UNLAWFUL CORPORATE PAYMENTS ACT OF 1977

HEARINGS

BEFORE THE

SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE

OF THE

COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

HOUSE OF REPRESENTATIVES

NINETY-FIFTH CONGRESS

FIRST SESSION

ON

H.R. 3815 AND H.R. 1602

BILLS TO AMEND THE SECURITIES EXCHANGE ACT OF 1934 TO MAKE IT UNLAWFUL FOR AN ISSUER OF SECURITIES REGISTERED PURSUANT TO SECTION 12 OF SUCH ACT OR AN ISSUER REQUIRED TO FILE REPORTS PURSUANT TO SECTION 15(d) OF SUCH ACT TO MAKE CERTAIN PAYMENTS TO FOREIGN OFFICIALS AND OTHER FOREIGN PERSONS, AND FOR OTHER PURPOSES

APRIL 20 AND 21, 1977

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UNLAWFUL CORPORATE PAYMENTS ACT OF 1977

WEDNESDAY, APRIL 20, 1977

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 11 a.m. in room 2218, Rayburn House Office Building, Hon. Bob Eckhardt, chairman, presiding.

Mr. ECKHARDT. The Subcommittee on Consumer Protection and Finance will be in session.

Today, the Subcommittee on Consumer Protection and Finance begins 2 days of hearings on H.R. 3815, The Unlawful Corporate Payments Act of 1977. During the waning days of the 94th Congress, the subcommittee held hearings on a similar foreign bribery bill, but was unable to report it out because of end-of-session legislative pressures. H.R. 3815 would amend the Securities Exchange Act of 1934 and other acts to prohibit bribes to foreign officials. Violators would be subject to criminal sanctions.

Since 1974, approximately 200 American corporations have admitted making questionable foreign payments exceeding $300 million. The majority of these firms are Fortune 500 industrials. They are involved in aerospace, airlines and air service, drugs and health care, oil and gas production and services, and food products. As Pitney-Bowes Chairman Fred Allen observed: "Corporate corruption is big business."

There is a broad and growing concensus that foreign bribes are not only unethical, but bad business as well. They short-circuit the free marketplace by directing business to those companies too inefficient to compete in the traditional criteria of price, quality, or service. The publicity attendant to disclosure of such payoffs often jeopardizes corporate assets through cancellation of important contracts and confiscation of valuable overseas properties.

Not only is corporate bribery unethical and bad business, it may also be unnecessary. SEC Chairman Hills testified before the Senate: "Indeed, we find in every industry where bribes have been revealed that companies of equal size are proclaiming that they see no need to engage in such practices." A substantial number of the foreign bribes disclosed have not been made to "outcompete" foreign firms, but rather against American companies for the same business.

Bribery of foreign officials by U.S. corporations also creates severe foreign policy problems. Payments by Lockheed, alone, have had serious repercussions for the governments of Japan, Italy and the Netherlands, with concomitant diplomatic problems for the United States. As Theodore Sorenson testified during the subcommittee's hearings in 1976: "Such payments . . . [tarnish] 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 anti-American backlash . . ."

Significantly, many U.S. corporations would welcome a strong anti-bribery statute because it would make it easier to resist pressures from foreign officials. Former Gulf Oil Company Chairman Bob Dorsey testified that such a law would have put Gulf in a better position to resist and refuse demands by the South Korean Government for political contributions.

H.R. 3815 is divided into two sections, which I shall briefly summarize:

Section 1 applies to corporations subject to the jurisdiction of the SEC by virtue of the reporting requirements of the Securities Exchange Act of 1934. It applies the existing criminal penalties of the securities laws—up to 5 years imprisonment and a fine of up to $10,000 for individuals and a fine of up to $1,000 for companies—for payments, promises of payment, or authorization of payment of anything of value to any foreign official, 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 or to influence any official act or decision of a government.

Section 2 applies the identical prohibitions and penalties provided by section 1 to any domestic business concern other than one subject to the jurisdiction of the SEC pursuant to section 1. Violations of the criminal prohibition under section 2 by persons not subject to SEC jurisdiction would be investigated and prosecuted by the Justice Department. Violations under section 1 would normally be investigated initially by the SEC, but referred for criminal prosecution to the Justice Department. Since the 1934 act provides the SEC with authority to enforce its provisions by civil injunction, similar authority is granted the Justice Department to enforce the provisions of this section.

The bill does not address itself to "grease" or "facilitating" payments made to low-level clerical or ministerial government officials.

Without objection, at this point, the text of H.R. 3815 and H.R. 1602 and all Agency reports thereon will be placed in the record.

[Testimony resumes on p. 25.]

[The text of H.R. 3815 and H.R. 1602 and Agency reports thereon follows:]

95TH CONGRESS
1ST SESSION

H. R. 3815

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 22, 1977

Mr. ECKHARDT introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

A BILL

To amend the Securities Exchange Act of 1934 to make it unlawful for an issuer of securities registered pursuant to section 12 of such Act or an issuer required to file reports pursuant to section 15 (d) of such Act to make certain payments to foreign officials and other foreign persons, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SHORT TITLE

SECTION 1. This Act may be cited as the "Unlawful Corporate Payments Act of 1977".

UNLAWFUL PAYMENTS BY ISSUERS OF REGISTERED SECURITIES

SEC. 2. (a) The Securities Exchange Act of 1934 (15 U.S.C. 78a et seq.) is amended by inserting immediately after section 30 the following new section:

"UNLAWFUL PAYMENTS TO OFFICIALS

"SEC. 30A. (a) 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 foreign official for purposes of—

"(A) influencing any act or decision of such foreign official in his official capacity; or

"(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality;

"(2) any foreign political party or official or any candidate for foreign political office for purposes of inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality

thereof to affect or influence any act or decision of such government or instrumentality; or

"(3) any person, while knowing or having reason to know that all or any portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to—

"(A) any foreign official for purposes of—

"(i) influencing any act or decision of such foreign official in his official capacity; or

"(ii) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality; or

"(B) any foreign political party or official thereof or any candidate for foreign political office for purposes of inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality.

"(b) Any issuer which violates subsection (a) of this section shall, upon conviction, be punished by a fine of not more than $1,000,000.

"(c) Whenever an issuer violates subsection (a) of this section—

"(1) any officer, director, or employee of such issuer, or any natural person in control of such issuer, who knowingly and willfully ordered, authorized, or acquiesced in the act or practice constituting such violation; and

"(2) any agent of such issuer who knowingly and willfully carried out such act or practice,

shall, upon conviction, be punished by a fine of not more than $10,000 or by imprisonment for not more than five years, or both.

"(d) Whenever a fine is imposed under subsection (c) of this section upon any officer, director, employee, or agent of an issuer, or upon any natural person in control of such issuer, such fine shall not be paid, directly or indirectly, by such issuer.

"(e) As used in this section:

"(1) The term 'control' means the power to exercise a controlling influence over the management or policies of an issuer, unless such power is solely the result of an official position with such issuer. In determining whether a person controls an issuer for purposes of this section, any person who owns beneficially, either directly or through one or more controlled issuers, 25

per centum or more of the voting securities of an issuer shall be presumed to control such issuer, and any person who does not so own 25 per centum or more of the voting securities of an issuer shall be presumed not to control such issuer.

"(2) The term 'foreign official' means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are ministerial or clerical.".

(b) Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended by inserting immediately after "title" the first place it appears the following: "(other than section 30A)".

UNLAWFUL PAYMENTS BY OTHER DOMESTIC CONCERNS

SEC. 3. (a) It shall be unlawful for any domestic concern 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 foreign official for purposes of—

(A) influencing any act or decision of such foreign official in his official capacity; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality;

(2) any foreign political party or official or any candidate for foreign political office for purposes of inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality; or

(3) any person, while knowing or having reason to know that all or any portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to—

(A) any foreign official for purposes of—

(i) influencing any act or decision of such foreign official in his official capacity; or

(ii) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality; or

(B) any foreign political party or official thereof or any candidate for foreign political office for purposes of inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality.

(b) Any domestic concern which violates subsection (a) of this section shall, upon conviction, be punished by a fine of not more than $1,000,000.

(c) Whenever a domestic concern violates subsection (a) of this section—

(1) any officer, director, or employee of such domestic concern, or any natural person in control of such domestic concern, who knowingly and willfully ordered, authorized, or acquiesced in the act or practice constituting such violation; and

(2) any agent of such domestic concern who knowingly and willfully carried out such act or practice,

shall, upon conviction, be punished by a fine of not more than $10,000 or by imprisonment for not more than five years, or both.

(d) Whenever a fine is imposed under subsection (c) of this section upon any officer, director, employee, agent of a domestic concern, or upon any natural person in

control of such domestic concern, such fine shall not be paid, directly or indirectly, by such domestic concern.

(e) Whenever it appears to the Attorney General that any person has engaged, is engaged, or is about to engage in any act or practice constituting a violation of subsection (a) of this section, the Attorney General may, in his discretion, bring a civil action in an appropriate district court of the United States to enjoin such act or practice, and upon a proper showing a permanent or temporary injunction or a temporary restraining order shall be granted without bond.

(f) As used in this section:

(1) The term "control" means the power to exercise a controlling influence over the management or policies of a domestic concern, unless such power is solely the result of an official position with such domestic concern. In determining whether a person controls a domestic concern for purposes of this section, any person who owns beneficially, either directly or through one or more controlled domestic concerns, 25 per centum or more of the voting securities of a domestic concern shall be presumed to control such domestic concern, and any person who does not so own 25 per centum or more of the voting securities of a domestic concern shall be presumed not to control such domestic concern.

(2) The term "domestic concern" means any cor-

poration, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship—

(A) which is owned or controlled by individuals who are citizens or nationals of the United States;

(B) which has its principal place of business in the United States; or

(C) which is organized under the laws of a State of the United States or any territory, possession, or commonwealth of the United States.

Such term does not include any issuer which is subject to section 30A of the Securities Exchange Act of 1934.

(3) The term "foreign official" means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are ministerial or clerical.

(4) The term "interstate commerce" means trade, commerce, transportation, or comunication among the several States, or between any foreign country and any

State, or between any State and any place or ship outside thereof. Such term includes the intrastate use of (A) a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

95TH CONGRESS
1ST SESSION

H. R. 1602

IN THE HOUSE OF REPRESENTATIVES

JANUARY 10, 1977

Mr. MURPHY of New York (for himself and Mr. SOLARZ) introduced the following bill; which was referred to the Committee on Interstate and Foreign Commerce

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—

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"(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 five 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.

DEPARTMENT OF STATE

Washington, D.C. 20520

APR 20 1977

Dear Mr. Chairman:

The Secretary has asked me to reply to your letter of March 7, requesting the Department of State's views on H.R. 3815, a bill to amend the Securities Exchange Act to make it unlawful for specified persons to make certain payments to foreign officials and other foreign persons.

The Administration has carefully reviewed the problem of foreign bribery, and has made its views known through Secretary of the Treasury Michael Blumenthal's testimony on S.305 before the Senate Banking Committee on March 16, 1977. The Administration agrees with the aims of both S.305 and H.R. 3815 and is in the process of suggesting improvements to them. The Department of State is hopeful that a law can be passed which will aid the Government's efforts to deter bribery of public officials abroad.

The Office of Management and Budget advises that from the standpoint of the Administration's program there is no objection to the submission of this report.

Sincerely,

Douglas J. Bennet, Jr.
Assistant Secretary for
Congressional Relations

The Honorable
Harley O. Staggers, Chairman
Committee on Interstate and
Foreign Commerce

ASSISTANT ATTORNEY GENERAL
LEGISLATIVE AFFAIRS

Department of Justice
Washington, D.C. 20530

APR 20 1977

Honorable Harley O. Staggers
Chairman, Interstate and Foreign
Commerce Committee
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

As previously indicated to the Senate Banking Committee, the Administration firmly supports legislation which would proscribe the bribery of foreign public officials by American businesses and their representatives. Accordingly, we are in complete accord with the aims and objectives of H.R. 3815 which would directly criminalize such illicit practices. Secretary Blumenthal will be testifying before the Committee on H.R. 3815 and will fully elaborate the Administration's position with respect to the issue of foreign payments. The purpose of this letter is to directly address our specific concerns regarding the enforcement provisions of H.R. 3815 and to point out certain apparent weaknesses of the Bill.

As the Department that will be ultimately responsible for criminally prosecuting any violations of H.R. 3815, we are acutely sensitive to the need for the Bill to provide an effective mechanism for detecting and investigating suspected violations of its provisions. Our experience in combatting domestic political corruption, coupled with our own recent efforts to develop prosecutions involving the bribery of foreign officials amply demonstrates the difficulties of gathering sufficient credible and admissible evidence to support prosecution. By its very nature the bribery of public officials is covert and generally involves consensual parties who go to great lengths to conceal the transaction. When the official involved is a representative of a foreign government and most of the critical acts take place outside of the country, the problems of detection, investigation and prosecution are necessarily compounded.

Considering the anticipated enforcement problems associated with any statute which would proscribe bribery of foreign officials, we believe it imperative that we be in a position to rapidly mobilize maximum available investigative resources to pursue possible violations. As currently worded, H.R. 3815 would hamper this effort by sharply dividing investigative responsibility between the Securities and Exchange Commission and the Federal Bureau of Investigation. Rather than create such an anomaly, the Administration proposes instead to retain present Securities and Exchange Commission jurisdiction over illicit foreign payments by issuers subject to their registration requirements while simultaneously assigning criminal investigative jurisdiction to the Federal Bureau of Investigation for such cases regardless of the identity of the briber. This is in accord with current practices involving alleged domestic corruption by issuers and their representatives and experience has shown that it in no way restricts the Securities and Exchange Commission from continuing its own civil investigative efforts designed to protect the investing public.

The Department fully recognizes the expertise developed by the Securities and Exchange Commission over the past several years in the area of illicit foreign payments and believes they must play a vital role in any future attempt to deter and eradicate once and for all bribery of foreign officials by American issuers. Through their voluntary disclosure program they have performed a vital public service in exposing the pervasive and apparently long-standing practice of some businesses to engage in such illicit practices. Their proposed Rules governing corporate record keeping, if promulgated, should further thwart attempts by issuers to conceal such payments and will presumably result in many fertile investigative leads. In order to be in a position to develop credible evidence in admissible form, this expertise, in our view, should be combined with that of the Federal Bureau of Investigation in investigating corruption and in gathering evidence abroad. By affording jurisdiction over such offenses to the Federal Bureau of

Investigation, we would be able to utilize the expertise of both agencies to ensure vigorous and prompt criminal prosecutions of violations of the proposed statute.

Several additional features of H.R. 3815, in our view, pose potential enforcement problems. First, as currently worded the statute would require that the mails or instrumentality of interstate commerce be directly used to offer ... or make the prohibited payment. We believe this to be unduly restrictive and suggest instead that the provision be modified so as to provide that the mails or interstate facility need only be used in furtherance of the illicit payment, offer, etc.

Secondly, we believe "acquiesce" by employees or officials is too vague a concept upon which to predicate criminal liability. If by the term you wish to reach those who assist those engaging in the illicit practice, then we suggest that the term is not needed in light of the provisions of Sections 2, 3 and 4 of Title 18.

Lastly, we wish to comment briefly on the provision of H.R. 3815 which would enable the Department to seek in appropriate cases injunctive relief. While we welcome this authority, we anticipate that in the future relatively few cases will involve continuing criminal activities which would initially lend themselves to such action. While it is conceivable that instances will arise where bribe payments will be made over a period of time possibly linked to the volume of sales, thereby suggesting immediate injunctive action, we expect future cases to primarily involve single bribe instances which will not effectively lend themselves to this preliminary form of judicial action.

I would be more than happy for Department representatives to meet with members of your staff and discuss more fully the points raised in this letter.

Sincerely,

Patricia M. Wald
Assistant Attorney General
Office of Legislative Affairs

Mr. ECKHARDT. Does the gentleman from North Carolina wish to be heard?

Mr. BROYHILL. No, Mr. Chairman.

Mr. ECKHARDT. The first witness is Dr. Gordon Adams, Director of Military Research, Council on Economic Priorities.

Dr. ADAMS. We are glad to have you here. You may proceed in the manner that you select.

STATEMENT OF DR. GORDON ADAMS, DIRECTOR OF MILITARY RESEARCH, COUNCIL ON ECONOMIC PRIORITIES

Dr. ADAMS. Thank you, Mr. Chairman.

I am happy to appear before this subcommittee today to testify on behalf of the Council on Economic Priorities. The Council is a public interest research organization, based in New York. Since it was created in 1969, the Council has published a number of newsletters, reports and studies on social and economic issues of major public importance including corporate disclosure practices, equal employment, energy costs and alternatives, environmental pollution, and military contracting. We focus on corporate performance, ranking companies according to objective criteria. Our goal of publishing and disseminating unbiased and detailed information on the practices of U.S. corporations in areas that vitally affect society is based on the belief that such practices have a profound impact on the quality of American life and that the American public should be aware of this impact in order to assure corporate social responsibility.

Given our commitment to more adequate and systematic corporate disclosure, we have followed for some time the mounting evidence, disclosed to the Securities and Exchange Commission, of widespread questionable payments by American firms doing business overseas. To date over 350 companies have made such disclosures under the voluntary disclosure program of the SEC. The evidence of questionable payments has become so voluminous, in fact, that the American public is becoming immune to the serious issues of corporate performance and public policy involved. Company disclosures are no longer front page news; they have slipped into the "Other News" columns of the business sections of even the most thorough papers. There have been few efforts to review in detail what American corporations have reported.

Last year, in an initial effort to fill this gap, CEP undertook a survey of the disclosure statements filed with the SEC up to November 1, 1976. We found that 175 companies had filed such statements by that date. My testimony today thus concerns roughly half of the companies reporting questionable overseas payments. Nonetheless, I am confident that subsequent disclosures have not seriously altered the conclusions drawn in our report.[1]

I want to review our findings with the subcommittee today because they bear on the need for and nature of legislation such as that under consideration here. Our findings suggest that legislation dealing with questionable payments is needed, including and perhaps even going beyond the current bill.

THE SIZE OF THE PROBLEM

Our report was intended to increase public knowledge of the questionable payments problem and of efforts to bring it under control. It was the first complete outside review of corporate disclosures to the SEC. Our initial finding, which will come as no surprise to this subcommittee, was that many of this country's leading companies were engaged in such practices. Of the 175 companies discussed in our report, 130 rank among the largest 1,000 industrial companies in the United States; 117 are in the Fortune 500. (Only 15 companies in our investigation had sales under $100 million.)

We also discovered that questionable payments appeared to be particularly common in several areas of American industry: 22 of the companies on our list were in the field of drugs, health care and pharmaceutical production. Another 22 were involved in oil and gas production and services; 16 manufactured and marketed food products; 14 were in the aerospace, airlines and air services area, and another 14 were chemical companies. These categories include over half of the companies covered in our report.

Relatively few companies in such areas as textiles, retail merchandising, mining, communications equipment or electronics, to cite only a few examples, have disclosed any questionable overseas payments to the SEC.

In addition, we found that an immense amount of money was involved in such payments. We estimated that the companies on our list had paid out roughly $300 million between the years of 1970 and 1976. It was difficult to be precise about this estimate, since, as I will describe in a minute, the disclosures were often incomplete and uninformative. Lockheed, for example, disclosed making $25 million in questionable payments overseas, though the SEC raised questions about nearly $200 million in Lockheed sales commissions. In other words, we felt we were dealing with the tip of the iceberg, both in terms of the number of companies reporting and the accuracy of their reports.

IS OVERSEAS BRIBERY A PROBLEM?

One common reaction to findings such as ours is "so what?" Questionable corporate uses of corporate funds has a long, if not

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[1] Gordon Adams and Sherri Zann Rosenthal, *The Invisible Hand: Questionable Corporate Payments Overseas* (New York: Council on Economic Priorities, 1976).

honored, history. Such payments are not new to commerce or to politics, and past efforts to control them do not seem to have ended the practice. Such payments have become a problem of growing concern to American business and the public with the expansion of U.S. business overseas following World War II. Some firms—as recently exemplified by Core Laboratories, Castle and Cooke, and Santa Fe International—consider the smaller, so-called "grease" or "facilitating" payments a normal part of doing business abroad. They have announced their intention of continuing such payments, where necessary.

Even larger payments are so common as to suggest that bribery and questionable payments have become a routine part of commercial practice for many firms. As Leonard Meeker of the Center for Law and Social Policy put it recently, before this committee, "The facts do not permit the conclusion that foreign bribes and payoffs have occurred only in isolated instances." [2]

If this is so, bribery may have to be added to the list of traditional competitive practices, including price, quality, and company reputation. The Federal Trade Commission has suggested, for example, that General Tire and Rubber bribed government officials in Morocco and Chile to keep competitors, notably Goodyear, off the local market.[3]

Nevertheless, we feel that this growing "norm" of competitive commerce is not without its risks to American business, government, the investor, and the public. As Senator William Proxmire put it in April, 1976:

"The practice of bribing foreign officials has corrupted the free market system, under which the most efficient producers with the best products are supposed to prevail." [4]

Gerald Parsky, former Assistant Secretary of the Treasury, shared this view:

"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." [5]

Representatives of the private sector have agreed:

"Singly or in combination, these practices have a corrosive effect on free markets and free trade which are fundamental to the survival of the free enterprise system. They subvert the laws of supply and demand. They short-circuit competition based on classical ideas of product quality, service and price, and free markets are replaced by contrived markets." [6]

Overseas bribery can also cause problems for stockholders and potential investors. As Leonard Meeker has pointed out, the publicity attending the disclosure of such payments can damage a com-

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[2] "Statement of Leonard C. Meeker before the Subcommittee on Consumer Protection and Finance of the House of Representatives Committee on Commerce," September 22, 1976, p. 2.

[3] *Wall Street Journal*, April 28 and May 11, 1976.

[4] U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, *Hearings on Foreign and Corporate Bribes*, April 5, 7, and 8, 1976 p. 1.

[5] "Statement by The Honorable Gerald L. Parsky before the Subcommittee on Consumer Protection and Finance: House Committee on Interstate and Foreign Commerce," September 21, 1976, p. 2.

[6] Statement of Fred Allen, Chairman, Pitney-Bowes, October 16, 1975, as quoted in testimony of Ralph Nader, Senate *Hearings on Foreign and Corporate Bribes*, April 5, 1976, p. 19.

pany's image, lead to costly lawsuits here and abroad, cause the cancellation of contracts, and result in the appropriation of valuable assets overseas.[7] In the long run, this practice can reduce trade and investment opportunities, thus limiting a company's growth. It would be better, Meeker suggests, to make such payments impossible to begin with.

Foreign reactions to corporate bribery also pose a threat to U.S. foreign policy. The State Department has expressed concern that such actions damage the reputation of the United States and cut off U.S. access to Third World economies. Charles W. Robinson, former Under Secretary of State for Economic Affairs said, for example:

"Illicit payments abroad and disclosures in the United States of questionable transactions with foreign officials can and have caused serious damage to U.S. foreign relations." [8]

Companies making such payments sometimes put themselves in the position of making foreign policy for the government. Lockheed's contacts with the Japanese right wing, and payments to Prince Bernhard of the Netherlands threatened the governments of both countries, causing diplomatic problems for the United States.

DEFINING QUESTIONABLE PAYMENTS

The government has gradually become aware of the need for some action to control corporate behavior in this area. Despite the publicity attending early SEC actions and congressional hearings, policy moves have been cautious. Even the bill before this subcommittee reflects a cautious approach to this immense problem. Clearly, we need to have a full understanding of the problem and its limits before a full public policy can be defined. Our investigation showed that the SEC's program developed only gradually out of individual investigations and injunctions directed at specific companies whose questionable payments at home and abroad had caused widespread public comment, for example, Minnesota Mining and Manufacturing, Gulf Oil, Northrop, Lockheed, and Ashland Oil. No single standard guided the actions of the SEC's Enforcement Division, though it was clear that in each case the payments in question were significant in amount, and the company had no intention of making a public disclosure.

The Commission quickly realized, however, that it did not have the resources to conduct investigations and court cases for every one of the growing number of bribing companies:

"As the Commission's enforcement efforts unfolded, it became apparent that the potential magnitude of the problems required an additional disclosure mechanism to supplement the enforcement actions undertaken, and that the most appropriate means was to encourage voluntary corporate disclosure of questionable or illegal foreign payments. It, therefore, was suggested in public statements . . . that companies determining they might have engaged in such activities should conduct a careful investigation of the facts under the auspices of persons not involved in the questionable activities." [9]

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[7] Draft Petition of the Project on Corporate Responsibility to the Securities and Exchange Commission, October 1975, p. 8.

[8] Testimony of Charles W. Robinson, Senate, *Hearings on Foreign and Corporate Bribes*, April 8, 1976, p. 97.

[9] Securities and Exchange Commission, *Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices*, May 12, 1976, pp. 6-7.

