions of materiality which have evolved over more than 40 years. We believe such a result would introduce confusion into commonly understood notions of materiality and would lay the groundwork for additional structural distortions of the securities laws. This would be detrimental to the 10,000 Reporting Companies and their advisors which are continually obliged to sift, evaluate and determine those facts which are appropriate for disclosure to investors. This process already is time-consuming, costly, difficult and hazardous.

In view of the foregoing, we reiterate our earlier suggestion that a prohibition on foreign payments would be more appropriate for inclusion in Title 18 of the United States Code.

2. *Bifurcated Enforcement Has Serious Drawbacks.*—Further in support of the above suggestion, we submit that bifurcated enforcement of Sections 2 and 3 of the bill would have undesirable effects. This appears to be a consequence of placing one of these prohibitions in the Exchange Act and one in another statute. First, bifurcation would provide a basis for inconsistent enforcement of the prohibitions as between Reporting Companies covered by Section 2 and domestic concerns covered by Section 3. There is also the likelihood of inefficient duplication of enforcement efforts. For example, the applicability of this prohibition to conduct by aiders and abetters makes it likely that neither the SEC nor the Justice Department would be in a position to seek adequate redress against a single violation which involved both reporting and non-reporting companies. This risk is particularly apparent in the foreign bribery context where Reporting Companies often deal through enterprises which are privately-owned and, therefore, beyond SEC jurisdiction.

The Senate Report defends the bifurcated enforcement approach but we must respectfully disagree with the stated justifications. The Senate Report states that that the "SEC already has an experienced enforcement staff with considerable knowledge of the foreign bribery area" and that the retention of jurisdiction in the SEC "will avoid a costly duplication of effort." Senate Report 10. However, by virtue of Section 3, it will be necessary for the Justice Department to develop an experienced enforcement staff with knowledge of the foreign bribery area, and this necessity will not be reduced by retaining some responsibility in the SEC. We believe it would be desirable to centralize enforcement of an anti-bribery statute in a single agency to promote increased efficiency and to enhance the likelihood of more evenhanded enforcement.

Dividing responsibility between the SEC and the Justice Department (with the SEC's responsibility being limited to conducting investigations and bringing civil actions and the Justice Department seeking criminal prosecution) will result, of necessity, in a costly duplication of effort since any criminal reference to the Justice Department will require examination by the Justice Department of the facts developed by the SEC during the course of its investigation in order to determine whether criminal prosecution is warranted.

The Senate Report further notes that "a direct prohibition would give the SEC [an] additional effective tool for deterring future improper conduct." Senate Report 10. The factors which have induced issuers to cooperate with the SEC's voluntary disclosure program would be present whether prosecution of the substantive offense is handled by the SEC staff or by the Justice Department. Corporations have participated in the voluntary program because of an awareness that the proscribed conduct was likely to be disclosed even if the SEC did not investigate. For example, numerous corporations have elected to participate in the voluntary disclosure program as a result of discoveries of improper conduct made in the course of preparing responses to the eleven questions of the Internal Revenue Service. In these cases, and in cases invloving investigations by the Watergate special prosecutor, Federal grand juries or other government agencies, the participation in the voluntary program has come from the possibility of criminal prosecution despite the absence of SEC jurisdiction over the substantive offense.

The Senate Report argues that "by assigning the SEC enforcement responsibilities for the criminal prohibition, it will strengthen the Commission's ability to enforce compliance with existing requirements of the securities laws." Senate Report 10. There is no evidence of which we are aware that the SEC lacks the ability to enforce compliance with existing requirements of the securities laws, and the bill would provide the SEC with no new enforcement tools. If needed the SEC's ability to enforce the existing requirements of the securities laws needs strengthening, this should be accomplished by expanding the powers of the SEC under Section 21 of the Exchange Act with its augmented powers applicable to all enforcement proceedings, not merely to those related to foreign payments.

3. *Assuming Congress does not favorably respond to our comments that Sections 2 and 3 should be incorporated in the U.S. Criminal Code, we submit the following comments designed to improve these Sections as drafted.*—If Congress should conclude that a prohibition against bribery of foreign officials by domestic concerns should be included in the securities laws, and that responsibility for its enforcement should be divided between the SEC and the Justice Department, we believe that Sections 2 and 3 should be revised to resolve several ambiguities.