Rather than lay down detailed, mandatory guidelines, the Commission decided to issue a more loose, flexible framework for disclosure. Although the SEC voluntary disclosure program has provided a wealth of information, its voluntary nature has left an almost insurmountable problem of defining questionable payments, structuring that disclosed information, and searching for appropriate policy responses. Our investigation revealed several categories of payments, some of which are not covered by the legislation pending before this subcommittee. The SEC guidelines left disclosing firms free to define what they considered to be questionable payments, hence, not all disclosures include all of the categories of payments we discovered.

The first such category, and the most clearly illegal in the jurisdictions where paid, are those made to foreign government officials, from the most senior to the lowest administrative level. Ashland Oil, for example, paid $150,000 in 1972 to Albert Bernard Bongo, President of Gabon.[10] At the other end of a government hierarchy, Memorex reported an aggregate $731,000 in payments "to low level non-elected foreign government officials to persuade them to perform their required functions" between 1971 and 1976. These payments are usually designed to obtain business, to procure favors that will ensure the firm's position in that country's market, or to facilitate the conduct of normal government business, such as procuring customs permits, licenses, or health clearances. There is little doubt that bribes for top officials are neither legal nor customary. Lower level payments, often called "grease," raise another problem. Some companies, in fact, consider them such a normal part of business that they are willing to continue to pay them and acknowledge them on their books.

Castle and Cooke, for example, noted its intention to continue "security and expediting" payments: "The discontinuance of such security and expediting payments at this time would needlessly hamper the conduct of the business of the company in numerous foreign locations, would contravene local practices, in some cases would imperil the safety of company employees or the protection of its property, and would be detrimental to the best interests of the stockholders."

The second major category covers payments to politicians and political parties, often during election campaigns. Gulf illegally contributed $4 million to the campaign war chest of South Korea's governing Democratic Republican Party. Exxon's Italian subsidiary made $27 million in authorized political contributions in Italy between 1963 and 1971. Further company investigation revealed another $19 million in questionable or illegal Exxon campaign contributions in Italy, from 40 secret accounts. A number of companies have reported legal, properly recorded political contributions to Canada.

Though sometimes legal, many campaign contributions were seen at the time as questionable even by the paying company. Exxon, for example, concealed the bulk of its contributions as payments to

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[10] Here, and in the references to particular company actions and policies which follow, the information has been drawn from or directly quotes the company's disclosure statement, as listed in the table.

newspapers, publicity agencies, et cetera. A number of firms recognize that public knowledge of political contributions by U.S. firms could harm their public image.

The third category of payment is even more difficult to classify, since it covers a variety of questionable commercial practices by U.S. firms abroad. Twentieth Century Fox, for example, paid $60,744 in 1973 to an attorney in a foreign country "in connection with the restructuring of the company distribution operation in that country." Some of this went on to local trade union representatives to help arrange for the employment of a certain number of personnel and to settle "indemnities required to be paid to members of that labor union." Signode paid $6,000 to a union official in another country between 1971 and 1975. Both companies considered these actions toward trade unions questionable.

Another type of questionable commercial payment involves gifts and payments to employees of foreign customers, to obtain business or to celebrate a successful commercial relationship. Honeywell, for example, reported payments of $800,000 from 1971 to 1975 "to employees of private customers by a number of subsidiaries in connection with specific sales." Harris, which made over $1.4 million in payments of this kind from 1971 to 1976, reported one instance of payments aggregating $125,000:

". . . made upon the demand of a highly placed employee of a customer who claimed he could prevent award of a contract involving a price in excess of $2,000,000 on which the Company understood it had been selected as the contractor . . . ."

Still another questionable commercial practice concerns overbilling and illegal rebating to foreign customers. International Minerals and Chemicals, for example, reported payments as high as $1,213,000 in 1974 by subsidiaries which were instructed by customers "that they be billed at amounts in excess of the agreed price for products or services supplied and that such excess amounts due them be paid outside their country of domicile." Armco Steel reported nearly $17,000,000 in rebates to foreign customers as the result of over-invoicing. Companies reporting to the SEC disclosed questionable commercial practices quite unevenly; some said nothing at all about business conducted beyond governmental and political payments.

Commissions and bookkeeping questions further complicate the task of defining and locating questionable payments. A large proportion of the bribes paid government officials did not result from direct company/government contact. Most firms have used sales agents, often local nationals, to seek orders and to carry out such transactions. The SEC's questioning of $200 million in Lockheed commissions has already been mentioned. Northrop's report indicated the difficulty of tracing the uses to which commissions are put. As the SEC summarized it:

"In all the company paid approximately $30 million to foreign consultants and sales agents, a significant portion of which was found to have been inadequately accounted for, lacking in documentary support, or incapable of satisfactory corroboration." [11]

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[11] Securities and Exchange Commission, *Report of the Securities and Exchange Commission*, May 12, 1976, p B-17.

American Standard's report reflects the same problem:

"In another subsidiary in a foreign country, payments in the form of excessive commissions were made to salesmen of the subsidiary which the Registrant believes were probably paid by the salesman to purchasing agents or customers' employees, in part for orders received from government-owned businesses and agencies."

Tenneco is yet another illustration of this problem:

"Although it is not feasible to state with substantial certainty that none of the payments during such period, other than those described in the following paragraph, were indirectly for the use or benefit of employees of foreign governments or agencies thereof, the investigation did not reveal the existence of any other payments to foreign government employees or military personnel or that any such payments were being 'kicked back' to the Company or its employees or used to create a 'slush fund' of any kind. However, in some cases the payments are made to the consultant or his nominee outside the country of his residence and verification of the end use of the payments is not feasible. The question of whether local laws of the countries involved are being violated by making such payments to the consultant or his nominee outside the country of his residence is being reviewed and will be reported to the Audit Committee."

In several cases, the task of locating questionable payments is rendered nearly impossible by improper bookkeeping practices. Exxon's mislabeling of Italian political payments and use of separate, secret accounts has been mentioned. Frequently companies have created off-the-book accounts or slush funds, which have gone unrecorded and have been used for multiple purposes. Alcoa, for example, reported $400,000 received and maintained in an off-book fund, used for corporate purposes and a gift to a government employee.

THE DIFFICULTIES IN STANDARDIZING THE DATA

Given the fact that most disclosing companies have chosen their own definitions of what to report and what to ignore, CEP found it difficult to determine just how much was paid in what category to whom at what point in time. We based our investigation on the company's disclosure. Thus, in our report, we defined "questionable payments," as: payments the company suggested were illegal or improper, whether made to government, political or private customers, as well as sales commissions about which the company disclosed some uncertainty. Legal political contributions, where identifiable, have been excluded, unless they were improperly recorded or the company has raised questions about them.[12]

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[12] Our cautious approach occasionally meant we differed from the company's own report in unexpected directions. An extreme example is that of Boise Cascade. The company claimed to have disbursed $11,000 "which violates company policy." CEP's compilation, from Boise Cascade's own disclosure statement, shows roughly $340,000 in questionable payments. Boise Cascade regards everything not explicitly illegal as not questionable. One major source of disagreement is "grease" paid to government officials. The company reports "small gratuities . . . to minor government employees to expedite such matters as customs clearances, visa applications, and central bank exchange or license transactions. These payments, which are customary in the localities where given, usually range between $25 and $100 per individual, and are estimated to have totalled approximately $20,000 in each of the past five years." This item alone, adds $100,000 to Boise Cascade's total questionable payments.

The inconsistencies between the various disclosures, however, are endless. Because the program and its guidelines have been voluntary, each company, for example, has been able to choose the time period it would cover in its investigation. Thus, investigation dates range from Gulf and Western's 1 year to Exxon's 12. Most investigations covered roughly, but inconsistently, the period from 1970 to 1976.[13] It would be impossible to determine precisely the importance of questionable payments to each company's foreign business during the years covered. Only a few companies report the value of foreign sales related to such payments. As the table in our report indicates, many companies do not report their volume of foreign sales at all.

In addition, almost all companies claim that questionable payments did not have a material effect on their overall business. Occasionally a company left no basis at all for questioning this judgment. Rorer-Amchem, a drug and health care firm, for example, described several instances of questionable payments, but gave no dollar figures in the report. As a limiting case, Celanese reviewed the years 1971-1975 and tersely stated that "the review disclosed nothing of a material nature, any questionable transactions were promptly terminated, and no significant loss of earnings is expect to result."

It is equally impossible to make meaningful statements about the geographic distribution of questionable payments. Ashland Oil, Gulf Oil, and Northrop are among the very few companies which have disclosed countries and names of recipients. Most other reports simply state "in one foreign country" and fail to name any specific recipient. Here, too, more complete information could be meaningful. A relatively small payment to a key figure or in a small country could have major political or commercial consequences.

Although it has long been CEP's practice to compare corporations' social performance and rank them against each other, the companies' disclosures did not permit such comparisons. On the basis of existing data, moreover, comparisons would be misleading. Companies which have made full disclosure, using the broad definition "questionable payments," such as Armco Steel or Inmont, may appear to have engaged in greater foreign misconduct only because they supplied more information. Firms which have disclosed nothing, or have used a strictly legal definition, could appear most ethical, while concealing a large number of questionable payments.

SOLUTIONS TO THE PROBLEM

The legislation under discussion today represents one approach to dealing with the problem of questionable payments which goes beyond the valuable, but, in our view, insufficient voluntary disclosure program of the SEC. Criminalization of foreign bribes, through American law, is sometimes seen as the most drastic of the alterna-

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[13] For some companies, the years chosen could be convenient. ITT, for example, admitted at its 1976 stockholders' meeting that its payments in Chile had, for the most part, been completed by 1971, the starting date of its investigation. A proxy resolution brought by church stockholders requiring more complete disclosure received 6.6% of the vote at that meeting, with 14% abstaining. Source: Interfaith Center on Corporate Responsibility, November 1976.

tive approaches. Certain other alternatives have been put forward. One of the most commonly suggested is to allow corporations to govern themselves, without legislation. John J. McCloy, who chaired the Gulf Oil investigation, endorsed this view last year before the House Banking Committee: "I believe it would be ideal if industry could reform itself. I think it's in the process of reforming itself." [14]

It is true that many companies have responded to the payments problem by issuing new or clarified statements of company policy prohibiting such payments. The SEC program explicitly urged companies to define such policies. Although the policies vary, almost all prohibit payments to government officials. Many also rule out political contributions, even where legal. Only a few such statements address the problem of questionable commercial payments. Often the policy statements specifically prescribe that contracts with sales agents should prohibit the use of fees for illegal purposes. Most statements call for accurate bookkeeping and an end to off-the-books slush funds. Finally, a number of statements call for high level executive approval for political contributions, gifts, and gratuities.

The effectiveness of such policy statements, however, is uncertain; theoretically honored, they are often ignored in practice. Xerox, for example, had an impressive anti-bribery policy in effect while an operating group was making $100,000 in questionable payments abroad from 1971 to 1975. The elaborate and detailed policies drawn up since disclosure by such firms as Northrop and Control Data remain to be tested. Still other companies, such as Abex—I.C. Industries—have made merely perfunctory statements proscribing illegal payments and the falsification of records, but provide their employees with no detailed guidelines.

Several companies—Castle and Cooke, Core Laboratories, and Santa Fe International—have indicated skepticism about policies against facilitating payments in particular, and indicate that they intend to continue such payments. This attitude is widely shared among the business community.[15] A July 1975 survey by the Opinion Research Corporation indicated that nearly 50 percent of America's business executives saw nothing wrong with paying foreign officials in order to attract or retain contracts.

A vivid statement of this attitude was made by Charles Bowen, Chairman of Booz Allen and Hamilton, consultants. Asked what he thought of the government's anti-bribery drive, he stated: "A bunch of pip-squeak moralists running around trying to apply U.S. puritanical standards to other countries." Would he fire a worker for paying bribes abroad? "Hell, no!" Mr. Bowen replied. "Why fire him for something he was paid to do?" [16]

Many company executives consider it unrealistic to apply strict anti-bribery standards abroad. Time and again the phrase "payments were made in accordance with local custom and tradition" appears in a disclosure statement. Company officials often feel that

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[14] *Hearings on Foreign and Corporate Bribes*, April 5, 1976, p. 14.

[15] Rollins originally indicated it shared this view, but reversed its policy in September, 1976 and now prohibits all such payments. *The New York Times*, September 30, 1976.

[16] *Wall Street Journal*, July 9, 1976.

conforming to "American ethical standards" will place them at a competitive disadvantage with foreign multinationals.

There are no doubt situations in which the failure to make a questionable payment might cost a company access to a particular market. However, corporate arguments that the problem stems from less ethical foreign competitors and foreign business standards needs to be critically examined. Frequently the major competitor for the business in question is another American firm.

As former Secretary of Commerce Elliot Richardson pointed out:

"In a number of questionable payments cases—especially those involving sales of military and commercial aircraft—payments have been made not to 'outcompete' foreign competitors, but rather to gain an edge over other U.S. manufacturers." [17]

United Nations data on multinational corporations tend to support Richardson's argument:

"Of a total estimated stock of foreign investment of about $165 billion, most of which is owned by multinational corporations, the U.S. accounts for more than half, and over four-fifths of the total is owned by four countries, the United States, the United Kingdom, France, and the Federal Republic of Germany." [18]

It is also not clear that the questionable payments problem is caused solely by less ethical standards of business and government conduct abroad. A number of Chief Executive Officers recently surveyed by Business International claim that such payments are either extorted or so customary as to be a necessary part of doing business abroad.[19] Not all firms appear to believe this proposition. Lilly, for example, is an exception from standard practice in the drug industry in refusing to make such payments.[20] As Roderick Hills, former SEC Chairman, pointed out, "Indeed, if we find in every industry where bribes have been revealed that companies of equal size are proclaiming that they see no need to engage in such practices." [21]

The behavior of bribing companies indicates that they do not expect positive public responses abroad. Often, the firms go to great lengths to keep their payments secret. A retired Lockheed vice-president, for example, warned Lockheed's director of contracts in Georgia of the need for secrecy in the company's dealings in Italy:

"I hope that you will keep this letter on a very strict need to know basis with your compatriots. As for the compensation to third persons, in part we are dealing with dynamite that could blow Lockheed right out of Italy with terrible repercussions." [22]

As has been seen, the revelation of such payments has seriously shaken the governments of the Netherlands and Japan. Clearly, these governments and others are aware that bribery is not a popularly accepted custom. Merck's disclosure underlines the

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[17] U.S. Congress, Senate, Committee on Banking, Housing and Urban Affairs, *Hearings on Prohibiting Bribes to Foreign Officials*, May 18, 1976, Letter from Richardson to Sen. William Proximire, p. 42.

[18] United Nations, Department of Economic and Social Affairs, *Multinational Corporations in World Development* (New York: 1973). p.7.

[19] Business International Corporation, *Questionable Corporate Payments Abroad: Patterns, Policies, Solutions* (New York: October, 1976).

[20] Personal communication to authors from United Church of Christ, Board of World Ministries, October, 1976.

[21] In *Hearings on Prohibiting Bribes*, May 18, 1976, p. 4.

[22] Anthony Sampson, "Lockheed's Foreign Policy: Who, in the End, Corrupted Whom:", *New York Magazine*, March 15, 1976, p.56.

awareness of both the bribing company and the recipient that such payments are publicly unacceptable.

"The company was advised by counsel that such political contributions were legal under the laws of these countries. One such contribution was recorded on the books of the company in the United States as a promotional expenditure, in keeping with the accepted custom in the foreign country involved not to acknowledge or disclose corporate political contributions."

The reports of illegal domestic contributions that flowed from Watergate suggest that the problem may not be one of lower standards abroad, but of low standards in general for U.S. corporate behavior. As an industrial machinery manufacturer put it: "If anyone thinks that these standards are vastly different in other countries than they are in the United States, then that person must indeed be naive." [23]

ADMINISTRATIVE ACTION

Administrative action has also been suggested as an adequate means of controlling corporate behavior. CEP's investigation reviewed several administrative actions, which have played a role in inhibiting corporate practice. The activities of the SEC, including both injunctive and voluntary disclosure policies, merit prominent mention. Clearly, too, the Internal Revenue Service has had an effect through its supplementary regulations requiring agents to ask corporate officials and key employees a series of questions if tax information indicates the possible existence and use of slush funds for questionable purposes. The Federal Trade Commission, the Department of Justice and the Department of State have also taken actions to prevent corporate bribery.

Administrative action, however, has been an inadequate deterrent to the practice of questionable payments overseas. Existing statutes do not provide clear distinctions between allowable and unallowable corporate practice. Voluntary disclosure programs have, as our investigation shows, not provided adequate information on which to base sound public policy. The attitude that the U.S. Government takes toward questionable corporate practices overseas has, as a result, not been clear. Some form of legislative action has seemed desirable as a vehicle for clarifying goverment policy. Two approaches to such legislation have been advocated: disclosure and criminalization. The latter is the focus of the bill pending before the committee. The former approach characterized the bill introduced by the previous administration.

Requiring fuller, more systematic corporate disclosure of questionable payments overseas would appear to solve the data problem CEP encountered in reviewing the SEC filings. You will be hearing testimony later today from the Association of the Bar of the City of New York which argues that the publicity attendant such disclosures would provide an adequate deterrent to future payments and pose serious problems for the company concerned:

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[23] As quoted in a report of the Conference Board, an independent research organization funded by U.S. business. *The New York Times*, February 13, 1976.

"Disclosures can result in loss of favorable public relations, prosecutions under the U.S. tax laws, loss of business, lawsuits for contract damages, antitrust actions, removals of officers, criminal prosecutions abroad, shareholder suits and securities laws prosecutions." [24]

Far be it for the Council which has long been a champion of more comprehensive and systematic disclosure requirements, to object to legislation which would move toward this goal. In my view, however, the disclosure approach will not suffice as a method of preventing such payments in the future. However useful it might be to have systematic data, including the names of the recipients of such payments, disclosure might actually have the effect of legitimating this practice, especially for firms which now consider them unacceptable. If one company can do it, report it, and get away with it, why not all companies? The companies now rushing to file voluntary disclosures with the SEC before the voluntary program terminates seem to be saying that they expect less long-lasting damage to the corporate image from such a disclosure than they would from the later discovery of information they had withheld.

THE CRIMINALIZATION OF QUESTIONABLE PAYMENTS

This brings me to the bill currently pending before this committee. I think it contains a preferable approach, with certain recognizable limitations. The bill's language deals with the most prominent cases of questionable payments: Bribes paid to government officials to influence them in the performance of their duties. It also deals, though in looser language, with the problem of political contributions. As is appropriate, the bill goes beyond direct payments from company employees to include sales commissions which might be passed on in questionable ways. Finally, the penalties for violation of the proposed statutes, because they are strong, could give pause to corporate executives who might otherwise be tempted to take the risk of authorizing an illegal payment.

There would appear to be, at least internally, a couple of limitations in the proposed bill. Its applicability to "grease" or facilitating payments is not clear, although the Chairman's opening statement makes this more clear. CEP has found such payments a common practice with most of the companies included in its report. It is clearly not easy to control and prohibit such payments, but a clear prohibition might strengthen the hand of companies seeking not to be drawn into the "customary" nature of such practices in other countries.

Perhaps appropriately, the bill also does not deal with overseas business practices: payments, kickbacks, rebates involving private foreign customers and businesses. CEP found this practice to be equally common, and conceivably equally injurious to the reputation of American business abroad. This legislation may not be the appropriate context for handling this problem, but I mention it as an issue with which this subcommittee, the Congress and the Executive ought to be concerned.

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[24] The Association of the Bar of the City of New York, *Report on Questionable Foreign Payments by Corporations: The Problem and Approaches to a Solution* (New York: March 14, 1977), p. 19.

I am aware that strong opposition exists to the criminalization approach. Critics have argued that the law would be unenforceable, since much of the evidence is only available abroad. As Gerald Parsky, former Assistant Secretary of the Treasury, said:

"In a criminal bribery action, the intent of the payor, and possibly the payee, would have to be proved. . . Proving intent would be particularly difficult where the payee resides outside of the United States and is not a U.S. citizen." [25]

Trying to solve this problem of evidence would mean applying U.S. laws outside U.S. territory, which could also cause problems for U.S. foreign policy. Moreover, the bill would not deal with the problem of punishing the individuals who solicit bribes overseas.

This bill, however, hardly constitutes the first case of a law whose application was extraterritorial. To my knowledge, as a layman, American tax, antitrust, trademark and "Trading With the Enemy" laws currently have such status. Of course, this does not solve the problem of obtaining evidence, witnesses, depositions, et cetera overseas. This problem is only partly corrected by the likelihood that much of the evidence for a successful prosecution may be available in the company's home headquarters.

The effort to obtain such evidence, and the exposure of foreign governmental practices such a prosecution would entail could pose problems for U.S. foreign policy. Of course, one of the goals of such legislation is to make American policy in this area more clear than it has been. One purpose of such a law is to set an example which other countries will hopefully follow. As Leonard Meeker has argued, strong action is needed in order to "demonstrate that this country is serious. It will serve as a spur to other countries to enact compatible legislation." [26]

Clearly the demonstration effect of this bill will not be enough to cease the practice of making questionable payments. Foreign jurisdictions, sensitivities and sovereignties are all involved. The ultimate solution to the problem depends on action in the international level. This bill could make an important contribution to strengthening the American position in such negotiations. First, it would strengthen the resistance of American firms to pressures from officials in other countries. American business might welcome such support from their own domestic laws. Second, the U.S. Government will be participating in international talks on this issue with a clear, strong policy opposing such practices, giving it a leadership position rather than that of being a reluctant participant. Thus, this bill can be seen as an important step, among others, in the responsible regulation of the questionable payments problem.

Thank you, Mr. Chairman.

Mr. ECKHARDT. Thank you, Mr. Adams.

Mr. Broyhill?

Mr. BROYHILL. Thank you, Mr. Chairman.

I am not clear whether you are advocating that the bill be expanded to include what you call the so-called "grease" or "facilitating" payments. Is that what you are asking for in the latter part here or are you arguing that that should be left out at this time?

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[25] "Statement to House Subcommittee," September 22, 1976, p. 13.
[26] "Statement to House Subcommittee," September 22, 1976, p. 13.

Dr. ADAMS. It is up ultimately to the committee to include it or leave it out. I have cited it here as a particularly difficult problem to control and regulate.

Mr. BROYHILL. You indicate that it is a common practice with most companies, including competitors of American companies.

Dr. ADAMS. One way to include it in this legislation would be to set out a minimum dollar limit on the size of payments covered by the legislation. Such a limit was included in last year's legislation and it is one possible way of dealing with the issue in this year's legislation.

Mr. BROYHILL. Do you find that most of the foreign competitors do utilize these type of payments?

Dr. ADAMS. Both other American and foreign competitors make such payments. In our study we found one case—and there are many such examples where a firm doing business in Argentina and the necessity of paying a local police official in order to insure protection for its local facility in Argentina. The police were unable to provide such protection as a normal routine matter of police business.

Mr. BROYHILL. Thank you, Mr. Chairman.

Mr. ECKHARDT. Mr. Luken?

Mr. LUKEN. This bill would apply to U.S. corporations and individuals?

Dr. ADAMS. As I understand it, it would apply to corporations.

Mr. LUKEN. Maybe I should ask counsel. I assume it would apply to the individual who carried it out, carried out the bribery for the corporation and the corporation alike.

Mr. OPPER Yes.

Mr. LUKEN. You touched upon the jurisdiction question. Is there any question legally if a U.S. corporation—and it would only apply to U.S. corporations, of course, not foreign corporations—if the U.S. corporation insulated the activity or the reverse of insulated it, that all the transactions occurred outside the territorial limits of the United States? Does that raise a question of the applicability, the legal, constitutional question?

I think the analogous laws that you cited are a little different. Some of the tax laws would apply to the corporation which is a U.S. corporation, but this would be a little different than a tax law. I don't know whether you have any comment on this. I am sorry I am asking this in such a halting manner. Obviously, I am not able to phrase it, but a rather inchoate question arises.

Dr. ADAMS. I am not a lawyer so I cannot answer the question as a lawyer might. Since we are dealing here with a law that applies to legal personalities in the United States, it should, in fact would cover such payments. A number of these payments had the characteristics you described, that is, they have been made by sales agents in foreign jurisdictions acting as agents of the company, using slush funds created with income drawn from a foreign subsidiary.

As I understand it, this law can be applied to such a case, but I don't give that answer as a lawyer.

Mr. LUKEN. Can I ask counsel if there is a precedent for such? Has the Supreme Court decided that one?

Mr. OPPER. Well, the approach here would be prohibit such activity directly or indirectly be a U.S. corporation would be equally subject to the bill. Accordingly, it would be difficult for a domestic corporation to isolate itself from liability by using a foreign subsidiary.

Mr. LUKEN. That is a little different question. It is a good question and a related question. But I don't think that gets to the basic question that I had in mind. If the entire transaction occurs outside of the United States, what is the application of U.S. law; simply because it is a domestic corporation?

If we were talking about State jurisdictions, criminal matters, that question would arise. Does it also arise with regard to international questions of jurisdiction?

Dr. ADAMS. I can't answer that question from a legal point of view, Mr. Luken.

Mr. LUKEN. Maybe we will have to look it up.

Dr. ADAMS. At least as regards business practices.

Mr. LUKEN. We don't accept that copout. You can't come in here and say, "I am not a lawyer and I don't know the answer."

Mr. ECKHARDT. Mr. Luken, is your question whether or not we have the constitutional authority to apply U.S. law to an act in another nation or outside the United States?

Mr. LUKEN. I think that is my question, Mr. Chairman.

Mr. ECKHARDT. I think the answer to that is yes, if it has a nexus to an activity in the United States. For instance, if a corporation, in order to foster its business abroad and to do it in opposition to an established congressional policy violates U.S. law, even though that violation may be overseas, it is still constitutionally reachable as an offense against American law.

There were relationships that existed between some of our chemical companies and I.G. Farben prior to the Second World War which constituted violations of antitrust law in the United States. That would be reachable. It seems to me that competition of this type which is determined as a matter of U.S. policy is injurious to the interests of the United States or injurious to free competition between businesses on fair bases in the United States and would clearly be reachable. Of course, there is another question of the ability to arrest and apprehend the violator, but that exists in many other types of problems.

Mr. LUKEN. I understand that would be a question of enforcement. I am asking the basic question of constitutionality.

Mr. ECKHARDT. We also ran into this question with respect to airplane hijacking in this committee. I think the question was raised as to whether or not when a plane of the United States was flying over foreign territory, we could make the offense of hijacking an offense against American law.

Mr. LUKEN. What did we decide?

Mr. ECKHARDT. We decided we could.

Mr. LUKEN. Has it been tested?

Mr. ECKHARDT. Not on that specific point, but there are cases in other areas where the question of the reach of U.S. jurisdiction has been tested. I would suggest that we might leave the record open at this point for a citation of cases on that issue.

[The following material was received for the record:]

TESTED CASES OF U.S. JURISDICTION

As a general rule, the application of federal criminal law is limited to the territory of the United States. However, there are a number of federal statutes with criminal sanctions which have extraterritorial application: 18 U.S.C. §1546 (fraud and misuse of visas, permits, and other entry documents), 18 U.S.C. §2314 (transportation of stolen goods, securities, moneys, fraudulent state tax stamps, or articles used in counterfeiting), 18 U.S.C. §2381 (treason committed "within the United States or elsewhere",), 50 App. U.S.C. §1 *et seq.* (Trading with the Enemy Act), 15 U.S.C. §776 *et seq.* (Securities Exchange Act of 1934), 15 U.S.C. §1-7 (Sherman Anti-Trust Act), 15 U.S.C. §41 *et seq.* (Federal Trade Commission Act), etc.

The cases indicate that in the extraterritorial application of U.S. law by the Congress," *United States v. Erdos*, 474 F. 2d 157, 159 (4th Cir.1973). "From the body of international law, Congress may pick and choose whatever recognized principle of international jurisdiction is necessary to accomplish the purpose sought by the legislation, *United States v. Rodriquez*, 182, F. Supp.479, 491 (S.D.Cal.1960).

There are a number of theories of legislative jurisdiction under international law, at least three of which are applicable here. See, "Jurisdiction with Respect to Crime-Draft Convention, with Comment, Prepared by the Research in International Law of the Harvard Law School" 29 *American Journal of International Law* (Supp.) 439(1935) and American Law Institute, *Restatement (Second) of the Law of Foreign Relations of the United States, ch.2(1965).*

The first of these is the familiar territorial principle. Restatement §17. Under this principle, a nation may presecribe rules of law regulating conduct occurring within its territory, regardless of where the effect of the conduct falls. This is the principle Congress is presumed to have relied upon unless it specifically indicates otherwise. *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1907).

The second principle grants a nation jurisdiction to prescribe rules of law attaching legal consequences to conduct that occurs outside its territory if the conduct causes an effect within the prescribing nation's territory. Restatement §18. Under this theory, the courts have upheld Congressional regulation of the conduct of noncitizens, even if the conduct took place outside the U.S., so long as the consequences of the conduct are felt within the U.S. See, *United States v. Pizzarusso*, 388 F. 2d 8 (2d Cir.), *cert. denied*, 392 F. 2d 912 (D.C. Cir. 1973); *United States v. Braverman*, 376 F. 2d 249 - Cir.), *cert. denied*, 389 U.S. 885 (1967); and *Revord v. United States*, 375 F. 2d 882 (5th Cir.), *cert. denied sub nom. Groleau v. United Staes*, 389 U.S. 884 (1967).

A third pertinent theory of international jurisdiction is the nationality principle. *Restatement* §30. Under this theory, a nation has jurisdiction to prescribe rules of law regulating the conduct of its nationals wherever located. This principle would extend jurisdiction to include any corporation chartered by a State of the United States. See, *Vermilya-Brown Co. v. Cornell*, 335 U.S. 377 (1948); *United States v. Cotten*, 471 F 2d 744 (9th Cir.), *cert. denied*, 411 U.S. 936 (1973); and *Gillars v. United States*, 182 F.2d 962 (D.C.Cir.1950) as cases where the courts have upheld Congressional regulation of the actions of U.S. citizens outside the territorial jursdiction of the U.S.

Mr. LUKEN. Could I read this paragraph from the Senate report?

Mr. ECKHARDT. Surely.

Mr. LUKEN. "The committee recognizes that principles of international law and comity generally operate to preclude a nation from establishing laws applicable to conduct which takes place outside that country's territorial boundaries." That states the question I was raising.

'However, it is clear that a nation may adopt and enforce laws covering foreign conduct of its own nationals and covering foriegn conduct which has significant effects within that nation."

We are referred to a case of Steele versus Bulova Watch, 344 U.S. 280, which I assume is not a criminal case.

Dr. ADAMS. I assume one of the issues here is the nature of the functional link between a foreign, let's say 40 percent U.S.-owned

subsidiary—to be above the threshold of 25 percent control in the committee's bill—and the parent company.

Mr. LUKEN. I was not asking about the subsidiary. My question was less complex than that.

Let's say it is not a subsidiary, but they carefuly set the conduct apart so that no decisions were made in this country and no officials in this country participated, had any knowledge, and the whole thing was isolated in the foreign country, the entire course of conduct that constituted the transgression.

Dr. ADAMS. One of the points of access to such an act, both as prescribed by this committee's proposed legislation and in as found corporate operations in general, would be the accounting procedures of the corporation. That is, in one way or another, that payment would have to have been accounted for on the company's books.

Mr. LUKEN. If it is, that is not my question.

Dr. ADAMS. I am not sure how many cases lie beyond such circumstances.

Mr. LUKEN. It could be completely isolated.

Dr. ADAMS. I am not sure it could be. Once the SEC, as was proposed in legislation last year, has made new rules with regard to accounting procedures, I am not sure that you can effectively sever that link.

Mr. LUKEN. Thank you, Mr. Chairman.

Dr. ADAMS. The issue that I raised is the extent to which this same problem exists with regard to actions by subsidiaries of the American companies operating abroad. I was suggesting that there is a closer link in this case than in the hypothetical situation that you were raising.

Mr. LUKEN. We can phrase it this way: If the criminal action would be applicable to an American corporation because of the actions of its employees, officers and directors, to what extent would it be applicable to foreign subsidiaries?

Mr. ECKHARDT. On that point, it would seem to me that if the foreign subsidiary is the corporation established in another country and under the law of the other country, you cannot reach the foreign subsidiary because it has no connection with the United States sufficient to give a basis for an action against that corporation as such. But it would seem to me that you might make it illegal for the U.S corporation to deal through its subsidiary in a way that it could not deal if it were dealing directly in a foreign country because there would be a U.S. connection with respect to a corporation established in the United States.

Mr. LUKEN. Is that what the present law purports to do?

Mr. ECKHARDT. That is as far as I would think this law would reach with respect to that situation.

Mr. LUKEN. I am satisifed with that answer if that is what the law purports to do.

Dr. ADAMS. I could foresee some difficulty if the subsidiary was not consolidated with the parent company.

Mr. OPPER. To your knowledge, Mr. Adams, does the Internal Revenue Code apply some definition of control for tax purposes?

Dr. ADAMS. I don't know how the IRS has defined control. I do know that of the cases that the IRS is examining, and there are

probably upwards of 100 at this point to include some that involve actions by subsidiaries.

How they have defined control for the purposes of IRS intervention, I cannot say. I don't know whether there is a percentage floor or not. The SEC, I might add, has also included in its voluntary disclosure program cases where such actions have been carried out by subsidiaries.

Again, I cannot say if they have a threshold level of control to include such cases.

Mr. ECKHARDT. Mr. Krueger?

Mr. KRUEGER. Thank you, Mr. Chairman.

I am struck on the one hand by a kind of cultural ambivalence on this because I think of John Dunn's statement, "We are a part of the Continent. We are a part of the main. If Europe is in some way diminished, I am diminished as well."

In that sense, particularly with a President who is arguing for a kind of universality for human rights, it seems appropriate that we apply our business principles on those companies that are engaged in business overseas.

On the other hand, I am also partially reared in a time of cultural relativism in which I am taught the works of Michelangelo are perhaps no greater than the works of many unknown art principles on those companies that are engaged in business overseas.

On the other hand, I am also partially reared in a time of cultural relativism in which I am taught the works of Michelangelo are perhaps no greater than the works of many unknown artists because it is simply a matter of taste and we in America are not to impose our values on other people because that is a kind of nationalism that is out of fashion. I suppose that somewhere treading through that thicket is the question of whether or not we should legislate on our people when they are abroad.

I was interested in our chairman's observation that he did not believe that we can impose laws and penalties against American citizens practicing acts abroad which may be illegal as acts in t not we should legislate on our people when they are abroad.

I was interested in our chairman's observation that he did not believe that we can impose laws and penalties against American citizens practicing acts abroad which may be illegal as acts in the USA. I think of some of the border towns that I know of on the edge of my congessional district and the traffic that passes back and forth for acts that may be illegal on one side of the border but are not on the other.

Given that background, I would like to ask Dr. Adams whether you feel that it is possible to draw a distinction between the sort of what I think is called mordida in Spanish, that is the bite or the little minor payment that makes sure that someone will come and connect your water lines after the pipes are already in. Somehow it can take months if you don't have that $20 payment for the man.

It is my understanding that there are many countries, and I hope it will not seem improper and presumptuous to say, perhaps even most countries after the pipes are already in. Somehow it can take months if you don't have that $20 payment for the man.

It is my understanding that there are many countries, and I hope it will not seem improper and presumptuous to say, perhaps even most countries we deal with in which such payments are evidently far more common than they are here in terms of getting some of the minor details worked out.

I spoke to one person who is doing construction in one Middle Eastern country who told me they could not get their sewer system connected until certain payments were made. This was holding up their whole project.

How do we distinguish between those kinds of payments which may or may not be "susceptible"? In moral terms they are no more susceptible. I assume the morality is based on the motive rather than on the amount, that is a $10 bribe is an act of bribery as much as a $1 million bribe.

If we look at either Kant or Plato, we come out with the ethical imperative that it would be wrong in either case. Yet the assumption seems to be that it would be wrong in one case and not in the other. I wonder if you would comment on how the distinctions might be drawn between the minor bribes, the mordida, and when it becomes major?

In conclusion, I think we might set upon an amount like $8,700, since when a Congressman earns more than that in private income it is illegal, but if he earns less, it is legal.

Would you care to draw any distinctions between that?

Dr. ADAMS. I am not sure I would distinguish in any moral way between the two payments. I would agree with the view you are expressing that both of them are at the moral level, equally undesirable or immoral. You are really asking two questions: Is there a difference in practice and how would you establish the difference in legislation.

Very often a legislative approach is opposed because it is seen as "legislating foreign morality." They do things different there than we do here the argument goes.

My first response to that, which is perhaps a bit sophistic, is that legislation on this issue refers to U.S. corporate behavior, not foreign morality. There is relatively little we can do to touch practices in another country.

My second response is that we are dealing here with the practices of U.S. businesses facing their U.S. competitors as much as problems U.S. business facing rather less ethical foreign competitors. The problem is one of U.S. business practice.

My third response is to suggest that the between the context here and abroad may not be so great as some may suspect.

My conclusion on the basis of current data, pending any further revelations by the Watergate Special Prosecutor's Office, is that payments to higher government officials may be less common here, but what you call the mordida, we are talking about things has its equivalent in the United States.

In New York City, where I live for example there are countless stories about how one must obtain a building permit from building inspectors including a mordida in order to finish construction and move into an office building or a home. We have to be careful not to be more pious in the United States practices than we are about the mordida of other countries.

That suggests to me that the distinction between some important people and some less important people, between high level politicians and other bureaucrats is relatively meaningless.

Mr. KRUEGER. Which is the more important, bureaucrats or the politicians?

Dr. ADAMS. Financially speaking, the larger bribes go to the more important people and the smaller to the less important people, but both may be important for the functioning of a company's business. If you have perishable goods on a waterfront and the only way you can get them unloaded is by crossing the palm of a waterfront official, doing so is imperative to your business. I should add that it may be equally important to your business on the New York waterfront.

At the legislative level, the only practical way to deal with the issue I think is with some threshold, say, $1,000 or $8,750, or some other figure. The Ford Administration bill proposed last year, I believe, contained $1,000 as the threshold for kinds of payments that ought to be disclosed.

Mr. ECKHARDT. Would you yield?

Mr. KRUEGER. Yes.

Mr. ECKHARDT. Would you describe the threshold as "in accordance with the customs of the country?"

Dr. ADAMS. I don't think so.

Mr. KRUEGER. We could have the threshold vary according to the per capita income in the country.

Mr. ECKHARDT. Corruption is not directly proportionate to the per capita income, is it?

Mr. KRUEGER. No, but we would have cost equity that way.

Dr. ADAMS. Parenthetically some representatives of the business community in this country argue that this practice constitutes a form of covert development assistance.

Given the inadequate budgetary resources of some countries, and their inability to provide for an adequate public service or to pay adequate salaries to public officials, this becomes, some people argue, a way of providing a minimum income for those public officials. I am sure it is not the most effective form of development aid we might imagine.

Mr. KRUEGER. I observe in your testiomony on page 3, you say "relatively few companies in such areas as textiles, retail merchandising, mining, communications equipment or electronics, to cite only a few examples, have disclosed any questionable payments to the SEC."

If we assume that those are companies that might have decided they are not prepared to disclose whatever they have done, let's grant the more likely assumption that these are industries that have engaged in less bribery than the others that were mentioned.

But it seems to me that one possible reason for that is if we look at the first item, textiles, the United States is not an exporter of textiles to other countries and in purchasing textiles, there is a wide degree of competition that exists among foreign countries in trying to get U.S. markets.

So what we are saying in effect is there is no cause for any bribery in textiles. We are really saying there is no Rio Grande fruit rot on this pear. That is because it comes on oranges.

When we say there is no bribery in textiles, we are saying there is no bribery because there is no cause for bribery. The same would be true for retail merchandising. I would know less about mining. I would think that mining in my guess would have been about as likely a candidate as oil and gas, for example, because where we are concerned with removing minerals from foreign countries people encounter the need to get those permits. The problem might be that mining is, at this point, just something that we don't do quite as much of in dollar terms.

Communications equipment or electronics, again the United States is in a much stronger world position in those areas and we are basically sellers there without as much competition except perhaps from the Japanese with regard to consumer goods. So I don't really know that that is terribly instructive except to point out that as I would view it, bribes tend to exist where there is a belief among those people that they will benefit from bribes rather than to qualify some as being more moral than the others. I would think that that is the way we are likely to come out with that.

I observed as well that Exxon at least evidently has paid a great deal of money to Italian politicians. In that case they would not be drawing energy reserves out because I don't know that they have any drilling in Italy, but they probably were hoping to maintain some political group in power that would be favorable to them and I wonder if our CIA has ot done the same.

It may be that when the government does it, it does it better than private industry, and the government has not perhaps been required to disclose as much. Maybe we could have a voluntary amnesty for the CIA if they would wish to disclose their payments. It is not a practice I approve of either domestically or in foreign countries.

I wonder whether you have given thought, and by my late arrival I did not complete my reading of your testimony, whether you have given thought to the question of whether the United States might work out with those industrialized nations that basically have many of the ethical values we like to think of as being part of the tradition of western civilization and if we might, for example, work with European countries, perhaps the Japanese who are now in some ways coming into western civilization and others, sort of agreement between countries that we might together work out legislation that would forbid bribery of foreign officials.

I think that it would be a strengthening both of morality generally if we were able to do that and a strengthening of the likelihood of that morality being enforced if we were to have a number of countries working together because then it would not be Goodyear versus Firestone, but rather Goodyear and Firestone and General Tire and Michelin and other such companies that would be together approaching this question.

Do you have any suggestions on that kind of possibility?

Dr. ADAMS. Yes. Let me respond to both parts of what you said. The first relates to the categorization of companies, some of which are more and some, apparently, at least, less involved in the

practice. You quite rightly point out there may be a variety of reasons why the practice is more common in one industry than another.

One problem with the SEC disclosure statements is that they provide a minimum of data to get a grasp on the issue. You are quite right to say that in the communications or electronics field in the United States and abroad one, two or at the most three firms have a overwhelmingly predominant position on the market. Why bother to pay if you are in the kind of position IBM in, that is being the sole supplier in some areas.

In mining, on the other hand, there is a great deal of American activity overseas. The data disclosed to the SEC as of November 1 may suggest those companies simply aren't saying anything. We cannot say from the data; The voluntary disclosure program makes it almost impossible to make those kinds of distictions.

I can hypothesize a number of reasons as to why the companies found more frequently on the list, are there. Chemical companies face a great deal of foreign and domestic American competition for overseas sales. The aerospace, airlines and air service area involves almost entirely competition among U.S. firms. Foreign contracts have become so important to that industry that the companies work against each other, it would appear, for foreign contracts.

Mr. KRUEGER. Are major airframe builders without foreign competition? For example, the various planes, not only the Concorde but the various airplane manufacturers overseas? I would think we do have some foreign competition there.

Dr. ADAMS. They face relatively little competition in the area of wide-bodied transports. The only competition comes from a consortium airplane developed in Europe, the A-300 whose sales are much smaller than those of 747, the L 1011 or the DC 10. The American manufacturers overwhelmingly dominate the international market.

Mr. KRUEGER. So they are bidding against one another?

Dr. ADAMS. Yes, they are bidding against each other. With regard to food products, we are talking about things that require local marketing permits, custom permits, creating all kinds of possibilities for small level payments.

Oil and gas production and services given the enormous expansion of that business abroad in past 10 years is naturally on the list. A number of government permits and in some cases, foreign government participation are necessary in the industry. Drug, health care and pharmaceuticals are also, to a large extent, self-explanatory. These companies not only rely for a large proportion of their sales on overseas markets but have major foreign competitors. They also have additional requirements for health permits, and in some cases foreign legislation in order to be allowed to market their products.

Mr. KRUEGER. Chances are they would also have, in many cases, a central purchasing authority rather than having a varied group of purchasers. And all of a sudden single individuals who can't tell that much difference between aspirins can't tell that much difference between bribes.

Dr. ADAMS. Yes. In order to explain the presence or absence of any particular industrial or manufacturing sector from the list you really have to get in to the structure of their market, how they do

business abroad, what their requirements are for dealing with State officials, a whole series of things. These are the things that need to be learned in order to explain their presence in large numbers on this list.

To come to your second question at the end of my testimony I do mention the issue of international solutions to this practice. Ultimately, I would argue this legislation, while important, will require additional action at the international level because of the other countries involved and because of the problem of foreign competitors for the markets.

You may be aware that last summer the Organization for Economic Cooperation and Development—the OECD—in Paris, developed a voluntary code to prohibit such practices. As an OECD voluntary code, I don't personally expect it to be enforced. I think the required internationl action is going to have to be much stronger.

Mr. KRUEGER. Voluntary prohibition is an interesting use of semantics.

Dr. ADAMS. There is parallel action currently under discussion in the International Chamber of Commerce, looking at corporate policies to control such practices and in the United Nations through their Center on Transnational Corporations in New York. The U.N. has a working group on corrupt corporate practices which is trying to analyze the problem and develop solutions.

Actions on all of these levels is very, very slow. Each country has to develop its own policy; each has corporate interest at stake. In the case of the U.N., some of the countries are locations in which the bribes are paid, while others are jurisdictions in which the companies that are paying the bribes are chartered. There are inevitably different interests that need to be sorted out at the international level, which means international action is going to be very slow in coming.

In over a year of discussions the U.N. working party corrupt practices has barely been able to define its agenda. That shows how hard it is.

Ultimately you are right. International action is the only way fully to control such practices. This is not a reason to avoid to passing American legislation. In fact, I would argue, such legislation would strengthen the hand of the United States in international negotiations, since it would give us a very clear policy on this issue.

Mr. KRUEGER. Perhaps we need to bribe a few foreign legislatures.

Dr. ADAMS. Hopefully not.

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

Mr. ECKHARDT. I wonder if there isn't another factor, which you touched on it, that would influence the number of companies involved in such activity. That is the extent to which there is a governmental relationship by the foreign nations in that area of business. Of course, that would clearly be true of aerospace where airplane flights and times may be controlled by the government.

Dr. ADAMS. That is even true of the purchase of airplanes.

Mr. ECKHARDT. That would clearly be true of oil and gas, where most other nations are in much more active control of development

of oil and gas than the United States is. But it would not be true primarily in those two large areas of drugs and chemicals, and I think you explained that being due to the extensive and extremely active foreign competition. Of course, that would indicate to us though, that it is, in fact, a large measure of the impetus for such foreign payments that American companies are not engaged solely in competition with other American companies but are also engaged in competition with foreign countries. Of course, this is an area into which we must look with some caution in passing laws which would impede our nationals from competing with nationals of other areas. Would you agree with that?

Dr. ADAMS. I agree that is a problem but I do not see an easy way out of it. The question you are asking is whether it will pose a major threat to the market of an American firm with substantial foreign competition to be prohibited from making such payments. I think the record is quite open on that issue. There will be instances where that is the case. There will also be instances where corporations claim that is the case, where it is not. This is an area which requires substantial research before we can really conclude that nonpayment will create a market problem for U.S. companies.

Mr. KRUEGER. Mr. Chairman, would you yield for one question?

Mr. ECKHARDT. Sure.

Mr. KRUEGER. As to the question of how our companies might compete with foreign countries on this where you say you think the question is yet open as to whether or not we really would not be able to compete if we did not bribe, I would think offhand that there is no particular interest for the company in paying an unnecessary bribe so to speak, and they may be paying bribes where they could have gotten the business without, I don't know. That is, in effect, a business judgment as well as ethical judgment, but I would think they at least would not be wanting to make payments they didn't need to although they may have people so given to that mode of selling or buying, whichever it is, that they may just fall into that.

Thank you, Mr. Chairman.

Mr. ECKHARDT. In noting the actual language of the bill, perhaps the language answers some of the questions we have raised. Section 3 seems to be one of the salient sections and to leave out various qualifiers and to read straight to the point, one can say that the law makes it "illegal to corruptly offer to pay to any individual to use his influence with a foreign government or instrumentality or to fail to perform his official functions for the purpose of obtaining or retaining business." Now I have added a few words, but essentially it seems to me that is what the act is directed toward. Of course, there couldn't be any problem with making it illegal to try to bribe a foreign official that failed to perform his official function because if failure to perform official function, wouldn't involve the mordida kind of thing. It would be the opposite. The mordida would be to make him perform an official function so you have the advantage of equal participation with the competitors. So we can't find any flaw at all with the provision making it illegal to bribe him to fail to perform his official function, I would think. Do you agree with that?

Dr. ADAMS. Is that how you read the text under section 3, that these are a payment to influence a foreign official to fail to perform his official function?

Mr. ECKHARDT. That is one of the things. The other is to use his influence with a foreign government or instrumentality in order to obtain assistance in retaining or doing business and it is in that area that the problem of the mordida would be involved and not in the other defined illegal act. This is on pages 3 and 6.

So what I am trying to say is that we don't have to worry about the provision of B on line 5 because that doesn't have anything to do with the mordida at all. As I see it, there is no reason why we shouldn't make it illegal to bribe a person not to perform his official function. I am not saying the other ought not also be included, but I am saying there seems to me to be no reasonable argument against making it illegal to pay a person money to fail to perform his official function.

Dr. ADAMS. Are you referring here to H.R. 3815 or H.R. 1602?

Mr. ECKHARDT. H.R. 3815.

Dr. ADAMS. The language in H.R. 3815 is much more general than the case that you are citing. It refers to paying a foreign official for the purpose of influencing any act or decision of such a foreign official in his official capacity, pro or con, doing it or not doing it. This may not be the easiest way to legislate on the problem, but I think it is a more effective definition of the problem.

If you define the payment in the terms of H.R. 1602, which refers to paying somebody to fail to carry out action, then you have effectively not covered yourself on the payments that encourage officials to carry out an action in their official capacity that may assist a company.

Mr. ECKHARDT. Of course, what happens in H.R. 1602 is they break into halves, use the influence with a foreign government or instrumentality to assist such concern to obtaining or retaining business. Incidentally, I have some problems with that. Perhaps in separating these things and dealing with them as separate functions there may be more possibility of illegalizing the mordida than in the more general language because to assist such concern in retaining or obtaining business could conceivably be a corrupt action or noncorrupt action. Of course, the whole thing is predicated on to corruptly take such action. But assist such concern in obtaining or retaining business does seem to envelope some greasing operation which would not necessarily be undesirable.