(a) The Senate Report states that "virtually every country has its own laws against bribery, although some are not vigorously enforced." Senate Report 4. The bill should indicate whether the standard for determining if an official mis-

uses his position or corruptly assists in obtaining or retaining business is to be judged under United States law or under the law of the place where the act takes place. We submit that unless the relevant standard is provided under foreign law, the legislation clearly attempts to impose United States standards and morality on transactions taking place in other countries. This could be counterproductive because foreign countries may regard such a statute as an unwarranted intervention by the United States in domestic affairs.

(b) The exemption for "low-level facilitating payments" referred to in the Senate Report and in your statement before the House of Representatives on September 8, 1976 is not reflected in the bill. It is not clear that Sections 2 and 3 would not reach "a small gratuity paid to expedite a shipment through customs or the placement of a trans-Atlantic telephone call, to secure required permits." Senate Report 6. Sections 2 and 3 apply to all payments, regardless of amount, to a foreign official for the purpose of inducing him to use his influence with his government or to assist the issuer in obtaining or retaining business. If an issuer's shipments are subject to lengthy delays before receiving custom clearance or if needed permits are not forthcoming, it may be impossible for such issuer to effectively compete with other issuers doing business in the same country. This inability to effectively compete probably would have a direct relationship to one's ability to retain business or obtain new business. In actual practice then, a clear cut distinction does not exist between payments to a government official for the purpose of having such person fail to perform his official functions and permissible payments merely to expedite the proper performance of his duties.

(c) Section 3 is intended to apply criminal penalties identical to those provided by Section 2 which incorporates the penalties now in the Exchange Act. However, Section 3 provides for imprisonment of up to two years, whereas the Exchange Act penalty (as amended in 1975) included in Section 32 of that Act provides for imprisonment of up to five years.

(d) We believe that the second word of Section 2(1) of the bill, namely, "person", should be "individual" as in the parallel provision in paragraph (1) of Section 3 of the bill.

II. S. 3741 AND H.R. 15149

A. Introduction

In light of its close relationship to H.R. 15481, we also considered the legislation proposed by the Ford Administration relating to foreign payments. The Administration's proposal has been announced as a supplement to the legislation first proposed by the SEC (that is, S. 3418) which is incorporated verbatim in H.R. 15481 as Section 1 thereof. The Committee believes that the most appropriate legislative approach to the foreign payments problem is to combine Section 1 of H.R. 15481 (revised to incorporate our earlier comments) with the Administration's proposal (revised to reflect the following comments thereon) and to delete Sections 2 and 3 of H.R. 15481.

The Administration's proposal, referred to as the Foreign Payments Disclosure Act, is designed to help deter improper payments in international commerce by American corporations and their officials; to help restore the good reputation of American business; to help deter would-be foreign extorters from seeking improper rewards from American businessmen; and to set a forceful example to our trading partners and competitors regarding the imperative need to end improper payments. This legislation was prepared by the Cabinet-level Task Force on Questionable Corporate Payments Abroad created by President Ford on March 31, 1976 to conduct a sweeping policy review of the problem. The Administration's bill takes a markedly different approach from that of H.R. 15481. It would require reporting to the Secretary of Commerce of certain payments made by United States businesses in relation to business with foreign governments. Reports would be required of all payments made in connection with sales to or contracts with foreign governments or official actions by foreign public officials, where such are for the commercial benefit of the payor. The bill contemplates the promulgation of regulations by the Secretary of Commerce to specify the contents of the reports and to provide a threshold amount below which payments need not be reported. The purpose of this threshold would be to exclude so-called "grease" or "facilitating" payments. Civil and criminal penalties would be provided for violations of the reporting and recordkeeping requirements of the bill. Reports to the Department of Commerce would be made public one year from filing except that copies would be made promptly available

to the Departments of State and Justice, the Internal Revenue Service, and where appropriate, to the SEC. The Departments of State and Justice could relay information contained in the reports to authorities in foreign jurisdictions.