Dr. ADAMS. If you are dealing here with H.R. 3815 which excludes the ministerial and clerical officials, then I cannot think of any jurisdiction in which it is legal to make a payment to a high level government official to assist a corporation in obtaining business.

Mr. ECKHARDT. Well, let's take the situation like this. It depends on how you define assistance and I suppose the term corrupt in there would eliminate this sort of situation. If one, for instance, entertains a foreign official, saying, "Look, I would like for you to help me get an appointment with so and so tomorrow. He is the minister of aeronautics, and I need to talk to him in order to get that kind of assistance," you engage in some expenditures having to do with entertainment of some minor gift. I suppose that might be considered illegal assistance.

Dr. ADAMS. I think that would depend very much on the laws of the jurisdiction in question. The situation you describe is a fairly

common one in some countries. Grumann Corporation's International division paid sales commissions related to the F 14 contract to agents working for them in Iran, part of whose job was to perform precisely the function you describe to arrange appointments. Grumann claims that those were not questionable payments. They have reported these payments and describe them as not questionable in the terms of the voluntary disclosure procedure.

Mr. ECKHARDT. Would that be an individual who is an official of a foreign government?

Dr. ADAMS. The issue here, as I see it, is not solely what you get the foreign government official to do, but also paying that person to do it. We are concerned with the fact of a payment, a financial transaction involving that person.

Mr. ECKHARDT. A payment which induces him to assist would not necessarily be a money bribe. It could be an expenditure of money for entertainment, could it not?

Dr. ADAMS. It could be, yes.

Mr. ECKHARDT. Let's take a look at the comparable language in H.R. 3815. "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 foreign official for purposes of—

(A) influencing any act or decision of such foreign official in his official capacity; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality." And then the provision about candidates and about inducing somebody else to do it.

But of course, the key term is influencing any act or decision or inducing such foreign official to use his influence. In each instance, the illegal act is influencing, which seems to me to be somewhat tighter, though stated in more general terms. It seems to me that ultimately it is tighter than the language of giving something to get an official to assist such concern in obtaining or retaining business. So it would seem that this is tighter with respect to the mordida.

Dr. ADAMS. I think it is tighter. I want to point out that you have both dimensions of the transaction in this language, that is, corruptly to offer, give or promise to give money to a foreign official for that purpose.

Mr. ECKHARDT. The difference is to influence, in this case, and the other, the mere act of obtaining assistance might constitute a sufficient violation. So it would seem to me that the language of H.R. 3815 is, in fact, better drawn to exclude what would constitute nothing but a customer in a mordida type of practice. I think if we should enact this language, perhaps there should be some discussion of that in the report because I assume nobody wants to get to the situation in which the lazy official is simply spurred into activity to give an opportunity for the company to realize only the normal

practices and machinery of the government which is involved. I assume nobody wants to make that kind of activity illegal.

Dr. ADAMS. You will have to rephrase that. I am not sure I follow you.

Mr. ECKHARDT. I am saying that it seems to me there are three possible situations. One would be to pay a person money to wink, not to apply the standards and regulations of the nation. Now clearly that ought to be illegal. It certainly doesn't aid or promote commerce to encourage that type of thing. Or, for instance, to pay some money to a person not to further the application of a competitor. A thing like that, I think, is clearly bad.

The second situation would be a payment in which the foreign official is to provide a quid pro quo of actually acting within some official body or official capacity to convince a body that has the authority to determine the ultimate contract to decide in favor of the company that pays the money. It seems to me that is clearly something we want to stop by this action.

Dr. ADAMS. Yes, I think the bill effectively handles that situation.

Mr. ECKHARDT. The third situation is one which may verge on the second, and it may be somewhat difficult to divide the two. However, it is conceivable to me that the payment of some money to an official, well, not the payment in cash, I suppose, but the payment of some small gift, entertainment, and perhaps a small amount of money, virtually as a tip to get that official to get the process rolling is sometimes perhaps a customary practice. If we made it illegal for our companies to engage in that abroad, we might create a situation in which our companies were at a disadvantage with respect to others. I merely suggest that there are perhaps three categories of activity.

Dr. ADAMS. I have trouble distinguishing the third category from the other two. I suspect this legislation could be applied, except in special circumstances, to the third case you cite.

Mr. ECKHARDT. I think it possibly could, too, and I think it may be a matter of degree. The question is how can we influence the legislation or write into the legislation language which distinguishes between these two situations. The Acme Company is selling insecticide in Italy or Egypt and the Acme Company in selling that insecticide has a rather reluctant official at some level who will not pass on these applications and bids to governmental officials. He gives every indication of a surly waiter, and he is not going to do anything unless he is assured of a tip. The Acme Company, through its minor officials, or perhaps its official in Egypt, takes it on himself to kind of spur up this action and sends this man a bottle of champagne or conducts a party for him or takes him to dinner.

Now it is conceivable that that could be construed as giving a thing of value for the purpose of getting an official to influence his government. I don't think that really is the influence of the government. It would be very difficult to show, No.1, that it was corrupt; No. 2, that it resulted in influence of the government, and, No. 3, that it was a willfully wrong act. All of those things would have to be brought together to convict.

Another situation that may verge on the first is that the Acme Company is trying to sell its insecticide and there is some indication

by the official that there is a competitor from Japan producing the same chemical. The official of the Acme Company says, 'Look, I feel that we have the best chemical, and I want to convince you of this fact." And then there is extensive entertainment, high-priced gifts, a fur coat given to the official's wife. The official then goes to bat for the Acme Company and influences the governmental purchasing agent and the Acme Company gets the bid instead of the Nikita Company in Japan. It seems to me that kind of thing, if the facts I described were proved, would constitute, one, corrupt action because it was intended to substitute or get this company an advantage over its competitor——

Dr. ADAMS. Based on something other than price.

Mr. ECKHARDT. No. 2, there was a quid pro quo passed in the situation, and, No. 3, there was actual activity on the part of the official to influence, not merely to further the transaction. Admittedly these two cases may merge on each other rather closely.

Dr. ADAMS. I think they tend to overlap a great deal. There are probably two ways to tackle the issue. One of them concerns paying the foreign official money to obtain such action, which is what this legislation covers. The other concerns the circumstances, a dinner, bottle of champagne, conference over lunch for which the company pays. Maybe the solution is to establish a dollars threshold for the law to apply in order to eliminate being dragged into every situation and crossing over frequently into the area of normal human relations.

Mr. ECKHARDT. You raise a question of whether we can divide these things by having a monetary threshold. If it were possible to do so, we might provide that anything that can be eaten, drunk or consumed within the period of 6 hours will not apply, but that seems somewhat impractical. I think what we are really trying to get at is the question of what constitutes a mere greasing operation, a mere facilitation of the normal processes of the other government and what constitutes a pressure or a bribe to influence a decision corruptly.

I am inclined to think that the fact that we have in H.R. 3815, both the requirement of a corrupt intent of the influencing of the government which I think would be construed to be something more than merely to put into effect the normal channels of operation or to open the sluices of bureaucracy within that particular nation, plus the requirement that if it be criminal, it be willful, would probably be as good a standard as we can adopt. I am a little bit skeptical about trying to draw minimum amounts because I can conceive of situations which involve $100 that would be clearly corrupt, whereas a situation which may involve as much as $500 may not be. Besides that, we ordinarily don't put in criminal statutes a kind of de minimis basis on the offense. For instance, we do not provide that a man under 150 pounds will receive a less penalty for rape than a man of over 200. I would prefer to act on the basis of principle rather than amount of criminal statute.

Dr. ADAMS. I can understand that feeling. I think either approach is going to be difficult to define. The only question I would raise is that in defining the principle involved, don't you encounter two

problems? One is, how do you describe the distinction between the two situations in the legislation?

Mr. ECKHARDT. Do you find any problems in the language of H.R. 3815?

Dr. ADAMS. No, I like the language here, better than the language in the other bill as it applies to this situation.

The other problem you run into is that of enforcement. If the practice of corrupt payments at a very small dollar level is as widespread and common, as suggested, the enforcing agencies may be simply flooded by prosecutions.

Mr. ECKHARDT. Maybe that will work itself out. It would probably indicate that the activity was so common there was very little the United States could do about it. We would simply find ourselves overwhelmed if we attempted to enforce it in that country and would not do so. I think there has to be a considerable amount of prosecutorial discretion as in almost all criminal action.

Thank you very much.

Dr. ADAMS. Thank you, Mr. Chairman.

Mr. ECKHARDT. We next have a panel. Mr. von Mehren, Mr. Schell, and Mr. Kennedy, will you please come to the table?

Mr. von Mehren is the chairman of the Ad Hoc Committee on Foreign Payments of the Association of the Bar of the City of New York.

Orville Schell, Ad Hoc Inter-Professional Study Group on the Corporate Conduct, and Mr. William Kennedy is also a member of Mr. von Mehren's ad hoc committee.

You may proceed in any manner you see fit.

STATEMENT OF ROBERT B. VON MEHREN, CHAIRPERSON, AD HOC COMMITTEE ON FOREIGN PAYMENTS, ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK; WILLIAM F. KENNEDY, COCHAIRPERSON, AND ORVILLE H. SCHELL, AD HOC INTER-PROFESSIONAL STUDY GROUP ON CORPORATE CONDUCT

Mr. VON MEHREN. Thank you, Mr. Chairman. My name is Robert B. von Mehren. I am a member of the Bar of the State of New York and a partner in the New York law firm of Debevoise, Plimpton, Lyons and Gates. I am accompanied by Mr. William F. Kennedy, Counsel for General Electric Company.

Both Mr. Kennedy and I are appearing on behalf of the ad hoc Committee on Foreign Payments of The Association of the Bar of the City of New York. I am the Chairperson of that committee, and Mr. Kennedy is the Co-Chairperson. As some of you may recall, Mr. Kennedy appeared before your subcommittee on September 22, 1976 to give testimony with respect to H.R. 15481.

I. THE AD HOC COMMITTEE ON FOREIGN PAYMENTS

At the outset, I should say something about the committee which we represent. That committee was formed in the fall of 1975 at the suggestion of Mr. Cyrus Vance, the then president of The Association of the Bar of the City of New York. It was originally composed of members drawn from three standing committees of the Associ-

ation—the Committee on Corporation Law, the Committee on Foreign and Comparative Law and the Committee on International Law. In late 1976, additional members were added from two other standing committees of the Association—the Committee on Securities Regulation and the Committee on Taxation. I might note here that one index to the complexity of the problem which is before your subcommittee is the wide spectrum of backgrounds and experience which it was felt desirable to draw together in our ad hoc committee.

The individuals composing the ad hoc committee are lawyers in private practice, lawyers employed by corporations and a member of the Law Faculty of Columbia University. As such, they brought to the deliberations of the ad hoc committee a variety of experiences and points of view. Many of them represent or have represented clients active in international trade and international investment, some of which have undoubtedly had problems in the area of questionable foreign payments. It is, however, a long-standing and well-observed rule of the Association of the Bar of the City of New York that, to use the expression of a former President Harrison Tweed—"Clients are left at the door when one enters the House of the Association." Accordingly, the formal report of the ad hoc committee, which was submitted March 14, 1977, and which we have made available to this subcommittee, represents the views and conclusions of the members of the ad hoc committee as individuals, views and conclusions which they reached within the framework of the general public interest, as they perceive it, without regard to the interest of any particular person, including clients. I should add, although it is probably unnecessary to do so, that Mr. Kennedy and I are appearing here today only in our capacity as members of the ad hoc committee.

II. THE MARCH 14, 1977 REPORT OF THE AD HOC COMMITTEE

Our report, copies of which have been made available to you and which I request be included in the records of these hearings, [see p. —.] was developed over a substantial period of time. We began our work by attempting to define the problem with which we were dealing and to consider what existing administrative and judicial regulations applied in the foreign payment area. After these questions had been considered at meetings of the ad hoc committee and in papers prepared for the ad hoc committee by its members, we began in the fall of 1976 to draft our report.

Our report, which is a unanimous report, represents an effort to place in one document (a) a description of the present state of the law with respect to the foreign payments problem, (b) an analysis of the two fundamental approaches to additional legislation—criminalization and disclosure—and (c) recommendations with respect to the most desirable course for the United States to follow. Our basic conclusion is, in the words of the report:

"We have concluded that the most desirable ultimate solution would be one based on multilateral or bilateral conventions or treaties. With respect to unilateral American actions, we have concluded that the approach of disclosure is more satisfactory than

that of making improper foreign payments illegal under new criminal legislation. After we have set forth the arguments which we believe render criminalization an unsatisfactory solution, we discuss a generic disclosure system which we conclude, in conjunction with the existing regulatory and legal deterrents, will do the job at the least cost to other national objectives." Report, pp. 1 2.

III. THE CHOICE OF AN APPROACH TO FURTHER LEGISLATION

The bill before you is H.R. 3815. It adopts a crimialization approach to the foreign payments problem. In the remaining portion of my statement, I shall explain why the ad hoc committee believes that the criminalization approach should not be adopted.

We oppose criminalization for a number of reasons:

(a) As a general principle, states have been reluctant to extend the reach of their criminal law to acts done abroad. This reluctance arises from considerations of comity and from the potential foreign relations impact of extending domestic criminal laws to acts which have their center of gravity abroad and which, therefore, in most cases concern the foreign state more than the legislating state.

(b) It is difficult to investigate and prosecute acts done abroad. The writs of our grand juries and courts do not run as to non-United States citizens outside our boundaries. Thus cooperation of foreign individuals or governments would usually be required to investigate and prosecute a crime based of acts done abroad.

(c) Extraterritorial application of criminal laws also raises serious questions of fairness and due process. The prosecution may be able to obtain cooperation from a foreign government through diplomatic channels; no such possibility is open to the defendant. Certainly the accused would not enjoy the right to have compulsory process for obtaining witnesses in his favor. Moreover, the accused is placed in a position where he might be tried and acquitted in the foreign state and then tried and convicted in the United States, perhaps because the witnesses for the defense who had been available to the defendant in the foreign trial were not available to him in the trial here.

All of these considerations militate against the choice of a criminalization approach to the foreign payments problem. I might add I think the colloquy that has taken place this morning illustrates another inherent difficulty in criminalization. That is the problem of defining what is a crime—what is moral or immoral—when you are dealing with a variety of societies and a variety of backgrounds. One of the advantages of disclosure is that it doesn't require any such neat categorizations, any such neat drawing of lines, be done as you have to do if you are trying to draft a criminal law.

In our view, therefore, criminalization should be chosen only if it can be demonstrated either, one, that there is no other practical approach, or, two, that there are significant and unique advantages in criminalization. We do not believe that either of the alternatives have be established by the proponents of criminalization.

First, there is an alternative approach—disclosure. In our report we have outlined a disclosure system; it is not the only one and

there may be ways in which it could been improved. In any event, there is no evidence that a well thought-out disclosure system will not work. The many instances of questionable payments which have been disclosed relate to past payments, not to payments made after the problem was brought into the limelight. Most corporations appear to have set about putting their houses in order; corporate codes of conduct have been developed, enforced in many instances by audit committees of outside directors. I know of no evidence that these codes are not working and that they will not largely prevent in the future the improper payments of the past. It was disclosure, primarily resulting from the efforts of the SEC, that brought about this significant improvement in corporate governance.

Second, criminalization does not offer significant and unique advantages. Indeed, the contrary is true. It has, in addition to the problems that I have mentioned earlier in this statement, on important disadvantage: it does not lend itself to an international approach to the foreign payments problem.

Our ad hoc committee is strongly of the view that the most effective and fairest solution to the problem of foreign payments is an international solution. We would urge immediate bilateral discussions with a number of important developed trading countries—for example, Italy, Japan and The Netherlands—with the objective of establishing a bilateral pattern for dealing with the payments problem. The chances for success of such international initiatives would be far better, we believe, if U.S. legislation were cast in terms of disclosure rather than criminalization.

IV. SOME COMMENTS ON H.R. 3815

The chief argument advanced by proponents of criminalization in its favor is that it is more effective than disclosures; that it is the "strong"remedy and disclosure is the "weak" remedy. The report of the ad hoc committee reached the opposite conclusion; we have very considerable doubts about the effectiveness of criminalization.

Our concern in this regard may be illustrated by reference to the bill before your subcommittee. The act which the bill would make a crime is the act of "mak[ing] use 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" foreign officials and foreign political parties or political candidates to influence them improperly or to any person "while knowing or having reason to know" that such payment will go "directly or indirectly" to foreign officials, political parties or political candidates to influence them improperly. The bill then extends its reach to officers, directors, employees, controlling persons and agents of the entity committing the criminal act when they are "knowingly and willfully" involved.

The definition of the crime in terms of the act of making use of a means or instrumentality of interstate commerce was undoubtedly the result of constitutional considerations. Secretary of the Treasury Blumenthal made this point in his testimony before the Senate subcommittee on this matter.

It has the effect, however, of making many aspects of the proposed legislation illusory and ineffective. Thus, for example, it is difficult to imagine the situation where a foreign issuer, which came within proposed section 30A because it had a class of securities registered pursuant to section 12 or fell within section 15(d), would ever use a "means or instrumentality of interstate commerce" to effect a prohibited payment. It would use the means and instrumentalities of the commerce of its own nationality and of the nationality of the payee, but not those of the United States. Take the case of a German corporation whose shares are listed on the New York Stock Exchange. If it wishes to make a prohibited payment to someone in the Near East, it is obviously not going to use the means and instrumentality of interstate commerce, but the means and instrumentalities of German commerce.

However, and I think much more fundamental, U.S. entities could, it would seem to me, largely avoid the reach of the proposed law by leaving matters of questionable payments to their foreign subsidiaries and agents. Again, such subsidiaries and agents would not make use of "interstate commerce" in making the corrupt payment, and it would necessarily follow that no crime under the proposed bill would be committed.

Two further observations on the text of the bill before you may be useful in your consideration of H.R. 3815. First, I read the definition of "foreign official" which term "does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are ministerial or clerical" to be intended to exclude from the reach of the law what have been called "grease" or "facilitating payments."

Your Chairman averted to this problem in his opening statement, and there has been considerable discussion of it in the colloquy with the preceding witness.

In connection with that discussion, I would like to make two points. First of all, I think the subcommittee should consider the effect, if the intent is to exclude the grease or facilitating payment, of the definition of foreign official because the way in which the draft bill, as I read it, seeks to exclude the grease payment is in terms of the status of the official. You can make any payment that you want to to an official whose duties are merely ministerial or clerical. However, even if you make a facilitating payment to somebody who has a different status, that comes within the reach of the bill.

Second, I would like to note that I am not sure that the gloss which the Chairman has put on section 30 A(a)(1)(A), and, of course, there is a corresponding section later on applying to domestic concerns, where he has defined influencing any act or decision of such foreign official in his official capacity as seeking to influence governmental action, I would read the language of this bill to extend to, for example, an effort to get an official to do what he is supposed to do in his official capacity, not necessarily requiring any further governmental act.

So I think that if the intent is to restrict it to influencing a governmental act, then there needs to be some changes in the drafting of the bill.

In any event, I think it is very important if this legislation is passed, which, of course, as you understand I do not believe would be in the best interest of the United States, that at least it clearly discusses this point, because I don't believe there is any consensus that grease or facilitating payments are necessarily immoral. Certainly there is no consensus abroad that they are, and it would certainly put American foreign enterprise at a substantial competitive disadvantage if they couldn't make the payment to the head of the port of XYZ to get their shipment cleared when the German or English or French competitor could.

The next observation on the bill I would like to make is that in those portions of the bill which attach criminal liability to natural persons, in the case of officers, directors, employees and controlling persons, such liability attaches to any person "who knowingly and willfully ordered, authorized, or acquiesced in the act or practice constituting", and I emphasize the word acquiesce, a violation by an issue or a domestic concern. This language is intended, it would seem to me, to make an officer, director, employee or controlling person "who knowingly and willfully . . . acquiesced" in a prohibited payment guilty as a principal along with the paying issuer or domestic concern. The precise meaning of "acquiesce" is, however, not clear. Does one "acquiesce" if he has authority to prevent a payment and, knowing that a payment may be made, fails to prevent the payment? Does one "acquiesce" if he learns that a payment is to be made and he fails to inform the President of the entity involved in an effort to stop the payment? If he fails to inform the directors? Or if he fails to inform the U.S. Attorney? Similarly, does one "acquiesce" if he becomes aware that a prohibited payment has been made and fails to inform the President, the directors or the U.S. Attorney?

18 U.S.C., Section 2, defines principals:

"(a) Whoever commits an offense against the United States or aids, abets, counsels, commands, induces or procures its commission, is punishable as a principal.

"(b) Whoever willfully causes an act to be done which if directly performed by him or another would be an offense against the United States, is punishable as a principal."

The concept of "acquiescence"as it appears in H.R. 3815 not only goes beyond the definition of "principal" contained in the Federal Criminal Code, but it also is both unclear in scope and most unusual as a concept upon which to base criminal liability. I understand that there is a real possibility that Congress may be reexamining the Federal Criminal Code in the relatively near future. Perhaps the question of whether and under what conditions one who "acquiesces" in a crime should himself be guilty of that crime should be dealt with in the context of our general criminal legislation rather than in the instant bill.

On behalf of both Mr. Kennedy and myself, I want to emphasize in conclusion that, in the view of the ad hoc committee, the best way to get the job done in the international payments area is disclosure coupled with diplomatic initiatives by the United States. We both appreciate the opportunity of appearing before you today and your courtesy in listening to us. The ad hoc committee stands

ready, at your request, to be of assistance to you and your staff in the future.

Thank you.

[Testimony resumes on p. —.]

[The Report on Questionable Foreign Payments follows:]

THE ASSOCIATION OF THE BAR OF THE CITY OF NEW YORK

REPORT ON QUESTIONABLE FOREIGN PAYMENTS BY CORPORATIONS: THE PROBLEM AND APPROACHES TO A SOLUTION

By the Ad Hoc Committee on Foreign Payments

March 14, 1977

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Preface

The Ad Hoc Committee on Foreign Payments was formed, at the suggestion of the then President of The Association of the Bar of the City of New York, in the Fall of 1975. Its initial members were drawn from three standing committees of the Association–the Committee on Corporation Law, the Committee on Foreign and Comparative Law and the Committee on International Law. In late 1976, additional members were added from two other standing committees–the Committee on Securities Regulation and the Committee on Taxation.

The Ad Hoc Committee is today submitting its unanimous report. This report has been developed through preparation of background papers and by discussion of the members of the Committee in subcommittees and meetings of the whole Committee. At the outset, it seemed doubtful that a consensus could be reached. The Committee's conclusions, however, developed in an evolutionary process. As the series of drafts which culminated in this report were prepared, differences were resolved and consensus was reached.

The problem of questionable foreign payments is very complex. One measure of that complexity is the fact that concerned departments and agencies of the executive branch of government include Commerce, Justice, State, Treasury and the Securities and Exchange Commission. The foreign payments problem cannot be solved wisely without serious and informed debate. The Ad Hoc Committee hopes that its report will be a contribution to such a debate.

March 14, 1977

Robert B. von Mehren
Chairperson

REPORT ON QUESTIONABLE FOREIGN PAYMENTS BY CORPORATIONS: THE PROBLEM AND APPROACHES TO A SOLUTION

No single issue of corporate behavior has engendered in recent times as much discussion in the United States–both in the private and public arenas–and as much administrative and legislative activity, as payments made abroad by corporations. In part, this interest derives from the important issue of integrity in public life. In part, it derives from the impact of the political and social controversies which eddy about corporate enterprise and the free enterprise system–Are multinational corporations good or bad? Should the center of gravity of corporate governance be under state or federal control? Are the concepts of private management and initiative consistent with notions of corporate ethics?

The Ad Hoc Committee on Foreign Payments was formed by The Association of the Bar of the City of New York to examine the problem and to consider approaches to a solution. Fortunately, in our view, none of the legislation introduced in the 94th Congress dealing with the subject matter of our report became law. In a calmer atmosphere and with more time for study, we hope that legislation consistent with broader national goals can be obtained.

Our report represents an effort to place in one document a description of the present state of the law with respect to the foreign payments problem, an analysis of the two fundamental approaches to additional legislation–criminalization and disclosure–and recommendations with respect to the most desirable course for the United States to follow. We address the general principles involved in the foreign payments issue and have not attempted to present a detailed statement of any legislative proposal or any draft legislation.

Although significant deterrents to and sanctions against improper foreign payments now exist and corporate management has made determined and effective efforts to eliminate such payments, we have concluded that it is in the national interest to do more. The question of what more should be done is very complex. No solution will be perfect, satisfy everyone and serve all the policy considerations which apply to this question. The attempt should be, therefore, to adopt–after study and reasoned debate–an approach which will furnish an effective solution, always recognizing that no solution will be 100 percent effective, and, at the same time, do the least injury to other perceived interests.

We have concluded* that the most desirable ultimate solution would be one based on multilateral or bilateral conventions or treaties. With respect to unilateral American actions, we have concluded that the approach of

*Our general conclusions appear in Section VI of our report at pages 43-45 *infra*.

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disclosure is more satisfactory than that of making improper foreign payments illegal under new criminal legislation. After we have set forth the arguments which we believe render criminalization an unsatisfactory solution, we discuss a generic disclosure system which we conclude, in conjunction with the existing regulatory and legal deterrents, will do the job at the least cost to other national objectives.

I. *DEFINITION OF THE PROBLEM*

No problem can be analyzed until it has been defined. The events which give rise to the problem discussed here are payments made outside the territorial limits of the United States by United States owned or controlled corporations to officials of a foreign country. The objective sought by the payment may be merely to have the payee do more rapidly or efficiently what he would and should have done without the payment; it may be to influence the payee to do something he would not and should not have done in the absence of the payment; or it may be to create a reservoir of good will to be drawn upon at a later time. The initiative for the payment may come from the payor or from the payee and the payment may, or may not, be illegal under the law of the jurisdiction where it is made.

The questionable payments which have been brought to light in the recent past have varied tremendously in type and amount.[1] Those which have been the principal focus of attention by the public, the Congress and the Securities and Exchange Commission (the "SEC") are payments made to foreign government officials to gain some important business advantage. In many instances, the payment was intended to affect a governmental procurement decision, to influence an important regulatory decision or simply to promote a generally favorable climate. The methods by which such payments have been made have also varied considerably. For example, some were made directly to a government official or his relatives, others were made indirectly through inflated commissions to sales agents or consultants and still others were disguised as political contributions. Whether most of these payments have been initiated by the company making the payment or by government officials receiving them is a question which raises subtle distinctions and does not permit easy generalizations. On the one hand, the payments disclosed to date unquestionably include clear bribes by United States firms. On the other hand, there are cases where a reluctant United States company is a victim of extortion by a foreign official in a significant position to affect an important part of that company's overseas business.

The question of corporate ethics or morality which a particular payment raises depends on many factors. At one end of the spectrum is the bribe where the initiative comes from the payor and the payment is in violation of the laws of the state in whose territory the payment was made; at the other end of the spectrum is the facilitating payment–the so-called "grease" payment–made to get done within a reasonable time that which the payor is properly entitled to have done and not made to obtain a competitive advantage. While it seems clear that the bribe raises serious moral and ethical questions, there is real doubt that many "grease" payments do; indeed, the latter type of payments may be considered normal, and not illegal, in the country of payment.* Furthermore, it is difficult to raise moral objections to political contributions which are legal and are made in accordance with the accepted customs of the state in which they are made.[2]

Even though foreign payments are made by a United States owned or controlled corporation, the connection with the United States as such may

*The SEC has described these payments as intended "to persuade low-level governmental officials to perform functions or services which they are obliged to perform as part of their governmental responsibilities, but which they may refuse or delay unless compensated." *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, May 12, 1976, at 26-27. Common examples are small gratuities paid to expedite customs clearance or overseas telephone calls, to secure required permits or to protect facilities from sabotage. The SEC has deemed such payments material "where the payments to particular persons are large in amount or the aggregate amounts are large, or where corporate management has taken steps to conceal them through false entries in corporate books and records." *Id.* at 27. Although the SEC has apparently not required disclosure in other circumstances, it does require, as a condition of participation in its so-called "voluntary disclosure program," that the board of directors adopt and implement "an appropriate policy statement" including a "declaration of cessation" of "illegal or questionable activities." *Id.* at 9-10; *see, e.g., Securities and Exchange Commission v. Gulf Oil Corporation and Claude C. Wild, Jr.*, 75 Civ. 0324 (agreed final judgment of permanent injunction filed March 11, 1975). The Senate Committee on Banking, Housing and Urban Affairs (the "Senate Banking Committee") excluded "grease" payments from the bribery prohibitions of S. 3664, which passed the Senate late in the 94th Congress, concluding that "payments made to expedite the proper performance of duties may be reprehensible, but it does not appear feasible for the United States to attempt unilaterally to eradicate all such payments." Senate Comm. on Banking, Housing and Urban Affairs, "Corrupt Overseas Payments by U.S. Business Enterprises," S. Rep. No. 94-1031, 94th Cong., 2d Sess. 7 (1976) (the "Senate Report on S. 3664"). The Foreign Payments Disclosure Act (the "Task Force Bill") proposed by the President's Task Force on Questionable Corporate Payments Abroad (the "Task Force") included rule-making authority which was intended to be exercised to exclude "grease" payments below a certain threshold amount from the reporting requirements of the Act. Section-by-Section Analysis accompanying S.3741, *reprinted at* 122 Cong. Rec. S13808-09 (daily ed. Aug. 6, 1976) (analysis of § 9(a)(1)).

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be more or less remote. It should be remembered that in every instance the questionable foreign payments are at least physically removed from the United States. If, for example, the payment is made by a controlled foreign subsidiary, which is largely independent from an operating point of view, the payment becomes more remote; if it is authorized and made by the top management of the parent corporation, it becomes less remote. In any event, all of these payments involve national interests other than and in addition to those of the United States and, in most instances, our national interests may well be secondary to those of the state in which the payment is made.

Furthermore, the interests of the United States in the foreign payments area are varied. On the federal level, they concern the free and unrestricted flow of our foreign commerce, our capacity to compete abroad and fair competition for export markets among our business enterprises. They also concern the protection of the American investor through the legislation administered by the SEC. On the state level, they concern issues of proper accounting and corporate governance and the question whether the federal presence in these areas should be increased. And on the broadest national and public level, they concern our relations with other countries and the image of our free enterprise society and private corporations both in our own eyes and in the eyes of the world.

It is not inappropriate to observe here—especially because it has been little remarked upon in the debate that has swirled about foreign payments—that all of these considerations cannot be accommodated in any single legislative solution. One set of legislative solutions to the problem addresses the means to prohibit the class of foreign payments which are, or which are perceived to be, immoral or illegal or both. A second set deals with the concealment activities used to accomplish the payments. Of course, legislation directed at the means of making payments has as a goal their prohibition. But such legislation also raises broad questions as to the appropriateness and efficacy of the internal accounting and recordkeeping processes of United States corporations and as to present governmental regulation of internal corporate affairs. Although both sets of legislative solutions will affect other issues of public significance, some of which may be more important than foreign payments, this report is principally concerned with the first set, because their objective and effect are restricted to a far greater degree to the foreign payments problem whose elements have been set forth above.*

*The second set of legislative solutions, which relate to accounting and auditing standards and practices, is addressed at pages 32-34 *infra* and in the Supplement.

II. *TWO FUNDAMENTAL APPROACHES TO A LEGISLATIVE SOLUTION*

Any legislative solution to the foreign payments problem will adopt, or perhaps combine, these approaches: (a) the proscription of certain payments as "crimes" and the imposition of criminal penalties–fines and imprisonment; and (b) the establishment of a system of disclosure on the theory that "sunshine" will prevent those payments which may be significant and morally reprehensible or illegal. Therefore, we turn first to a general analysis of these approaches. Our objective in this part of our report is not to deal with specific legislation but rather with the general concepts of "criminalization" and "disclosure."

A. *Criminalization*

It is unusual to find in the statutes of the United States laws which proscribe as criminal acts done abroad. This reluctance has at least four explanations: (1) the traditional principle that states should not extend their criminal laws to extraterritorial conduct; (2) the difficulties inherent in prosecution based on acts done abroad; (3) the burdens on a defendant which are created by imposing criminal penalties for acts done abroad and which raise significant constitutional questions of fairness and due process; and (4) deference to the principle of comity between nations, a principle which may be offended by prosecution for extraterritorial crimes.

1. *The extension of criminal laws to extraterritorial conduct*

As a general proposition, states have been reluctant to extend the reach of their criminal law to acts done abroad. In part this reluctance stems from the concepts of sovereignty and the territorial supremacy of states.[3]

Criminalization of the act of paying a bribe necessarily involves the characterization of the act of receiving it as a criminal act under United States law. If such a law had existed at the time of the alleged payments by Lockheed to Mr. Tanaka and if Lockheed or any of its officers had been prosecuted under such a statute, a conviction of Lockheed would have stigmatized Mr. Tanaka's acts whether or not he had been convicted of a violation of any law of his own country. Moreover, it would seem that some foreign citizens, and perhaps the foreign payee, would also be subject to prosecution in the United States–again irrespective of any action taken by their home government–at least on a conspiracy theory. Thus, inherent in criminalization is a reaching out by the United States to characterize acts done in a foreign country by a foreign national as "criminal." The

possible foreign relations impact of this is such that the wisdom of criminalization should be carefully considered.

Despite such important foreign relations effects, Congress clearly has jurisdiction to impose criminal sanctions on United States citizens or corporations organized under the laws of any state of the United States for engaging in proscribed conduct abroad.[4] In the bills which have been introduced in the 94th and 95th Congress with respect to foreign payments, it has been proposed that Congress exercise its legislative jurisdiction by applying criminal sanctions to United States bribers but not to the foreign recipients (see pages 29-30 *infra*). These bills also proposed that Congress exercise its jurisdiction to include within the class subject to criminal sanctions as bribers foreign companies registered under the Securities Exchange Act of 1934 (the "1934 Act") and foreign corporations owned or controlled by United States citizens. The validity under international law of these latter proposed exercises of jurisdiction would depend on the occurrence of a substantial impact on the United States as a direct result of a foreign payment.[5]

The leading case in international law on this question is the decision of the Permanent Court of International Justice in the *Case of the S.S. Lotus.*[6] There the jurisdiction of Turkey was upheld in respect of its criminal prosecution and conviction of the officer of the watch of the Lotus, a French national, in connection with the collision of the Lotus with a Turkish vessel on the open sea which resulted in the loss of the Turkish vessel and the lives of eight Turkish nationals. As noted in a report of the Committee on International Law of this Association in 1966:

> ". . . [I]t is implicit in the [*Lotus*] case that international law does impose limits on the extraterritorial assertion of jurisdiction by states–and, if jurisdiction is to be based on the fact that one of the constituent elements of the offense, and more especially its effects, have taken place within the state asserting jurisdiction, . . . such effects must be, in the language of *Lotus* 'legally and entirely inseparable' from the conduct outside the territory, 'so much so that their separation renders the offense nonexistent.' "[7]

The landmark judicial departure in the United States from the principle of strict territoriality is *United States v. Aluminum Co. of America.*[8] The *Alcoa* court held that even though no American party was involved and no act took place in the United States certain restrictive agreements "were

unlawful [under the antitrust laws], though made abroad, if they were intended to affect imports and did affect them."[9] In reaching this decision, the Second Circuit noted that:

> "[A]ny state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize."[10]

This principle has been restated in a number of subsequent criminal and civil decisions, most of which recently have related to the extraterritorial application of the 1934 Act.[11]

The Restatement (Second) of Foreign Relations Law liberally interpreted the *Lotus* and *Alcoa* decisions and formulated in Section 18 a broad statement extending the territorial principle:

> "A state has jurisdiction to prescribe a rule of law attaching legal consequences to conduct that occurs outside its territory and causes an effect within its territory, if either
>
> (a) the conduct and its effect are generally recognized as constituent elements of a crime or tort under the law of states that have reasonably developed legal systems, or
>
> (b) (i) the conduct and its effect are constituent elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principles of justice generally recognized by states that have reasonably developed legal systems."[12]

Although the jurisdiction of states to legislate has been extended beyond a strict territorial principle by the principles stated in Section 18, international law requires a state to take into account the competing jurisdictional interests of other states:

> "Where two states have jurisdiction to prescribe and enforce rules of law and the rules they may prescribe require inconsistent conduct upon the part of a person, each state is required by international law to consider in good faith, moderating the exercise of its enforcement jurisdiction, in the light of such factors as

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(a) vital national interests of each of the states,

(b) the extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person,

(c) the extent to which the required conduct is to take place in the territory of the other state,

(d) the nationality of the person, and

(e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state."[13]

Consistent with an approach that considers foreign interests, Congress has rarely used the expanded territorial jurisdiction in the area of criminal law. Where Congress has exercised this jurisdiction, the acts proscribed are usually acts committed within the United States and/or acts by United States nationals related to conduct taking place in and adversely affecting a foreign state. Title 18, Chapter 45 of the United States Code, entitled "Foreign Relations", contains a number of such provisions. Thus, it is a domestic substantive offense within the United States (a) to conspire to destroy the property of a friendly foreign country situated in such country, (b) to purchase or sell securities of or make a loan to any government in default in its obligations to the United States Government or (c) to participate in or support any military expedition against any friendly foreign government.[14] Other sections of Title 18 similarly treat comparable types of conduct adversely affecting foreign countries. For example, it is a domestic substantive offense to counterfeit foreign currency within the United States.[15]

2. *Difficulties of enforcement*

Whatever may be the scope of Congress' legislative jurisdiction, it is clear that our judicial writ does not run as to non-United States citizens outside our boundaries. Thus, both investigation and prosecution of foreign payments would depend, in many instances to a large extent and in some cases entirely, upon the voluntary cooperation of foreign individuals or governments. Whether this cooperation would be forthcoming is problematic.

Two government officials, whose positions led them to comment on the criminalization proposals submitted to the 94th Congress, have concluded that such legislation, if enacted, is likely to be extremely

difficult to enforce. In a letter to Senator Proxmire, former Secretary of Commerce Elliot Richardson stated this view on behalf of the Task Force:

> "The Task Force has 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 would typically depend upon witnesses and information beyond the reach of the 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 has concluded that unless reasonably enforceable criminal sanctions were devised, the criminal approach would represent poor public policy."[16]

A similar assessment of the enforceability of a statute criminalizing foreign bribery was expressed by the Assistant Counsel of the Senate Banking Committee in response to the comment that "the bill [S. 3133] presents insurmountable problems of administration and enforcement."[17] In the portion of his memorandum contained in the Senate Report on S. 3664, the Assistant Counsel stated:

> "First, 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."[18]

The last sentence of the excerpt from Secretary Richardson's letter to Senator Proxmire reflects the sound principle that laws which cannot be enforced "represent poor public policy" because, after the failure in enforcement becomes evident, the credibility of the government enacting them is diminished. While a statute criminalizing foreign payments may continue to deter some United States citizens even after the failure to enforce it becomes evident, it is unlikely to be accepted by any foreign official as a serious justification for the failure to make such a payment.

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3. *Questions of fairness and due process*

As noted above, legislation expressly proscribing conduct affecting foreign states has usually been limited to acts within the United States. One explanation for this restraint is recognition, from policy considerations rather than constitutional mandate, of two fundamental United States legal principles relating to the rights of defendants–the right to compulsory process to obtain witnesses and the right not to be subject to double jeopardy.

The Sixth Amendment provides that "the accused shall enjoy the right . . . to have compulsory process for obtaining witnesses in his favor . . . ." The Supreme Court stated in *Washington v. Texas* that the accused's right to have compulsory process for obtaining witnesses in his favor "stands on no lesser footing than the other Sixth Amendment rights . . . previously held applicable to the States . . ." and, as such, "is so fundamental and essential to a fair trial that it is incorporated in the Due Process Clause of the Fourteenth Amendment."[19] This decision, however, does not affect several prior decisions holding that the Sixth Amendment can give the right to compulsory process only where it is within the power of the federal government to supply it.[20]

The position of the defendant before a United States court indicted for the crime of making a foreign payment would indeed be difficult. The existence of a foreign recipient of a payment is an essential element of the crime and the operative acts would almost inevitably have occurred on foreign soil. Whether or not the prosecution could obtain necessary evidence, the defendant would in most cases be without the benefit of compulsory process with respect to foreign witnesses. To hypothesize an extreme situation, it would be possible for an individual who has been prosecuted in the country where the bribe occurred and acquitted through testimony of foreign witnesses given under compulsory process available in the foreign country to be prosecuted under laws of the United States without means to compel the testimony of the very witnesses who had influenced the acquittal in the foreign trial. In short, the unique thrust of criminalization leads us to expect from its implementation severe strains upon the spirit of the portion of the Sixth Amendment in question.

The criminalization of foreign acts of bribery is also inconsistent with the spirit of the double jeopardy principle set forth in the Fifth Amendment–"nor shall any person be subject for the same offense to be twice put in jeopardy of life or limb . . . ."[21] This principle is summarized in the dissenting opinion by Justice Black in *Bartkus v. Illinois* as follows:

"Fear and abhorrence of governmental power to try people twice for the same conduct is one of the oldest ideas found in western civilization. Its roots run deep into Greek and Roman times. Even in the Dark Ages, when so many other principles of justice were lost, the idea that one trial and one punishment were enough remained alive through the canon law and the teachings of the early Christian writers. By the thirteenth century it seems to have been firmly established in England, where it came to be considered as a 'universal maxim of the common law.' It is not surprising, therefore, that the principle was brought to this country by the earliest settlers as part of their heritage of freedom, and that it has been recognized here as fundamental again and again. Today it is found, in varying forms, not only in the Federal Constitution, but in the jurisprudence or constitutions of every State, as well as most foreign nations.... While some writers have explained the opposition to double prosecutions by emphasizing the injustice inherent in two punishments for the same act, and others have stressed the dangers to the innocent from allowing the full power of the state to be brought against them in two trials, the basic and recurring theme has always simply been that it is wrong for a man to 'be brought into Danger for the same Offense more than once.' Few principles have been more deeply 'rooted in the traditions and conscience of our people.' "[22]

In *Bartkus* the Supreme Court approved, by a five to four decision, successive state and federal prosecutions for the same offense.[23] Despite this doctrine that the Constitutional right against double jeopardy applies only to successive prosecutions by a single sovereign, it is recognized, as reflected in Justice Black's dissent and other judicial decisions, that a second prosecution by a different sovereign violates the spirit of the double jeopardy provision,[24] and is usually at least taken into consideration by both sovereigns.

After a successful United States prosecution, a foreign prosecutor may nevertheless feel compelled to prosecute in his country to compensate for any loss of national face due to the prior United States prosecution or simply to establish his official diligence. These same considerations might also lead to a second prosecution by the foreign prosecutor in the event of an acquittal in the United States proceeding, particularly since the interest of the territory of the proscribed acts is often greater than the interest of the United States in such acts.

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Constitutional notions of fairness also embody a concept of territoriality. Under traditional common law principles a person accused of criminal acts should be tried by a jury in the locale in which the alleged acts took place. Justice Story expressed this so-called territorial principle in national terms as follows:

> "The common law considers crimes as altogether local, and cognizable and punishable exclusively in the country where they are committed."[25]

This territorial principle is directly reflected in our federal Constitution. Article 3, Section 2 of the Constitution provides that jury trials "shall be held in the State where the said Crimes shall have been committed; but when not committed within any State, the Trial shall be at such Place or Places as the Congress may by law have directed." The Sixth Amendment similarly provides for trials "by an impartial jury of the State and district wherein the crime shall have been committed, which district shall have been previously ascertained by law. . . ."

While the Constitution would not require conformity with the territorial principle in the event of a prosecution for a foreign payment, it does appear to express a preference for locating a jury trial in the place where the alleged crime was committed. This preference is consistent with the considerations of efficiency and enforceability, discussed at pages 8-9 *supra*, and with the considerations of fairness reflected in the discussions above of the traditional rights of an accused to obtain witnesses and not to be subject to a second prosecution for the same offense.

4. *Comity between nations*

"Comity" has been defined as "the body of rules which states observe toward one another from courtesy or mutual convenience, although they do not form part of international law."[26] Such rules reflect "the recognition which one nation allows within its territory to the legislative, executive, or judicial acts of another nation, having due regard both to international duty and convenience and to the rights of its own citizens or of other persons who are under the protection of its laws."[27] Enactment of criminalization legislation goes beyond the traditional application of the principles of comity to and by the United States.

The assertion of jurisdiction by the United States over behavior properly subject to the jurisdiction of a foreign country is unprecedented

in the absence of significant policy concerns which outweigh the interests of any affected foreign state in such behavior. Such an assertion of jurisdiction by the United States over conduct in a foreign country of necessity demeans the enforcement responsibility of the foreign state for such conduct, discredits the applicable foreign law[28] and deprives the foreign states of the often critical determination as to whether, in the light of relevant legal and political considerations, to initiate prosecution for a particular offense.

To the extent that any United States criminal law permits prosecution of foreign companies in the United States for bribery in their own or a third country, special resentment can be expected of countries considering themselves entitled to priority of regulation as the locus of the conduct in question or as the jurisdiction of incorporation of the foreign company, or both.

The hostile reaction of foreign states which may be expected to occur derives from the principle of territorial limitation on the jurisdiction of states with respect to foreigners, discussed at pages 5-8 *supra*, and is illustrated, in the case of individual citizens, by our national indignation in the so-called Cutting controversy. A United States citizen, A. K. Cutting, was arrested and imprisoned in Mexico for his publication in Texas of an allegedly libelous statement against a Mexican citizen. President Cleveland reflected this indignation in his sharp comments on Mexico's actions in his Annual Message delivered on December 6, 1886:

> "... [T]he right is denied of any foreign sovereign to punish a citizen of the United States for an offense consummated on our soil in violation of our laws, even though the offense be against a subject or citizen of such sovereign."[29]

The type of conflict which may arise in the case of foreign subsidiaries owned or controlled by U.S. parents can be seen by considering the *Fruehauf* case, which involved an effort by the United States to enforce the Trading with the Enemy Act against business activities of Fruehauf-France S.A.[30] Two-thirds of the stock of the French Company was owned by an American company, Fruehauf International (U.S.A.). When the French company contracted to deliver 60 vans to the People's Republic of China, the Treasury Department ordered Fruehauf (U.S.A.) to suspend performance of the contract on the grounds that the transaction violated regulations issued under the Trading with the Enemy Act. The French minority on the Board of Directors of the French

company then instituted litigation in the French courts which ultimately resulted in the appointment of an administrator to head the French company for three months and to perform the contract. What the United States perceived to be the activities of an "American" entity because it was controlled by a U.S. parent was perceived by the French to be the activities of a "French" entity to which French, and not American, standards applied.

It should be noted that the criminalization approach to curbing international bribery is unilateral action by one nation to expand its jurisdiction to the maximum extent. This is at the opposite end of the spectrum from an appropriate international resolution of the problem which is based on respect for the primary interest of the territory where the critical acts occur and mutual assistance in the detection and proof of such acts. Accordingly, criminalization is substantively alien to an international solution and if enacted might seriously disadvantage initiatives seeking such a solution by the United States.

B. *Disclosure*

It is not necessary to cite Justice Brandeis to demonstrate that disclosure can be an effective regulatory technique. It is, of course, firmly embedded in our laws regulating securities transactions; it is also found in requirements relating to political contributions and lobbying activities. Moreover, in the SEC's pioneering in the area of foreign payments, disclosure was its primary tool. We suggest that disclosure is the most effective and practical approach to an American solution to the problem and, at the same time, does the least injury to other national interests and best keeps open the option of an international solution.

We have reached this conclusion for a number of reasons, the most important of which are these: First, it is our view that disclosure should effectively deter the types of foreign payments which create the greatest concern and which most adversely affect the interests which are involved. Second, disclosure does not raise the substantial problems created by criminalization, discussed at pages 5-14 *supra*. Third, a disclosure approach is readily adaptable to an international solution of the foreign payments problem, whether by way of broad international conventions, more restricted multilateral agreements or bilateral treaties. Finally, regulation by disclosure should be subject to more effective enforcement than regulation based upon a criminalization approach.

1. *Outline of a disclosure approach*

Since we support disclosure as the best regulatory approach for the United States to follow in search of a solution to the questionable foreign payments problem, it is appropriate to sketch in broad outline the type of disclosure which we would view as appropriate and effective.

Basic to any disclosure approach are certain choices, the most important of which seem to be these: (1) Who should be required to disclose? (2) What type of disclosure should be required? (3) What agency should administer the disclosure system?

a. *Who should disclose.* We suggest that disclosure requirements should apply to individuals who are United States citizens, to resident aliens and to legal entities organized under the laws of the United States or any state, territory, possession or commonwealth of the United States. Such persons would be required to report for themselves and also on behalf of any controlled foreign affiliate which, for these purposes, would be defined to mean a foreign legal entity in which the person required to report held, directly or indirectly, a beneficial ownership of more than 50 percent. In order, however, to avoid imposing the burdens of reporting on small enterprises which do not, for the most part, seem to have significant roles in the foreign payments problem, enterprises which do not have aggregate foreign investments of more than $30 million or annual foreign sales of more than $10 million should not be required to report.