B. General comments

The Administration's proposal (i) treats private and public corporations in a more even-handed manner than they are treated in Section 1 of H.R. 15481; (ii) does not divert the thrust of the Federal securities laws from providing investors with information that is material to investment and voting decisions; and (iii) does not seek to apply civil and criminal sanctions to conduct, such as candor with auditors, which may not involve foreign payments. Although the Committee believes the Administration's proposal is susceptible to improvement in those respects discussed below, the Committee is of the view at this time that in substance and impact the proposal is a preferable alternative to that presented by Sections 2 and 3 of H.R. 15481.

C. Comments addressed to specific sections

1. The bill, in Section 2(b), defines "anything of value" but then does not use the term in Section 3 (the reporting section), although it is used in Section 9 (which refers to the reporting obligation).

2. The definition of "anything of value" appears somewhat circular and superfluous. The key element of the definition is the concept of "direct or indirect gain or advantage" which conveys little or no more meaning than the defined term itself. The Committee notes that "anything of value" is a term contained, without further definition, elsewhere in Title 18 of the United States Code suggesting no need for a definition.

3. Part (3) of the definition of "foreign government" is somewhat ambiguous. The words "established . . . by" and "subject to control by" appear susceptible of too inclusive an interpretation. Specifically, "established" should not include "organized under the laws of." In addition, since all entities operating within a jurisdiction are in some sense "subject to control by" the government within whose boundaries they exist, we suggest a more precise definition of this aspect of the definition of "foreign government" as follows:

"(3) a legal entity which a foreign government owns or controls as though an owner."

4. The bill is silent on the timing of the reporting requirement. In the absence of a time definition the duty to report may be deemed to be immediate. Recognition of the farflung activities of most multinational businesses suggests that such an obligation would be unrealistic. Quarterly or monthly reports filed within 30 to 45 days of the close of a period would appear appropriate.

If it is considered advisable, we would be pleased to meet with you or the staff to discuss these comments in greater detail.

Respectfully submitted.

KENNETH J. BIALKIN,
Chairman,
Federal Regulation of Securities Committee.
STEPHEN J. WEISS,
Chairman,
Ad Hoc Committee on Foreign Payments Legislation.
THOMAS E. BAKER,
Chairman,
Committee on Corporate Law and Accounting.
JAMES G. FRANGOS,
Chairman,
Committee on Foreign and International Business Law.
CHARLES F. OSBORN,
Chairman,
Committee on Corporate Law and Taxation.
JOSEPH A. HOWELL, JR.,
Chairman,
Committee on Corporate Law Departments.

APPENDIX I

As introduced, S. 3379 contained a section which created a private cause of action for any person who could establish "actual damage" to his business resulting from illegal payments made by a "competitor" and who had not made

such payments himself. The damages permitted under this proposed section were treble the actual damage accuring to the person's business activity. Due to ambiguities created by the drafted language, the Banking Committee deleted the section and requested the staff to devise more acceptable language, indicating that the Banking Committee might offer a floor amendment to the same substantive effect. Senate Report 13.

Since we do not have a redrafted section relating to the competitor's private right of action to analyze, this discussion necessarily must be limited to general policy considerations. H.R. 15481 presently contains several mechanisms by which its policies are sought to be achieved. The proposed legislation contains deterrent provisions in the form of fines or imprisonment and would permit preventive relief to be obtained in the form of civil injunctive actions.

In addition, private civil actions to provide compensation and restitution for shareholders who have suffered damages may be implied judicially either from the proposed legislation or under the pervasive standards of Rule 10b–5 under the Exchange Act; indeed, the Banking Committee recognized these actions in rejecting the insertion of a new shareholders' right of action in H.R. 15481 as being duplicative of existing remedies. While the inclusion of a treble damage action for a competitor would provide compensation for a damaged competitor (who may also be able to recover under the Federal antitrust laws), the primary motivating policy behind such a provision would be to increase the bite of the bill's deterrent mechanisms by supplementing public enforcement of the legislation through the "private attorney-general" concept developed under the Federal antitrust laws. There are a number of reasons why such a reparations-induced private type of action is not wise as a matter of policy and is not needed under, or suited to, the Federal securities laws.