Thus, we would require reporting by United States persons, even though they were corporations not subject to the 1934 Act, and by United States persons, even though they were corporations controlled by foreigners. Reporting would not be required, however, by foreign corporations which are not controlled foreign affiliates, even though such foreign corporations are subject to the 1934 Act, or by foreign corporations which are not controlled foreign affiliates, even though such corporations have a principal place of business in the United States.

b. *The type of disclosure.* There are strong arguments in favor of a generic disclosure requirement of payments known to be directed to foreign officials. This type of reporting has been used successfully in the many reports required under the SEC's voluntary compliance program (see pages 20-22 *infra*) and has shown that companies, however unwillingly, can live with such disclosure without ruining commercial relationships. Moreover, this type of aggregate disclosure, which is a practical device to

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eliminate improper payments, does not require ethical line-drawing which would be both difficult and invidious. Finally, generic reporting should allow immediate public access to the reports thus avoiding many problems inherent in confidential treatment for any period of time.[31]

The most significant practical problem which we find in generic reporting is the treatment of fees and commissions paid to agents, consultants or sales representatives where it is not known whether a part thereof may be directed to foreign government officials. If all such fees and commissions, even if subject to reasonable threshold tests designed to eliminate the burden of reporting all foreign-related fees, were reported generically, the total amounts reported would be largely meaningless since, in all probability, they would include primarily payments which are proper. Another approach would be to adopt a mixed system with generic reporting of some payments and specific reporting of fees and commissions. This would, however, have serious competitive impact on American business. It might, for example, make some foreign agents and representatives unwilling to represent Americans and it would touch on matters which are legitimately viewed as confidential by business enterprise. Secondly, although this would not be intended, the public might perceive all fees and commissions reported specifically as "tainted," even though all or most such fees and commissions were proper. These impacts might be lessened by restrictions on public access to the reports. But disclosure, in our opinion, is inconsistent with secrecy; the reports which are filed must be publicly available if disclosure is to have the significant deterrent effect of which it is capable. Thirdly, because the receiving of bribes is a crime in most jurisdictions and reprehensible in all, a requirement that American companies inform on foreign bribe recipients can be analogized to an outright prohibition in that the recipients will be stigmatized. Specific disclosure would thus raise even more acutely than criminalization the foreign relations problems discussed in the prior section of this report.

Consequently, although our Committee has rejected both specific reporting as well as mixed reporting, we believe that special provisions must be made in a generic system of reporting to take care of the fee-commission problem. Accordingly, we recommend consideration of the following approach to generic reporting. The generic system should require (a) reporting with respect to all payments made directly or indirectly to foreign government officials and (b) the reporting, as a separate category of payments and subject to certain threshold tests

outlined below, of every fee and commission paid to a foreign agent, consultant or representative unless the senior management of the reporting entity had reason to conclude, after making an appropriate investigation, that no part of the fee or commission would be paid directly or indirectly to foreign government officials.

The threshold tests which we have in mind are these: First, to be reportable at all, the fee or commission would have to be paid to an agent, consultant or sales representative with respect to (a) foreign investments which directly or indirectly involve any significant (*i.e.*, non-routine) foreign governmental action or consent, (b) sales to foreign governments or foreign government entities or (c) the creation of foreign governmental good will. Second, payments of less than a very substantial amount, perhaps $100,000 in the aggregate, made with respect to one transaction or a related series of transactions, would not be reportable; however, in determining whether this threshold test had been met, payments made to different entities would be aggregated if they were made with respect to one transaction or a related series of transactions by or at the direction of the reporting party or any of its affiliates. We suggest a substantial threshold amount because large fees or commissions, in view of the type of transactions which result in improper payments, are usually required to support such payments and because the burden of investigation may be considerable. By limiting the area to be investigated, the threshold will encourage companies to take such action as may be necessary in order not to report large fees or commissions. If there were no threshold, the practical problems of investigation could lead companies to adopt the practice of reporting all fees and commissions in the aggregate, which will be largely meaningless.

If this approach were adopted, the report should show with respect to all payments made directly or indirectly to foreign government officials or to foreign political parties: (i) the number of such payments made during the reporting period, (ii) a general description of the purpose for which they were made, (iii) a general description of the recipients without necessarily identifying their location and (iv) the total amount of such payments. With respect to all reportable payments made to agents, consultants or sales representatives, the report should separately state the same information. If a fee or commission were paid directly or indirectly to a foreign government official, it would be reportable as such and not as a payment made to an agent, consultant or sales representative.

c. *Legislative and administrative considerations.* Any generic reporting system such as we are proposing should be enacted as new legislation and

should apply only prospectively. Although it is not the primary purpose of our report to suggest all the details of legislation, some general comments are required. One significant question in such legislation is the identity of the agency to administer the system. We suggest that the agency be either the Department of State or the Department of Commerce. This recommendation—that the Department of State or Commerce, rather than the SEC, be the agency to which the reports are made—does not reflect any lack of confidence in the SEC. We believe that the efforts of the SEC will be most effective if they continue to be focused on the protection of the investor and delimited by the traditional concept of materiality.*

The reports should be available to the public as soon as they are filed and the designated receiving agency should immediately supply copies to other interested parts of the government such as the Departments of Commerce, State and Justice and the Internal Revenue Service (the "IRS"). In addition, reports filed by companies subject to the reporting requirements of the 1934 Act should be supplied to the SEC. At the request of a foreign government, the information contained in the reports could be directly transmitted by the Department of State. The receiving agency should also have the power to prescribe reporting forms. Any legislation should in addition establish the legal obligation to maintain the records needed to fulfill the reporting requirement. Finally, it should be a crime wilfully or knowlingly to fail to keep the required records or to falsify them (see page 33 *infra*).

2. *Criticisms of disclosure*

In supporting a disclosure approach to legislation in this area, account must be taken of at least two criticisms of disclosure. One criticism relating to enforcement problems is found in the Senate Report on S. 3664. That report made the point that:

*The SEC has recently proposed rules which would require issuers subject to the reporting requirements of the 1934 Act to include in proxy material supplied to investors information concerning the involvement of management in any foreign political contributions and any payments to foreign government officials "for purposes other than the satisfaction of lawful obligations." Exchange Act Release No. 13185 (Jan. 19, 1977), at 23-27, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,382-83. The SEC deems such information "highly significant to shareholders in determining whether to give a proxy." Release No. 13185, at 25; ¶ 80,896, at 87,383. Further, the SEC has invited comment on whether corporate policies regarding questionable payments and transactions should be included in proxy solicitations. Release No. 13185, at 27; ¶ 80,896, at 87,383-84.

> "... [T]he same evidence necessary to prove a violation of a direct prohibition would have to be marshalled in order to enforce a disclosure statute.... Accordingly the Committee concluded that a disclosure approach has at least the same enforcement problems inherent in the direct prohibition approach and none of its advantages."[32]

The Senate Banking Committee elaborated on this point by saying that a disclosure bill would "imply that bribery can be condoned as long as it is disclosed."[33] The other criticism is that disclosure is an inappropriate solution because it is too "lenient."

We cannot agree with either criticism. The evidence necessary to support proof of a violation of a disclosure requirement would be far less than that necessary to indict and convict for the crime of having made an improper payment. Evidence of the fact of having made payments which were not included in the report would be sufficient to establish the former. In many instances, these facts could be developed from the corporate records alone and, although there might be difficulties in extreme cases, the relevant evidence would seem to be largely within the reach of our judicial writ. Evidence to support conviction for the crime of making an illegal foreign payment–assuming that the crime was defined with sufficient specificity to escape the constitutional defect of vagueness –would be substantially greater. If S. 3664 had become law, the crime would include proof, beyond a reasonable doubt, of the "corrupt" motive of a payor, the proscribed purpose of the payment, and the receipt by the payee of the payment in exchange for the payee's undertaking, for example, to fail to perform his official functions or influence legislation. Proof beyond a reasonable doubt of these elements of the crime, particularly in this country and in those cases where the foreign government in whose territory the payment was made did not cooperate, would be very difficult in most cases and impossible in some.

As to the objection that the disclosure approach is too "lenient," we note that disclosures can result in loss of favorable public relations, prosecutions under the United States tax laws, loss of business, lawsuits for contract damages, antitrust actions, removal of officers, criminal prosecutions abroad, shareholder suits and securities laws prosecutions.[34] The important objective, in our view, is to eliminate the objectionable practices. We know of no *a priori* reason why disclosure should not be successful and of no analytical demonstration to that effect. Indeed, the

effectiveness of the SEC's disclosure programs suggest that disclosure is a most effective regulatory device in the area of questionable foreign payments.

III. *EXISTING ADMINISTRATIVE AND JUDICIAL DEVICES*

In addition to considering whether the criminalization route or the disclosure route is the more desirable, any legislative initiative must also take into account the existing devices–both those created legislatively and those created judicially–which have a bearing on the questionable foreign payments problem. These devices are discussed in the following section of our report.

A. *The Securities and Exchange Commission*

The SEC has summarized its activities as of May 1976 in the *Report of the Securities and Exchange Commission on Questionable and Illegal Payments and Practices*, submitted to the Senate Banking, Housing and Urban Affairs Committee (the "SEC Report"). The SEC has followed two lines of attack on the problem. It has used its considerable investigative powers under the Securities Act of 1933 (the "1933 Act") and the 1934 Act to force companies subject to its jurisdiction to disclose foreign payments. It has instituted suits in several cases, most of which have resulted in consent judgments which have generally called for disclosure to be made of past questionable behavior through a report prepared by independent directors and advisors and accountability standards to be enunciated to prevent recurrence of the undesirable acts.[35] As noted above (see page 18 *supra*), it has recently called for disclosure in proxy statements.

On a second front, the SEC's attack on questionable foreign payments has taken the form of a voluntary disclosure program, operating through the periodic reporting mechanism of the 1934 Act.[36] While the disclosure in an enforcement proceeding is typically extremely detailed, comprising information as to names of recipients, amounts paid and means of payment, the disclosure given on a voluntary basis is often considerably more general. This "generic" disclosure is sanctioned by the SEC Report, except in "egregious" cases.[37] Most notably, the SEC permits a filing company to omit identification of the recipients of the foreign payments.[38]

The SEC has been requested to undertake rule-making action to specify detailed standards for disclosure in the area of foreign payments. A petition filed on December 10, 1975 by the Center for Law and Social Policy on behalf of the National Council of Churches of Christ in the U.S.A. and others requests that the SEC amend Form S-1 and other related forms prescribed under the 1933 Act and Form 10-K and other forms prescribed under the 1934 Act to require disclosure of the amount, date, recipient, means and purpose of payments abroad which are illegal or "in furtherance of securing contracts or promoting corporate business" or in the nature of a political contribution. Far from acting on this petition, the SEC has denied that there can be any "litmus paper test" and has gone no further than to suggest certain categories or factors for consideration on the question of materiality.[39] The absence of explicit standards of materiality led to charges from the staff of the House Subcommittee on Oversight and Investigations that the SEC had applied its powers in the voluntary program in a spotty and unequal way.[40] The answer of the SEC was that cases of foreign payments are "highly fact-specific" and "matters on which reasonable men can and do differ."[41] Noting that the Subcommittee staff reached the conclusion that in the cases cited in its report the SEC had been too lenient, the response went on to say, "[T]he Commission is . . . the established body possessing the authority to make such judgments under the federal securities laws. . . ."[42]

As evidenced by this exchange, the SEC's attitude has been that of the keeper of the mysteries in this area, the sole judge of the corporate morality of foreign payments. This attitude has been criticized as being contrary to the SEC's charter and inconsistent with the constitutional framework within which administrative agencies should work.[43] Others have suggested that in administering the enforcement and voluntary program the SEC has responded less to investors' legitimate interest in significant information than to its own desire to control corporate conduct.[44]

The question for some is not whether the SEC is abusing its discretion in administering the payments program, but whether it properly has discretion in this area at all. Recent analyses appearing in the Harvard Law Review and the Michigan Law Review concluded that the SEC's authority stops far short of the range claimed in the SEC Report.[45] It is suggested that under traditional theories of financial materiality disclosure of foreign payments is called for only where management is aware of the payments and the payments entail significant possibilities of legal penalties or

expropriations.[46] The more recently developed concepts of "ethical materiality" have not been fully espoused by the courts or the SEC in the contexts in which they have been raised, primarily the environmental and equal employment areas. These concepts have often arisen in the context of special corporate duties under United States laws, such as the National Environmental Policy Act of 1970,[47] and seem to be without any feasible limitation if applied broadly to all social, political and moral issues.[48] The doubt which does not go away is whether it is good policy to add the deterrence of immoral conduct to the existing goals of the securities laws which have been in place for four decades.[49]

B. *The Internal Revenue Service*

The IRS functions under an existing Congressional mandate which penalizes bribes and kickbacks by denying such payments any status as tax deductions or deferral items. While the basic provision, Section 162(c)(1) of the Internal Revenue Code (the "Code"), has been in place since 1958, Congress amended the Code in the Tax Reform Act of 1976 to widen the penalties.[50] Section 162(c)(1) provides that no deduction shall be allowed for any bribe, kickback or other payment made directly or indirectly to a foreign government official or agent which would be illegal if made in the United States. Since foreign operations are frequently not accounted for in the consolidated tax return, the new legislation provides that the amounts of such payments shall constitute "subpart F income" taxable without deferral to the United States parent company.[51] Moreover, under the new legislation these amounts are not to be used to decrease the earnings and profits accounts of foreign corporations otherwise reporting subpart F income.[52] Congress also amended the Code to provide that such amounts will not qualify for the Domestic International Sales Corporation ("DISC") deferral, but will be construed as an immediate dividend to the taxpaying parent of a DISC.[53]

The IRS has been vigorously carrying out a "slush fund" investigation, devoting considerable effort to uncover by audit procedures diversions of corporate funds domestically and abroad.[54] Notably, the IRS has submitted to all major United States corporations a questionnaire composed of eleven questions calling for disclosure of specific practices, which, if engaged in, might indicate that payments have been made which should be accounted for as provided in Section 162(c)(1) or the new legislative provisions.

The argument has been made by some that the tax provisions are not a formidable deterrent because a company can pay a foreign bribe, and then avoid the tax sanctions by simply failing to take a deduction on its tax return for the amount of the bribe. However, it seems unlikely that many substantial companies would, in the face of recent developments, regard this as a prudent approach. For example, the IRS requires that a corporate taxpayer reconcile in a Schedule M its income as publicly reported* and its income as reported for tax purposes.[55] This Schedule M reconciliation in effect requires admitting on the record to the IRS a course of conduct which may subject the taxpayer to liabilities, civil or criminal or both, under other federal laws, under state laws and under foreign law. The alternative of filing a false tax return and inviting the extensive criminal and civil sanctions for tax fraud is, if anything, more unpalatable.

A more serious criticism of the current IRS program is the potentiality for abuse of administrative discretion. The obstacles to evenhanded administration are formidable, since the time and effort needed for a full audit are considerable. Companies which are forced to go through this effort may confront an investigation which, in order to be effective in this area, goes beyond the normal audit standards.[56] The investigation is all the more intimidating because with it runs the risk of a determination of fraud. Such a determination could entail a penalty equal to one half the company's total tax deficiency,[57] a deficiency which could be comprised of a majority of items as to which the company and the IRS differ on traditional grounds of Code interpretation and only a trifling amount of improperly reported foreign bribes.

C. *Antitrust Regulations*

It would seem reasonably clear that bribery can constitute a practice in restraint of trade in violation of Section 1 of the Sherman Act.[58] Since Section 1 contemplates two-party or multi-party conduct, it requires for its application a finding of a contract, combination or conspiracy. However, the courts have given this requirement a very expansive reading in cases like *Albrecht v. The Herald Company*[59] and *Poller v. Columbia Broadcasting System, Inc.*[60] and it seems likely that, if those cases are followed, the recipient of the bribe, or an intermediary who passes on the

*Manipulating corporate records to distort publicly reported income could open up the possibility of other legal sanctions (see pages 32-34 *infra*).

bribe, could be found to be a co-conspirator with the corporate payor. Where a United States parent and a foreign subsidiary collaborate in the illegal payment, the courts may also be ready to apply the often-attacked but never overruled doctrine of intra-enterprise conspiracy.[61]

The courts have on occasion stretched the statutory framework of the Sherman Act to reach one-party conduct amounting to an unfair method of competition, not only by giving an expansive reading to the contract, combination or conspiracy language of Section 1, but also to the attempt to monopolize language of Section 2.[62] Section 2, forbidding attempts to monopolize, is directed to unilateral conduct, but it is likely to apply only in those unusual cases where there is a finding that the briber has sufficient power in a defined market to permit the inference that there is a reasonable probability it will be successful in excluding its competitors from that market.[63] Mere pre-emption of particular sales opportunities through improper means would not seem in the typical case to amount to a Section 2 offense.

Section 2(c) of the Clayton Act makes it unlawful for a seller to make payments in connection with sales transactions except for services rendered.[64] It has been held in lower court cases to apply to foreign commerce, specifically to export sales[65] and to bribery.[66]

Finally, Section 5 of the Federal Trade Commission Act forbids unfair methods of competition and unfair practices.[67] The Federal Trade Commission (the "FTC") has taken the position that this prohibition is applicable to foreign bribery.[68] It would seem likely that commercial bribery which disadvantaged United States exporters or investors in competition with the payor would be characterized as "unfair" within the meaning of Section 5.[69]

Violators of the antitrust laws are subject to an array of sanctions. For violations of Sections 1 and 2 of the Sherman Act, sanctions include criminal prosecution, governmental suits for injunctive relief and private suits for triple damages.[70] Although Section 2(c) of the Clayton Act does not trigger criminal sanctions, aggrieved persons can seek triple damages.[71] There is also the possibility of injunctive relief in a private suit or in a suit by the Department of Justice,[72] as well as of an FTC proceeding for a cease and desist order.[73]

The application of the United States antitrust laws to conduct which takes place outside the territorial limits of the United States can in particular situations raise delicate and complex questions of United States foreign relations law, not present in a purely domestic context. One has to

begin with the holding of the *Alcoa* case that conduct outside the United States undertaken with the purpose and effect of restraining United States foreign commerce is within the reach of our courts under the Sherman Act.[74]

However, a rigorous reading of the Sherman Act would limit the principle of *Alcoa* to cases where there is either a restraint on import competition in the United States adversely affecting United States consumers or a restraint on export opportunities of United States based companies.[75] Where this notion may leave foreign buyers, private or governmental, of United States exports is problematical.[76] In any event, the United States antitrust laws would not reach many cases of foreign bribery relating, for example, to enforcement of foreign tax or regulatory requirements.

Where foreign governmental action is involved, there may be additional issues. The Antitrust Division of the Department of Justice has very recently taken the position that private representations to a foreign government leading to action of that government restraining United States foreign commerce is within the protection of the *Noerr-Pennington* doctrine,* even though in its original formulation that doctrine turned in part on domestic constitutional considerations.[77] However, relying on dictum in *California Motor Transport Co. v. Trucking Unlimited,*[78] the Antitrust Division has noted that the *Noerr-Pennington* defense may not apply where the representations are accompanied by bribery.

In general, if the restraining action is that of a foreign government, there may be an act of state defense, and private restraining action formally directed or required by a foreign government may be subject to a defense based on compulsion by a foreign sovereign.[79] These defenses seem of questionable application in the bribery context for two reasons. First, the challenged situation will normally involve commercial (*i.e.*, procurement) activities, as distinct from sovereign activities of the foreign government. Second, bribery, no matter how prevalent as a practical matter, seems to be everywhere condemned as a matter of law and formal official policy.

*This judicially-created doctrine, which takes its name from the cases, *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.*, 365 U.S. 127 (1961) and *United Mine Workers v. Pennington*, 381 U.S. 657 (1965), holds that it is a good defense to an antitrust claim that the otherwise illegal anticompetitive conduct is restricted to influencing legislative or executive action.

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The tentative conclusion to be drawn from the foregoing is that the antitrust laws probably do apply to bribery in connection with foreign governmental procurement in those cases where export opportunities of competing United States exporters are thereby pre-empted. This represents, in the new climate, a substantial sanction but not a comprehensive or totally adequate one. For one thing, just as problems of proof would make enforcement of criminal legislation difficult (see pages 8-9 *supra*), it will be hard to prove bribery in the antitrust context. For another, it may be hard to obtain jurisdiction in United States courts, if the briber is a foreign rather than a United States company. Again, an antitrust proceeding may be cumbersome, time-consuming and expensive.[80] Where much of the documentary and testimonial evidence lies outside the jurisdiction of United States courts, and involves the conduct of foreign officials, it may be difficult to enlist the cooperation of foreign governments in obtaining such evidence. Finally, the United States antitrust laws, as noted above, will not normally apply to bribery of tax or regulatory authorities, since any restraining impact on United States commerce will usually be minimal.

D. *Suits by Shareholders*

Because widespread disclosure of questionable corporate payments abroad is so recent a phenomenon, there is not yet a body of decisional law by which one can judge the efficacy of shareholder suits in identifying and remedying genuine injuries to the corporations involved. However, a sampling of shareholder complaints filed with respect to domestic political contributions, as well as overseas payments, suggests that shareholders and corporations have remedies within the framework of the traditional derivative and class action suits and the theories of liability on which such suits are predicated.

Under the federal securities laws, derivative and private actions have been brought under Sections 10(b), 13(a) and 14(a) of the 1934 Act and Rules 10b-5, 13a-1 and 14a-9 promulgated respectively thereunder.[81] Under Section 10(b) the theory of the claim is that individual officers and directors intentionally concealed illegal payments made by the corporation and that the non-disclosure operated as a "manipulative or deceptive scheme, device or contrivance" in violation of Rule 10b-5 causing damage to the corporation and to the purchaser or seller of securities on the open market.[82] Under Section 13(a), which requires issuers of securities registered pursuant to Section 12 to file information, documents and reports

required by the SEC, plaintiffs have claimed that such filings were materially misleading because illegal foreign payments were not disclosed. Since a private right of action does not exist under Section 13(a) directly, such plaintiffs must rely on Section 18(a), which gives a right of recovery to a purchaser or seller who relies on the false or misleading statement of a material fact contained in the Section 13 filings or in any other material filed pursuant to the 1934 Act.[83] Finally, plaintiffs have alleged under Section 14(a) that solicitations of proxies were materially false and misleading in not disclosing illegal payments.[84]

The full range of questions arising with respect to the above theories may only be suggested here. Derivative and private actions brought under Sections 10(b) and 18(a) of the 1934 Act face the common obstacle that a claim can only be established by a purchaser or seller of securities and not by a holder.[85] Since it is not usually the case that the corporation, on whose behalf the action is brought, effectuated purchases or sales of its securities, derivative actions face dismissal as a matter of law.[86] Both derivative and private actions also present problems of materiality, discussed at pages 21-22 *infra*,[87] and the meaning of scienter in the foreign payments context.[88] In derivative actions, plaintiffs face the additional burden of alleging and demonstrating that a demand was made on the corporation's directors to obtain enforcement of the right sought.[89] In individual or class actions, proof of damage may prove to be a significant impediment in that often the stock prices of corporate defendants have declined following disclosure but quickly rebounded.[90]

In addition to claims under the federal securities laws, shareholders have pleaded derivative causes of action on behalf of corporations under familiar common law theories of waste of corporate assets and breach of fiduciary duty, trust and loyalty. Suits brought under federal and state law, or both, have sought recovery of the questionable payments, of penalties which may have been suffered by the corporation as a result and of expenses incidental to making and later defending the payments. Plaintiffs have also sought rescission of proxy votes and management purchases of option stock, on behalf of the shareholders as a class, based on established securities law theories. Several cases, brought both derivatively and directly, have sought fundamental changes in management itself; at least one of these cases has been settled on terms which require restitution of funds paid by the corporation, removal of top officers and nomination of additional outside directors.[91]

Of course, shareholder suits protect the private interests of the corporation and its shareholders rather than the public at large. It must be

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recognized that fundamental to such actions is a showing of harm to the corporation or its shareholders, or both, which may or may not also represent harm to the broader national interest. That is not to downgrade the importance of private suits. Stockholders and the corporation have important, legitimate interests at stake in the area of foreign payments which are not fundamentally different from their interests with respect to other types of activity which management may choose to engage in or avoid. With foreign payments as with other conduct, the corporation has an interest in having loyal management, in avoiding the waste of its assets, in avoiding activities which may subject it to civil or criminal liability and in avoiding conduct which threatens its business generally. In their individual capacity, shareholders and other investors have an interest in being treated fairly by management and in receiving information material to their investment and voting decisions. Insofar as the shareholder's suit has been a successful vehicle for protecting the corporation and shareholders in the context of other types of wrongful conduct by management, it should also serve to redress injuries to the corporation resulting from improper foreign payments.

* * * * *

We conclude from our consideration of the existing administrative and judicial devices dealing with the foreign payments issue that many of the national interests of the United States are well served. The SEC has taken measures, especially with respect to disclosure, to meet its responsibility for protecting the American investor. The IRS has taken steps to obtain further information from corporations regarding the disclosure of specific practices. It has at its disposal severe penalties for those who do not, or who improperly, disclose such information, and financial penalties may be imposed on those who make improper payments. The antitrust laws, although perhaps not the most effective means of dealing with improper payments, do provide a legal framework which can protect the interest of free competition among American exporters. In addition, corporate shareholders do not seem to need greater protection than that already afforded to them in existing law and by the SEC. Moreover, the national interest in affirming the commitment of our society to proper corporate conduct has been served in a substantial measure by the strong public, intracorporate and legislative reaction against improper foreign payments. Consequently, the need for new legislative initiatives is, in our opinion,

not so imperative that extreme or hasty legislative solutions are either essential or wise.

IV. *COMMENTS ON PENDING LEGISLATIVE PROPOSALS*

In 1976 the 94th Congress received a series of legislative proposals addressed to the issue of improper foreign payments:

1. S. 3133, the original Proxmire bill, called for both disclosure and criminalization.

2. S. 3418, relating to accounting and auditing matters and recommended by the SEC in the SEC Report, was also introduced by Senator Proxmire and was supported by the Task Force.

3. S. 3664, as reported by the Senate Banking Committee, (i) dropped the disclosure feature of S. 3133 and (ii) combined the criminalization provisions of S. 3133 with the SEC recommendations on accounting and auditing embodied in S. 3418. S. 3664 was adopted by the Senate by an 86-0 vote on September 15, 1976. On September 21 and 22 the Subcommittee on Consumer Protection and Finance of the House Committee on Interstate and Foreign Commerce held hearings on H.R. 15481, the House counterpart of S. 3664, but following these hearings, the Subcommittee failed to muster a quorum to act on the bill, and S. 3664 expired with the end of the 94th Congress.[92]

4. S. 3379, introduced by Senators Church, Clark and Pearson, also contained disclosure provisions, as well as provisions relating to corporate governance and a private triple damage remedy. Portions of the Church bill were offered as floor amendments during Senate consideration of S. 3664, but these amendments were not adopted.

5. S. 3741 and H.R. 15149, counterpart bills developed by the Task Force and entitled "Foreign Payments Disclosure Act," embodied a disclosure approach, the details of which were to be spelled out in Department of Commerce regulations. These bills were not considered as such in hearings in either the Senate or House in the 94th Congress.

S. 3664 and its House counterpart, H.R. 15481, have been reintroduced in the 95th Congress as S. 305 and H.R. 1602, respectively, entitled "Foreign Corrupt Practices Act of 1977." In this discussion we shall focus on S. 305 and H.R. 1602 (collectively, the "Proxmire Bill") because these proposals seem most likely to receive intensive Congressional consideration

in this session, in view both of their sponsorship and the Senate action in September 1976. We shall not review the 1976 Church Proposals.* Similarly we shall not consider the Task Force Bill as such, but aspects of that proposal have already been considered in connection with the discussion on disclosure (see pages 14-20 *supra*).

In this portion of our report, we shall limit our examination of the Proxmire Bill essentially to its criminalization provisions. In the next section of our report and in the Supplement, we shall discuss certain of the accounting provisions embodied in this legislation.

A. *The Proxmire Bill*

Section 103 of the Proxmire Bill would add a new section 30A to the 1934 Act. Section 30A may be summarized as follows:

1. Its prohibitions apply to issuers which (a) have a class of securities registered under Section 12 of the 1934 Act or (b) are required to file reports under Section 15(d) of that Act. Section 104 of the Bill extends these prohibitions to "domestic concerns" which are not issuers, defined to mean individuals who are United States citizens, or any corporation or other organization which (i) is owned or controlled by individuals who are United States citizens, (ii) has its principal place of business in the United States or (iii) is organized under the laws of a state, territory, possession or commonwealth of the United States.

2. An issuer or a domestic concern is prohibited from making payments of money of the kind described below. Giving of anything of value is equated to payment of money. Also prohibited are offers or promises to pay or give, or authorizations to pay or give.

3. The prohibitions apply only where there is a use of the mails or an instrumentality of commerce, including foreign commerce.

4. The prohibitions apply only where the recipient or proposed recipient is (a) a foreign government official, (b) a foreign political party, a party official or a candidate for foreign political office or (c) an

*One aspect of these proposals relating to the composition of boards of directors' audit committees has been addressed in recent New York Stock Exchange action. The Exchange adopted a listing requirement that each domestic company with common stock listed on the Exchange establish by June 30, 1978 an audit committee comprised solely of outside directors. Letter of Exchange Chairman and Chief Executive Officer William M. Batten to Chief Executive Officers of Listed Companies dated January 6, 1977. *See* N.Y. Times, Jan. 7, 1977, at D-1, col. 4; *see also* New York Stock Exchange, "Recommendations and Comments on Financial Reporting to Shareholders and Related Matters" 5-7 (White Paper 1973).

intermediary if there is a reason to know that all or part of the payment or gift will be passed on to such persons.

5. Payments or gifts, actual or proposed, are prohibited only where the purpose is to induce the recipient to use his influence with a foreign government, or to fail to perform his official functions, in order (a) to assist the issuer or domestic concern to obtain or retain certain business or to direct such business to another or (b) influence legislation or governmental regulations.

6. Payments or gifts, or offers or promises or authorizations to pay or give, are prohibited only where made "corruptly."

7. Wilful violation in the case of a domestic concern would entail a fine of $10,000 and imprisonment for not more than two years. Wilful violation in the case of an issuer would be governed by the amended provisions of Section 32(a) of the 1934 Act, which provides the same fine but a maximum prison term of five years, not two.

We have already considered at pages 5-14 *supra* the basic objections to a criminalization approach. At this point, we take up some additional objections to the Proxmire Bill.

First, in effect, the Proxmire Bill assigns, on the one hand, investigative and civil enforcement responsibilities with respect to "issuers" to the SEC but, on the other hand, it assigns these responsibilities with respect to "domestic concerns" to the Department of Justice. In his September 21, 1976 testimony on H.R. 15481, SEC Chairman Hills emphatically objected to giving the SEC any enforcement responsibility:

> "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."[93]

Chairman Hills' position seems to us eminently sound. Turning the SEC into a general policeman of corporate behavior is inconsistent with, and diverts the SEC from, its basic charge of requiring corporate disclosure to protect investors and regulating securities markets (see pages 20-22 *supra*).

Second, although the Department of Justice would have criminal enforcement responsibility with respect to both "issuers" and "domestic concerns," responsibility for both initial investigation and civil enforcement would be divided between the SEC and the Department of Justice. The potential for confusion and conflict is evident.

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Third, the Proxmire Bill does not deal clearly with improper payments by controlled foreign subsidiaries of United States parents. On the other hand, it reaches foreign companies on the basis of registration under Section 12 of the 1934 Act or filing of reports under Section 15(d). The whole subject of foreign controlled companies and of foreign subsidiaries of United States parents ought to be dealt with in a more explicit and rational way. The difficulties of criminalization in this area are demonstrated by our discussion at pages 5-14 *supra.*

Fourth, we note that criminalization is inconsistent not only with disclosure proposals but with the SEC disclosure program. It is, of course, a commonplace that a corporation has no privilege against self-incrimination and that a corporate officer or employee cannot claim the privilege with respect to corporate records.[94] Nevertheless, the practical incompatibility of criminalization and disclosure is plain.

Fifth, above all, we question the fairness and effectiveness of criminalization as a deterrent. In addition to the underlying philosophical and jurisprudential reasons which argue against adoption of the criminalization approach (see pages 5-14 *supra*), the difficulty of enforcement substantially limits the effectiveness of the Proxmire Bill as a deterrent. As such, we agree with former Secretary of Commerce Richardson that legislation of this type represents "poor public policy."

B. *Accounting and Auditing Matters*

A notable aspect of the foreign payments problem is that illegal and questionable payments have often been accompanied by attempts at concealment which were themselves illegal or questionable. Corporate employees have attempted to conceal payments by creating off-book accounts, disguising entries, evading internal accounting and management controls and falsifying invoices and other underlying business records. These concealment activities have underscored one of the most troublesome and startling aspects of the foreign payments problem, namely, the intentional nature of the conduct and the seeming awareness of those involved that their conduct was improper.

Legislative proposals to deal with these concealment activities were introduced in the 94th Congress and have also been introduced in the 95th Congress. The SEC, in addition to its proposed proxy rules (see page 18 *supra*), has recently issued proposed accounting and auditing rules.[95] To consider the proposed legislation and rules in detail is not the principal

purpose of our report. Therefore, we are attaching hereto as a Supplement an analysis and discussion of the major legislative proposals, in the various forms in which they have been introduced, and the SEC's proposed rules.* Nevertheless, we shall briefly consider certain aspects of them.

Both the Proxmire Bill and the SEC's proposed accounting and auditing rules include provisions which would prohibit falsification of records. Legislation which imposes criminal sanctions for wilful falsification, manipulation or concealment of disclosure reports and of the underlying books, records or accounts from which they are drawn, would act as a deterrent to intentional conduct and would enhance the deterrent effect of a disclosure approach. Since this type of conduct is by its nature knowingly committed, criminal sanctions (taking into account appropriate jurisdictional limitations) would be traditional, practical and effective.

Since the majority of states have provisions rendering illegal the falsification of records,[96] there is no need for federal legislation to make such falsification unlawful, except in aid of federal disclosure legislation.[97] If broader federal legislation were enacted, we believe, as discussed more fully in the Supplement, that the specific provisions as they are presently drafted go too far in that sanctions do not appear to be limited to instances of wilful conduct but appear to include negligent and perhaps even mistaken entries.

In addition, the Proxmire Bill and the proposed SEC rules contain provisions which require each issuer to establish an "adequate" system of internal accounting controls in order to provide reasonable assurances that certain management and accounting objectives will be achieved. Other provisions seek to assure the truth and accuracy of statements made to auditors. These proposals, in our view, go beyond the remedy required to meet the problems raised by foreign payments and related concealment activities. To an even greater degree than the falsification provisions, these proposals represent a significant increase in federal regulatory jurisdiction over the internal affairs of corporations and, as such, raise broad and important issues with respect to the appropriate extent of federal corporate regulation and with respect to the appropriate relations between federal and state jurisdiction.

The legislative provisions which impose, as a matter of law, general accounting standards designed to assure the efficacy of internal corporate

*The legislative proposals discussed in the Supplement are found in S. 305, now before the 95th Congress (see pages 29-30 *supra*).

accounting controls seem to be based on a perception that the concealment activities demonstrate that these accounting controls themselves have been at fault. This view, however, ignores the evidence that existing accounting controls were in many cases deliberately and intentionally circumvented or the transactions placed outside of the corporate control system, precisely because such activities would have otherwise been exposed by existing corporate accounting practices. There is little in the Proxmire Bill or in the proposed SEC rules which would furnish any additional protection against wilful circumvention.

This view is also based on the assumption that it would be helpful to convert general guidelines, which must be applied with subjective professional judgment to specific situations, into legislative absolutes which must be applied in all situations.[98] As a matter of principle, it does not seem to us that the cause of proper corporate accounting is advanced by defining by legislative or administrative action broad standards to which internal accounting systems must conform. Moreover, the guideline-like broadness of the statutory language makes it difficult to predict what civil or criminal penalties would be imposed in any given situation.

V. *POSSIBLE INTERNATIONAL AND MULTINATIONAL MEASURES*

It is clear that the problem of questionable foreign payments is an international problem. As such, any solution attempted unilaterally through legislative action by one state is necessarily incomplete and may also be unwise. Several Senators have concurred with Senator Javits' view that the payments problem is "absolutely insoluble" unless it is resolved by international agreement.[99] Confidence must be restored in Western business as a whole, not just in United States business, if the damage caused by the bribery scandals is to be repaired. More practically, United States business cannot be taken out of the bribery syndrome so long as it remains a "way of life" for competing firms not subject to United States jurisdiction. In this regard, it should be noted that only a few countries are reported to have taken remedial action on a national level.[100]

A legislative recognition of the importance of an international approach is found in Senate Resolution 265, adopted on November 12, 1975 (the "Long-Ribicoff Resolution"), which calls upon all authorized negotiators of the United States government to urge in all "appropriate international forums" the formulation of an appropriate code of conduct and specific

treaty obligations among governments designed to eliminate the practices of "bribery, indirect payments, kickbacks, unethical political contributions and other such similar disreputable activities."[101]

The proponents of an international solution feel that it is possible to conclude an international agreement in view of the position of the United States in world trade and the indubitable rectitude of the moral justification for regulation. It is acknowledged that the negotiation of an international accord will take longer than the enactment of unilateral measures. However, speed may not be as important here as in some other areas and the desirability of some measure of equality coupled with international action of some type may outweigh speed, especially since the trauma of recent scandals has probably already had some substantial impact upon both potential payors and potential payees.

We shall discuss two broad issues concerned with any international or multinational approach on questionable foreign payments. First, the subject matter to be dealt with and, second, the negotiating forum to be used.

A. *The Subject Matter of an International or Multinational Agreement*

Discussion of the subject matter that should be included in any international or multinational agreement on questionable foreign payments divides into three categories: (1) questions relating to the scope of the agreement; (2) questions as to the requirements imposed by the agreement; and (3) questions regarding the resolution of disputes arising under, and enforcement of, the agreement. To the extent that the United States has already indicated a position as to these questions, this is mentioned in the following discussion.

1. *The scope of the agreement*

There is no reason why any international agreement should not cover both trade and investment transactions, since, as a spokesman for the United States has correctly said, "The problem of corrupt practices is both a trade and investment problem."[102]

It also seems clear that an international agreement should, as the same spokesman put it, "apply equally to those who offer or make improper payments and to those who request or accept them."[103] This position has two elements. First, the agreement should apply to recipients as well as payors. Second, the agreement should apply to extortion as well as to bribery.

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The agreement should not be limited to "multinational" or "transnational" corporations, since notorious examples of abuse have involved companies that fit neither of these categories. As a United States representative aptly summarized, "The problem of corrupt practices . . . extends beyond the activities of transnational enterprises."[104]

Furthermore, the agreement should apply not only to the activities of private corporations but should extend to governments and to state trading organizations. There may be resistance to this among those countries in which governments and state trading organizations play a large role in foreign trade and investment. But there is no reason why the scope should be restricted to private enterprise, nor would it be practicable in instances of mixed ownership. Again, we agree with the view of a spokesman of the United States that the agreement should be "applicable . . . to all enterprises . . . whether owned privately, by the state, or by a mixture of the two."[105]

2. *The requirements imposed by the agreement*

The most modest sort of international agreement would merely obligate member countries to enforce existing local laws regarding improper foreign payments, including those punishing bribery and requiring disclosure. Member countries would agree that enforcement would be nondiscriminatory as, for example, between payors and recipients and among American, other foreign and local enterprises.[106] Commitments might also be made to enact adequate local laws for the punishment of bribery and extortion. Arrangements might also be set up for international cooperation in the enforcement of these laws, including making available compulsory process to aid in prosecution or defense and exchanging data. Such a solution obviously leaves a great deal to the initiative of each member country in implementing the agreement.

A more ambitious international agreement would supply its own set of standards for dealing with improper foreign payments. These might include requirements to disclose, for example, payments to governmental officials, contributions to political parties and payments to private persons to influence official action, including substantial financial arrangements with intermediaries. Other provisions might include the actual prohibition of bribery and extortion and improper intervention in domestic political activity through making political contributions. Such an international agreement poses obvious problems of the resolution of disputes and of enforcement.

3. *Dispute resolution and enforcement*

One possibility is to make compliance with the agreement voluntary on the part of governments, businesses and others, who would be exhorted to comply with the standards prescribed by a "code" of behavior. This view is supported by some in the international community. The United States, however, has taken the position that prospective action to control improper payments should proceed on the basis of a binding international agreement implemented by national legislation.[107]

A satisfactory dispute resolution procedure would require, at the minimum, an impartial body with power to find facts and make recommendations. Ideally, such a role would be performed by an international agency, perhaps in a manner analogous to the disputes resolution procedure of the General Agreement on Tariffs and Trade. The alternative would be to entrust dispute resolution to national agencies, which would be charged with a duty to function without discrimination. Unless the decisions of such a body were left to voluntary compliance, a similar problem of whether to set up an international agency or to rely on national agencies would arise in connection with enforcement. Enforcement on the national level may be a more practical goal, but can scarcely be expected to result in uniformity. In any case, if national agencies are relied upon, there should be a commitment against discrimination.

B. *The Choice of a Forum and Negotiating Approach*

We have considered a number of forums in which the United States might seek an international agreement that would meet the goals outlined above. Each has its limitations. In some cases these limitations result from the forum's limited jurisdiction, which would prevent it from meeting some of those goals. In other cases, they result from the forum's political processes, which would make it difficult for the United States to achieve these goals or unreasonably delay their achievement. The United States is not, however, restricted to a single forum, and we believe that there are several forums that are sufficiently promising to merit serious American efforts. Their selection and the extent of the American efforts in each must turn on their potential as well as their limitations. There are six possibilities: (1) the United Nations, (2) the Organization of American States, (3) the Organization for Economic Cooperation and Development, (4) the General Agreement on Tariffs and Trade, (5) the International Chamber of Commerce and (6) bilateral negotiations.

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1. *The United Nations*

The United Nations offers the broadest jurisdiction in terms of membership and in terms of subject matter. Furthermore, it already has organs working in related areas and has initiated efforts to deal with the problem of improper foreign payments.

The General Assembly on December 15, 1975 adopted a resolution entitled "Measures against corrupt practices of transnational and other corporations, their intermediaries and others involved."[108] Governments were asked to take appropriate .action and the Economic and Social Council ("ECOSOC") was asked to direct the United Nations Commission on Transnational Corporations, formed in 1974, to include this matter in its program of work.[109] At the Commission's second session in Lima in March 1976, the United States proposed the establishment of a working group to negotiate a multinational agreement to deal with corrupt practices.[110] It was pointed out that both host and home countries had responsibilities to set out and enforce rules on these matters, that the problem was not limited to transnational corporations, that the problem involved both trade and investment, and that disclosure was a potent tool for dealing with the problem. This proposal was again put forward at the ECOSOC meeting in Geneva, and on August 4, 1976 ECOSOC adopted a draft resolution, replacing the United States proposal. The resolution established an 18-member Ad Hoc Intergovernmental Working Group on Corrupt Practices.[111] Its mandate is to conduct an examination of corrupt practices, elaborate an international agreement "to prevent and eliminate all illicit payments in connection with international commercial transactions as defined by the Working Group" and to report on the matter in 1977.[112] Because the problem is seen as extending beyond transnational corporations, the work at the United Nations Secretariat will be spread among a number of bodies, including the United Nations Commission on International Trade Law ("UNCITRAL").

In spite of the broad jurisdiction of the United Nations and the initiatives that it has already begun, there remains a question as to whether the political processes in that body will permit it to arrive at a solution that meets the goals of the United States. It is clear that the United States must make a major effort to achieve those goals through the United Nations. It is also clear that the United States must not confine its efforts to this forum.

2. *The Organization of American States*

The Organization of American States (the "OAS") is not only geographically restricted in its membership but, since the United States is its only economically developed member, it does not include those economically developed countries where improper foreign payments have caused particular concern. On July 10, 1975, the Permanent Council of the OAS, in a Resolution on the Behavior of Transnational Enterprises, condemned:

> "... in the most emphatic terms any act of bribery, illegal payment or offer of payment by any transnational enterprise; any demand for or acceptance of improper payments by any public or private person, as well as any act contrary to ethics and legal procedures. ..."[113]

The Permanent Council resolved to make a study and draft "a code of conduct which such enterprises should observe," taking account of the work on this subject being done at the United Nations.[114] It does not seem likely that the OAS will take further action in this area, nor does the OAS appear to be a particularly suitable forum for the United States efforts at the present.

3. *The Organization for Economic Cooperation and Development*

The Organization for Economic Cooperation and Development (the "OECD"), like the OAS, is restricted in its membership, although along much different lines. It is made up of those Western developed nations* where the headquarters of most multinational and other large corporations are located. The OECD has taken the only completed step on the international level to deal with the problem of improper payments.

Its Declaration of June 21, 1976 adopted Guidelines under which "multinational enterprises" ought to operate. The Guidelines cover a wide variety of areas, including general policies, disclosure of information, competition, financing, taxation, employment and industrial relations, and science and technology. Three of the general policies relate to improper payments. Under them, multinational enterprises should:

*Member states of OECD are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, The Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and United States. New Zealand and Yugoslavia have special status.

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"(7) 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;

(8) unless legally permissable, not make contributions to candidates for public office or to political parties or other political organizations;

(9) abstain from any improper involvement in local political activities."[115]

Although the Guidelines apply to both trade and investment, they place no obligations on governments, contain no disclosure requirements, and are couched in vague terms both as to their scope and the activities proscribed. A cardinal disadvantage of the Guidelines is that they are just that–guidelines recommended by member states to enterprises operating in their territories, the observance of which is "voluntary and not legally enforceable."[116]

With respect to the settlement of disputes, the Guidelines provide only that:

"(10) The use of appropriate international dispute settlement mechanisms, including arbitration, should be encouraged as a means of facilitating the resolution of problems arising between enterprises and Member countries.

(11) Member countries have agreed to establish appropriate review and consultation procedures concerning issues arising in respect of the guidelines . . . ."[117]

The voluntary nature of the Guidelines makes it unnecessary to elaborate a "precise legal definition of multinational enterprises."[118] The Guidelines are said to "reflect good practice for all," so that "multinational and domestic enterprises are subject to the same expectations in respect of their conduct wherever the Guidelines are relevant to both."[119]

Because the membership of the OECD is comprised of only Western developed countries, it has the advantage of making it easier to achieve consensus among its members. Because of "the evolutionary nature of the subject," the member countries agree that:

> "... [T]hey will review the above matters within three years with a view to improving the effectiveness of international economic cooperation among Member countries on issues relating to international investment and multinational enterprises."[120]

Considering the initiative already taken by the OECD and the productive role that the United States may be expected to play in that body, serious American efforts should be devoted to this forum in spite of the limitations imposed by its membership.

4. *The General Agreement on Tariffs and Trade*

The General Agreement on Tariffs and Trade ("GATT") has the advantage of a universality of membership second only to the United Nations among the possible forums. It has the disadvantage, however, that its activities are directed at trade rather than investment and that its negotiations in that area are particularly delicate and demanding. It has, nevertheless, been selected as an appropriate forum by the Long-Ribicoff Resolution, which was directed primarily to the Special Representative for Trade Negotiations and urged him to:

> "... initiate at once negotiations within the framework of the current multilateral trade negotiations in Geneva."[121]

GATT does have the advantage of having a procedure for the resolution of disputes. It is, however, open to question whether the fact that GATT is concerned with trade, but not with investment, impairs its suitability as a forum. Although the negotiators at the Multinational Trade Negotiations are engaged in an attempt to establish fair rules for government procurement policies, the problem of questionable foreign payments applies to government actions affecting investment as well as procurement. Furthermore, the effect of injecting these sensitive issues into the already delicate negotiations relating to international trade and the possible cost to the United States in terms of concessions in other areas argue against use of GATT for this purpose.

5. *The International Chamber of Commerce*

The International Chamber of Commerce (the "ICC") is not an inter-governmental body, nor does it have extensive representation in

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many of the economically developing areas of the world. Nevertheless, it is of interest because of its activity in the field of questionable foreign payments. On March 2, 1976 the ICC announced the formation of a Commission of Unethical Practices under Lord Shawcross of the United Kingdom. Two members of the Commission and one of the two rapporteurs are American. The Commission is:

> "... to suggest relevant guidelines for promoting correct conduct in such matters and to indicate the respective responsibilities therein of executive and non-executive directors, of officers and auditors of corporations and of the others concerned, including the relevant tax and law enforcement Agencies."[122]

On July 27, at the Geneva ECOSOC meeting, the ICC supported:

> "... the concept of an international convention, under which each signatory state would be obliged to take steps to eradicate corrupt practices, including the establishment of effective enforcement machinery. Such a convention should make disclosure of all political contributions mandatory; it should also prohibit companies from making political contributions outside their home country."[123]

It also stated that business should tackle the problem directly by self-regulation and that its Commission on Unethical Practices has decided to present an international code of good business behavior during 1977. In spite of the non-governmental nature of the ICC, the United States should encourage this effort since the advice of such a distinguished group could be of significant help in formulating solutions.

An additional noteworthy aspect of the ICC is its existing procedure for the resolution of disputes, one of which may serve as an even more useful model of an impartial tribunal than GATT because it is more focused on the commercial practices of corporations. The ICC tribunal is its council on Marketing Practice, created in 1973. It is charged with applying the ICC's code on marketing research practice, sales promotion practice and advertising practice. The Council investigates alleged unfair practices, renders written opinions and, where a dispute cannot be settled by conciliation, endeavors to dissuade the offending party from continuing the malpractice.[124]

6. *Bilateral treaties*

Both the interest in protecting the foreign sales of United States corporations against questionable foreign payments used competitively by foreign corporations and the interest in improving the international reputation of private enterprise might be approached by the United States through attempts to negotiate bilateral agreements with the principal developed nations. The governments of many of these countries—for example, Canada, Japan, The Netherlands and Italy—might be receptive, in view of recent scandals involving high government officials and important private persons in these countries, to concluding agreements with the United States which would impose the same regulatory pattern on the corporations of both signatory states.

We believe that negotiation of such agreements by the United States might be assisted through adoption of legislation establishing a disclosure system of the type which we have described in some detail at pages 14-20 *supra*. While we do not believe that bilateral agreements should attempt to reach the conduct of an American corporation within the United States, or a Japanese corporation within Japan, if the other major industrial nations were to conclude bilateral agreements with us requiring their corporations to make disclosures similar to those made by our corporations, any competitive advantage which non-United States corporations might have through the use of questionable foreign payments would be largely eliminated.