The concept of awarding damages to a party whose damages are totally unrelated to trading in securities is entirely foreign to the Federal securities laws. Generally, damages awarded under the Federal securities laws are compensatory in nature, providing a defrauded purchaser or seller of securities with restitution. Such damages under the Exchange Act (which H.R. 15481 proposes to amend) are limited to "actual damages" by Section 28(a), which has generally precluded the awarding of punitive damages. The institution of a treble damage provision for a person whose damage is wholly unrelated to trading in securities thus not only conflicts with the damage policies historically established by the Federal securities laws but also conflicts directly with Section 28(a) of the Exchange Act.

Presumably Congress could in its wisdom depart from the stated objectives and damage concept of the Exchange Act, but surely it should do so only if the inclusion of such a cause of action substantially furthers the substantive goals of the legislation without producing significant adverse side effects. This question must be examined primarily by balancing the deterrent effects of the proposed cause of action with the social and judicial costs of including such a cause of action. Drawing on the experience of private treble damage actions under the Federal antitrust laws, one must conclude that the costs of including such a provision are not justified.

There are several arguments which favor the use of treble damage provisions. Treble damages provide an incentive to attorneys and injured plaintiffs to institute litigation and thus to motivate the rooting out of violations that might otherwise escape the eye or budget of the public prosecutor.

In addition, it can be argued that treble damages add to the penalties for violations, and thus both to compensate for generally inadequate deterrents in public suit penalties and to create a largely laudible incentive for consent decrees in the kind of close cases that it is desirable to have settled quickly. These arguably sound objectives, however, do not outweight the costs which such damage actions actually create, particularly in light of the fact that the inducement of mandatory treble damages is no longer necessary to encourage suits by injured persons. The development of both the procedural and substantive law, largely favorable to plaintiffs, including the ease of getting standing for private suits and the ease of maintaining class actions, plus the award of attorneys fees, clearly affords sufficient incentive for private damage actions.

The negative factors surrounding the proposed treble damage provision primarily relate to the increased burdens and costs related to groundless litigation which would be encouraged by the provision and to a lesser extent to the so-called "perverse incentives" effect of such treble damage actions. With respect to the first it is clear that such a reparations system will increase the likelihood

that a private party will claim improper payments have taken place when in fact none existed or no "actual damage" was suffered. This type of suit will be brought in hopes that the defendants will pay some amount of money to buy peace rather than go to trial. Under the present structure of the bill with its emphasis on strict liability, there would be even greater incentive for suits of this nature.

Moreover, recent experience with antitrust and securities litigation indicates that private suits increasingly come in the wake of public suits. After the issuance of the complaint in a governmental suit, a flood of class action damage suits is frequently automatic and can be initiated at relatively little cost. These cases in turn are likely to be collected in a single court for trial, thus almost assuring they all will be decided the same way. A defendant determined to fight the public case on its merits may expose himself to enormous risks if he should lose. These factors, together with the risk adverse psychology of most corporations and their lawyers, indicate a strong possibility that such actions would be instituted strictly for settlement value.

A second problem with such a reparations-oriented system is that it results in private parties being concerned not with the efficient deterrents of violation but rather with their own individual welfare. This type of vigilante justice is inappropriate for governing the business sector; indeed, such treble damage provisions add an incentive for potential plaintiffs to maximize their damages rather than to minimize them. The possibility of receiving more than the actual amount of damages encourages a person not only to neglect seeking out substitutes or finding ways of avoiding damages but also to attempt to create or suffer additional damages in order to benefit from the collection of threefold the amount actually sustained.

This is particularly true in a judicial system which through the class action device encourages collective damages to be awarded and provides high settlement possibilities. Under this analysis, businessmen could even use this provision as a type of insurance policy against poor business operations having always available to them an allegation of improper payments as the cause of their damage which in actuality resulted from their own bad business practices.

In conclusion, the adverse side effects of the proposed treble damage provision would seem to outweigh any benefits which might be achieved from its inclusion in the foreign payment provisions to be added to the Exchange Act. Given the deterrent effect of other portions of proposed legislation, and given the vigorous enforcement of existing laws by the SEC, Internal Revenue Service and Federal Trade Commission, we think the inclusion in the proposed legislation of a treble damage cause of action is overkill. Surely the potential evils of the treble damage provision justify a wait-and-see approach.

[Whereupon, at 12:50 p.m., the subcommittee adjourned.]

○