This bilateral approach should not exclude continued efforts to establish more broadly based agreements. It would seem, however, to offer a means by which meaningful international action might be taken without delays which would almost certainly be experienced before any general international treaty could be negotiated.

VI. *CONCLUSIONS*

On the basis of our study of questionable foreign payments, the Ad Hoc Committee on Foreign Payments has reached these general conclusions:

1. Many of the issues presented by such payments are international rather than national. No national legislation will as effectively and

completely regulate these payments, nor will it operate as fairly, as regulation by international agreements.

2. Any United States federal legislation should take into account the desirability of an international solution and should adopt a legislative approach which will be compatible with later multilateral or bilateral agreements.

3. The most appropriate legislative approach is the generic disclosure system which we have described at pages 14-20 of this report. This approach demonstrates the national will to deal with the problem and does so in a manner compatible with the broad national interests. It should also furnish a useful platform from which to start both multinational and bilateral negotiations leading to a broader international regulation of questionable foreign payments.

4. An approach which would criminalize the making of foreign payments would be inconsistent with the goals set forth above. Furthermore, criminalization would involve an undue extension of our criminal laws to extraterritorial conduct, would involve difficult problems of enforcement, would present serious questions of fairness and due process to a defendant and would go beyond the traditional principles of comity between nations.

5. Because the foreign payments problem relates to foreign trade and investment and to the national and international reputation of United States corporations, the legislative framework for our proposed generic disclosure approach is not limited to the 1933 and 1934 Acts or the Code, and should not be enforced by either the SEC or the IRS. This is not to detract from the recognition that federal agencies, principally the SEC and the IRS, have acted forcefully and diligently to curb abuses in the area of corporate foreign payments. Each agency, acting under the statute which it is charged to enforce, has a continuing role to play in the foreign payments area: the SEC to enforce disclosure of such payments in statutory filings and communications to investors within the boundaries of the traditional standard of materiality; and the IRS to enforce the proper tax treatment of such payments.

6. The legislation before the 94th Congress was in many respects poorly drafted and embodied some concepts which were of doubtful validity. The national interest is not well served by legislation enacted in haste; if there is to be new legislation enacted, it must be carefully drafted and soundly based.

7. The United States should continue diplomatic initiatives in the

United Nations and should, in addition, open discussions with the major industrial nations in an effort to negotiate bilateral or multilateral agreements.

March 14, 1977

Respectfully submitted,

AD HOC COMMITTEE ON FOREIGN PAYMENTS
of
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OF THE CITY OF NEW YORK

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FOOTNOTES

[1]As SEC Commissioner Hills has noted:

> "Unfortunately, the distinctions between [the] 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." Statement Before The Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce (Sept. 21, 1976), at 5.

The 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, May 12, 1976 [hereinafter cited as SEC Report], contains a detailed analysis of information concerning questionable foreign payments disclosed in public documents filed with the SEC, as well as a description of the SEC's activities in this area. *See* pp. 20-22 *infra*. Hearings in Congress in 1975 canvassed foreign payments made by prominent U.S. multinational corporations: Mobil, Gulf, Lockheed, Northrop and Exxon. "Multinational Corporations and United States Foreign Policy," Hearings on Political Contributions to Foreign Governments Before the Subcomm. on Multinat'l Corps. of the Senate Comm. on Foreign Relations, 94th Cong., 1st Sess. Part 12 (1975); "The Activities of American Multinational Corporations Abroad," Hearings Before the Subcomm. on Int'l Econ. Policy of the House Comm. on Int'l Relations, 94th Cong., 1st Sess. (1975) [hereinafter cited as 1975 House Hearings]. One of the most complete public reports detailing the payments of a U.S. multinational corporation is the Report of the Special Review Committee of the Board of Directors of Gulf Oil Corporation, submitted on December 30, 1975 pursuant to an agreed final judgment of permanent injunction entered in *SEC v. Gulf Oil Corporation and Claude C. Wild, Jr.*, 75 Civ. 0324 (D.D.C.).

A recent overview of foreign payments is *Sensitive Payments by Corporations* (1977) prepared by Charles E. Simon and Company. It analyzes, as of December 31, 1976, the disclosures of foreign payments made by companies by various classifications, such as size of payment and industry groupings.

[2]*See* McCloy, "Corporations: The Problems of Political Contributions and Other Payments at Home and Overseas," 31 The Record 306, 307 (1976).

[3]*See* Comm. on Int'l Law, Ass'n of the Bar of the City of New York, "The 1964 Amendments to the Securities Exchange Act of 1934 and the Proposed Securities and Exchange Commission Rules–International Law Aspects," 21 The Record 240, 244-49 (1966) [hereinafter cited as Int'l Law Comm. Report].

In 1886 Secretary of State Bayard summarized the principle of territorial limitation upon the jurisdiction of states with respect to foreigners:

> "There is no principle better settled than that the penal laws of a country have no extraterritorial force. Each state may, it is true, provide for the punishment of its own citizens for acts committed by them outside of its territory. . . . To say, however, that the penal laws of a country can bind foreigners and regulate their conduct, either in their own or in any other foreign country is to assert a jurisdiction over such countries and to impair their independence. . . ." *Id.* at 245, citing 2 J. Moore, A Digest of International Law 236 (1906).

[4]Two of the leading cases on this point are *Blackmer v. United States*, 284 U.S. 421 (1932), and *Steele v. Bulova Watch Co.*, 344 U.S. 280 (1952). In *Blackmer*, the Supreme Court sustained the validity of the predecessor of 28 U.S.C. § 1783 which

compels, under penalty of contempt, an American citizen residing in a foreign country to comply with a subpoena served upon him personally by the American consul. In *Steele*, the Supreme Court upheld the jurisdiction of a federal district court to grant equitable relief under the Lanham Trade-Mark Act, 60 Stat. 427 (1946), to an American corporation whose trade reputation had been damaged by an American citizen who manufactured and sold poorly constructed watches in Mexico under the corporation's trademark with knowledge that many of the watches would subsequently be resold into the United States.

Under international law a state has virtually unlimited jurisdiction to regulate the conduct of its nationals abroad. Restatement (Second) of Foreign Relations Law of the United States § 30(1) (1965). A state may exercise such jurisdiction even though in so doing it may subject a person to liability in another state. *Id.* § 39(1).

[5]Certainly the exercise of legislative jurisdiction as to foreign issuers and United States owned or controlled foreign corporations has the potential for direct encroachment on the national interests of a number of foreign countries: the foreign country of the registered company, the foreign country or countries of that company's subsidiaries and the country in which a payment by that company or any subsidiary is made.

[6][1927] P.C.I.J., Ser. A, No. 10, [1927-1928] Ann. Dig. 153 (No. 98).

[7]Int'l Law Comm. Report, *supra* note 3, at 247-48.

[8]148 F.2d 416 (2d Cir. 1945)

[9]148 F. 2d at 444.

[10]148 F.2d at 443.

[11]*United States v. Watchmakers of Switzerland Information Center, Inc.*, 1963 Trade Cas. ¶ 70,600 (S.D.N.Y. 1962), *order modified*, 1965 Trade Cas. ¶ 71,352 (S.D.N.Y. 1965); *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968), (holding that lower court had jurisdiction, but that plaintiffs failed to state a claim under Rule 10b-5), *rev'd. in part and remanded*, 405 F.2d 215 (2d Circ. 1968) (en banc) (reversing dismissal for failure to state a claim), *cert. denied*, 395 U.S. 906 (1969); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir.), *cert. denied*, 423 U.S. 1018 (1975); *IIT v. Vencap, Ltd.* 519 F.2d 1001 (2d Cir. 1975); *Securities and Exchange Commission v. Kasser*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 95,845 (3d Cir. 1977). The *Alcoa* principle has been somewhat more restrictively applied in the two most recent Second Circuit decisions, *Bersch* and *IIT*, *supra*, which interpret the extraterritorial application of the 1934 Act, particularly insofar as it relates to losses sustained by foreign plaintiffs. In such cases, conduct must occur in the United States which directly contributes to or constitutes a part of the violation. *See* 519 F.2d at 993; 519 F.2d at 1018. *See also* Note, "Extraterritorial Application of § 10(b) of the Securities Exchange Act of 1934–The Implications of *Bersch v. Drexel Firestone, Inc.* and *IIT v. Vencap, Ltd.*, 33 Wash. & Lee L. Rev. 397 (1976); Note, "American Adjudication of Transnational Securities Fraud", 89 Harv. L. Rev. 553 (1976).

[12]The Int'l Law Comm. Report, *supra* note 3, criticizes Section 18 for going beyond the territorial principle as it is recognized by international practice:

> "Section 18(b) of the Restatement goes beyond the territorial principle as it is recognized by international practice. The main criticism is that an extension of the territorial principle to cover alien activity outside the territory on the ground that it produces an 'effect' within the territory represents a departure from, even a negation of, the territorial principle. While such an assertion of jurisdiction purports to be 'territorial', in fact it is not, as nothing has been done in the territory, no act has been committed there, not even a part of the activity commenced outside the territory can be found there. To assert juris-

diction over an alien for activity that takes place wholly abroad is to claim a jurisdiction based not on territory but on a unilateral decision of the prosecuting state. Such an assertion would not be confined to the few situations in which jurisdiction is claimed under the protective principle for crimes such as counterfeiting and forgery of state seals, but to any activity that a state might deem to have a harmful effect within its territory." Int'l Law Comm. Report, *supra* note 3, at 248-49.

[13]Restatement (Second) of Foreign Relations Law of the United States § 40 (1965). This principle has been followed by United States courts. For example, the Second Circuit applied Section 40 in the context of a subpoena for documents located in Germany issued by a grand jury investigating antitrust law violations. *United States v. First National City Bank*, 396 F.2d 897 (2d Cir. 1968).

[14]18 U.S.C. § § 955, 956, 960 (1970).

[15]18 U.S.C. § 482 (1970).

[16]Letter from Secretary Richardson to Senator Proxmire (June 11, 1976), at § 4 [hereinafter cited as Richardson Letter]. The Richardson Letter contains the Secretary's comments on proposed legislation concerning questionable payments abroad.

[17]Senate Comm. on Banking, Housing and Urban Affairs, "Corrupt Overseas Payments by U.S Business Enterprises," S. Rep. No. 94-1031, 94th Cong., 2d Sess. 15 (1976) [hereinafter cited as Senate Report]. Although the Assistant Counsel was addressing himself to S. 3133, the first bill introduced by Senator Proxmire imposing criminal penalties for bribery abroad, his comments on this point are equally applicable to S. 3664, a bill incorporating criminalization and disclosure approaches and also introduced by Senator Proxmire. *See* p. 29 *infra.*

[18]*Id.* at 17.

[19]*Washington v. Texas*, 388 U.S. 14, 17-18 (1967).

[20]*United States v. Greco*, 298 F.2d 247, 251 (2d Cir.), *cert. denied*, 369 U S. 820 (1962); *United States v. Haim*, 218 F. Supp. 922, 926-27 (S.D.N.Y 1963); *United States v. Hofmann*, 24 F. Supp. 847, 848 (S.D N.Y. 1938).

[21]The principle applies to any criminal penalty. *Clawans v. Rives*, 104 F.2d 240 (D.C. Cir. 1939), 122 A.L.R. 1436 (1939).

[22]*Bartkus v. Illinois*, 359 U.S. 121, 151-55 (1959) (footnotes omitted).

[23]*Bartkus* involved a state prosecution and conviction which followed a federal prosecution and acquittal. Subsequently, a trial and conviction for a state offense, which followed a federal conviction for virtually the same offense arising out of the same set of facts, was approved. *State v. Cooper*, 54 N.J. 330 (1969), 255 A.2d 232, *cert. denied*, 396 U.S. 1021 (1970).

In an opinion in chambers rendered by Justice Douglas on an application for stay of a District Court order in *Smith v. United States*, 423 U.S. 1303 (1975), Justice Douglas questioned the continuing vitality of *Bartkus.* 423 U.S at 1307.

[24]*See, e.g., United States v. Candelaria*, 131 F. Supp. 797 (S.D. Cal. 1955).

[25]J. Story, *Conflict of Laws* 840 (8th ed. 1883).

[26]*Black's Law Dictionary* 334 (4th ed. 1968).

[27]*Hilton v. Guyot*, 159 U.S. 113, 164 (1895).

[28]See the quotation of the Secretary of State Bayard at note 3, *supra*, in which he states that the extension of penal laws to conduct by foreigners in foreign countries "is to assert a jurisdiction over such countries and to impair their independence."

[29]2 J. Moore, *A Digest of International Law* 231-32 (1906).

[30]*Societe Fruehauf v. Massady* [1968], D. S. Jr. 147; [1965] J. C. P. IV 14.274 bis (cour d'appel, Paris); *translated in* 5 Int'l Leg. Materials, Current Documents 476 (1966). For a discussion of the *Fruehauf* case, see von Mehren and Gold, "Multinational Corporations: Conflicts and Controls," 11 Stan. J. Int'l Stud. 1, 13-14 (1976).

The *Fruehauf* case and other similar cases raise the question whether, as an analytical matter, the power of a state to regulate its citizens for activities abroad can properly be extended to the regulation of corporate subsidiaries which are located and incorporated in a foreign jurisdiction, even if the American parent owns a controlling interest in the subsidiary.

[31]One problem inherent in confidential treatment is that the national government may come to be perceived as an accomplice in improper corporate behavior. The departments notified under a confidential disclosure system could initiate undercover investigations in a particularly rank case or could alert a concerned foreign government, which might or might not initiate a prosecution on its own. If a reported foreign payment were not investigated by the departments notified and if it turned out to be an improper payment, the government's lack of investigation or prosecution would make it look foolish at best or conspiratorial at worst.

[32]Senate Comm. on Banking, Housing and Urban Affairs, "Corrupt Overseas Payments by U.S. Business Enterprises," S. Rep. No. 94-1031, 94th Cong., 2d Sess. 8 (1976).

[33]*Id.*

[34]*See* Note, "Foreign Bribes and the Securities Acts' Disclosure Requirements," 74 Mich. L. Rev. 1222, 1240 (1976) [hereinafter cited as Michigan Note].

[35]*See* SEC Report, *supra* note 1; *see also, e.g., SEC v. Lockheed Aircraft Corp.*, [Current] Fed. Sec. L. Rep. (CCH) ¶ 95,509 (D.D.C. 1976) (final judgment of permanent injunction on consent).

[36]In the past 21 months approximately 360 companies have made reports to the SEC under the voluntary compliance program. N.Y. Times, March 7, 1977, at 39, col. 4.

[37]SEC Report, *supra* note 1, at 32.

[38]To date, the SEC has not publicly indicated whether under the Freedom of Information Act, 5 U.S.C. § 552 (1970 ed. Supp. V), it will release information provided to it by corporations reporting under the voluntary compliance program. It has invited any person who has given testimony or supplied "documentary evidence" to it and "who might be adversely affected through disclosure of the [SEC's] investigatory files" to write the SEC if he believes the information is exempt from disclosure under the Freedom of Information Act. Exchange Act Release No. 11260 (Feb. 21, 1975), [1974-1975 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,114, at 85,123. If the SEC decides to release information furnished to it under the voluntary disclosure program, the only recourse of the supplier of the information is to bring a so-called "reverse Freedom of Information Act suit" to enjoin the SEC from releasing the information to third parties. The statutory basis for such an action is the Freedom of Information Act's exemption from disclosure of "... commercial or financial information obtained from a person and privileged or confidential." 5 U.S.C. § 522(b)(4) (1970 ed. Supp. V). Such suits raise questions, not yet definitively resolved, as to whether the supplier of the information has an implied claim under the Freedom of Information Act or under other federal statutes and as to the degree of harm which the information supplier must demonstrate in order to obtain an order enjoining release. *Compare Westinghouse Electric Co. v. Schlesinger*, 542 F.2d 1190 (4th Cir. 1976) *with Charles River Park "A", Inc. v. Dep't of HUD*, 519 F.2d 935 (D.C. Cir. 1975).

[39]SEC Report, *supra* note 1, at 21-23.

[40]Staff of Subcomm. on Oversight and Investigation of the House Comm. on Interstate and Foreign Commerce, 94th Cong., 2d Sess., "Study of SEC Voluntary Compliance Program on Corporate Disclosure" 1-2 (1976), *reprinted in* Sec. Reg. & L. Rep. (BNA), No. 354 (May 26, 1976), at H-1.

[41]Letter from SEC Chairman Hills to Rep. Moss (May 21, 1976), *reprinted in* Sec. Reg. & L. Rep. (BNA), No. 354 (May 26, 1976), at G-1, G-2.

[42]*Id.*

[43]*See* Sommer, "A Parting Look at Foreign Payments," Speech before the Ohio Legal Center Institute–Securities Law Seminar (April 2, 1976), at 4-5; Sommer, "The Slippery Slope of Materiality," Speech before the Practicing Law Institute (Dec. 8, 1975); Sommer, "Therapeutic Disclosure," 4 Sec. Reg. L.J. 263, 265-66, 273-75 (1976).

[44]Brownlee and Queenan, "Questionable Corporate Payments: Dealing With Fluid, Uncertain Factors," N.Y.L.J., Dec. 13, 1976, at 27, col. 1 and at 42, col. 1.

[45]Michigan Note, *supra* note 34; Note, "Disclosure of Payments to Foreign Government Officials under the Securities Acts," 89 Harv. L. Rev. 1848 (1976) [hereinafter cited as Harvard Note].

[46]Harvard Note, *supra*, at 1861 (1976).

[47]42 U.S.C. § § 4321-47 (1970), *as amended*, 42 U.S.C.A. § 4332 (1976 Supp.).

[48]Harvard Note, *supra* note 45, at 1866; Sommer, "A Parting Look at Foreign Payments," Speech before the Ohio Legal Center Institute–Securities Law Seminar (April 2, 1976), at 6-9.

In the environmental area the SEC has confined its requirements to disclosure of capital expenditures for environmental compliance purposes and has not required disclosure of corporate violations of environmental laws which have not resulted in actual or imminent litigation. *See* Securities Act Release 5704 (May 6, 1976), [1975-1976 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 80,495.

[49]Michigan Note, *supra* note 34, at 1241.

[50]Tax Reform Act of 1976, Pub. L. No. 94-455, § 1065, 90 Stat. 1520, 1653, codified at I.R.C. § 952.

[51]Pub. L. No. 94-455, § 1065(a)(1)(C), adding I.R.C. § 952(a)(4).

[52]Pub. L. No. 94-455, § 1065(b), amending I.R.C. § 964(a).

[53]Pub. L. No. 94-455, § 1065(a)(2), adding I.R.C. § 995(b)(1)(iii).

[54]Special Subcomm. of the Comm. on Practice and Procedure, Tax Section, New York State Bar Ass'n, "Report on the Internal Revenue Service 'Slush Fund' Investigation" 1 (June 22, 1976); *see also* 1975 House Hearings, *supra* note 1, at 40-41, 43-44 (statement of D. Alexander, Commissioner of the IRS).

[55]Schedule M-1 to Form 1120, Treas. Reg. § 1.6012-2(a)(3).

[56]Special Subcomm. of the Comm. on Practice and Procedure, Tax Section New York State Bar Ass'n, "Report on the Internal Revenue Service 'Slush Fund' Investigation" 3 (June 22, 1976).

[57]I.R.C. § 6653(b).

[58]Sherman Act § 1, 15 U.S.C. § 1 (1970 ed. Supp. V 1975).

[59]*Albrecht v. Herald Co.*, 390 U.S. 145 (1968).

[60]*Poller v. Columbia Broadcasting System, Inc.*, 368 U.S. 464 (1962); *cf.* 1975 House Hearings, *supra* note 1, at 88 (testimony of Donald I. Baker, then Deputy Assistant Attorney General, Antitrust Division, U.S. Department of Justice); *Calnetics Corp. v. Volkswagen of America, Inc.*, 532 F.2d 674 (9th Cir. 1976), *cert. denied*, 45 U.S.L.W. 3345 (November 9, 1976) (bribery not Sherman Act violation even though is violation of § 2(c) of Clayton Act).

[61]*Perma Life Mufflers, Inc. v. International Parts Corp.*, 392 U.S. 134 (1968); *Kiefer-Stewart Co. v. Joseph E. Seagram & Sons, Inc.*, 340 U.S. 211 (1951). A case which, seemingly, will require decision on the issue is *Societe Nationale pour la Recherche, etc. v. General Tire and Rubber Company*, 76 Civ. 3014 (S.D.N.Y., complaint filed July 7, 1976).

[62]Sherman Act § 2, 15 U.S.C. § 2 (1970 ed. Supp. V 1975); Turner, "The Scope of 'Attempt to Monopolize,'" 30 The Record 487 (1975); Section of Antitrust Law, A.B.A., Antitrust Law Developments 60 *et seq.* (1975).

[63]Turner, *supra*, at 497 *et seq.*; *Walker Process Equipment, Inc. v. Food Machinery & Chemical Corp.*, 382 U.S. 172, 177-78 (1965).

[64]Clayton Act § 2(c), 15 U.S.C. § 13(c) (1970).

[65]*Canadian Ingersoll-Rand Co., Ltd. v. D. Loveman & Sons, Inc.*, 227 F. Supp. 829 (N.D. Ohio 1964); *Baysoy v. Jessop Steel Co.*, 90 F. Supp. 303 (W.D. Pa. 1950).

[66]*Rangen, Inc. v. Sterling Nelson & Sons, Inc.*, 351 F.2d 851 (9th Cir. 1965), *cert. denied*, 383 U.S. 936 (1966); *Fitch v. Kentucky-Tennessee Light & Power Co.*, 136 F.2d 12 (6th Cir. 1943); *Canadian Ingersoll-Rand Co., Ltd. v. D. Loveman & Sons, Inc., supra.*

[67]Federal Trade Commission Act § 5, 15 U.S.C. § 45(a) (1970).

[68]Antitrust and Trade Reg. Rep. (BNA), No. 762 (May 4, 1976), at A-17 (FTC investigation of foreign payments of General Tire & Rubber Company); Antitrust and Trade Reg. Rep. (BNA), No. 779 (Aug. 31, 1976), at A-11 (FTC investigation of foreign payments of Lockheed Aircraft Corporation).

[69]Commercial bribery has been held to be an unfair method of competition, because one competitor gains an advantage over others by corrupt dealings with customers and their agents. 2 H. Toulmin, *Antitrust Laws of the United States* § 44.13 (1949, G. Stengel Supp. 1976).

[70]Sherman Act § § 1 and 2 (criminal prosecution), 4 (injunctive action by Attorney General), 7 (private action), 15 U.S.C. § § 1, 2, 4, 7 (1970), respectively. Under Section 4 of the Sherman Act, 15 U.S.C. § 4 (1970), only U.S. Attorneys, at the direction of the Attorney General, may commence injunctive actions to restrain Sherman Act violations. Under Section 16 of the Clayton Act, 15 U.S.C. § 26 (1970), a private plaintiff may sue for injunctive relief against threatened damage from an antitrust violation.

[71]Clayton Act § 4, 15 U.S.C. § 15 (1970).

[72]Clayton Act § § 16 and 15, respectively, 15 U.S.C. § § 26 and 25 (1970), respectively.

[73]Federal Trade Commission Act § 5(b), 15 U.S.C. § 45(b) (1970 ed. Supp. V 1975).

[74]*United States v. Aluminum Co. of America*, 148 F.2d 416, 443-44 (2d Cir. 1945); *see generally* K. Brewster, *Antitrust and American Business Abroad* (1958); W. Fugate, *Foreign Commerce and the Antitrust Laws* (2d ed. 1973).

[75]*See* Antitrust Division, U.S Department of Justice, *Antitrust Guide for International Operations* 7 (CCH Feb. 1, 1977) [hereinafter cited as Antitrust Guide]; *cf.* Rahl, "American Antitrust and Foreign Operations: What is Covered?," 8 Cornell Int'l L.J. 1 (1974).

[76]*See Pfizer, Inc. v. Lord*, 522 F.2d 612 (8th Cir. 1975), *cert. denied*, 424 U.S. 950 (1976); *Pfizer, Inc. v. Government of India*, 1976-1 Trade Cases ¶ 60,892 (8th Cir. 1976), *adopted en banc*, Trade Reg. Rep. (CCH) (1977-1 Trade Cases) ¶ 61,175 (8th Cir. 1976), *petition for cert. filed*, 45 U.S.L.W. 3417 (Dec. 1, 1976).

[77]Antitrust Guide, *supra* note 75, at 61 *et seq.*; *Eastern Railroad Presidents Conference v. Noerr Motor Freight, Inc.* 365 U.S. 127 (1961); *see also Parmelee Transportation Co. v. Keeshin*, 292 F.2d 794 (7th Cir. 1961), *cert. denied*, 368 U.S. 944 (1961) (bribery of Interstate Commerce Commissioner); *Metro Cable Co. v. CATV of Rockford, Inc.*, 516 F.2d 220 (7th Cir. 1975) (campaign contribution).

The *Noerr-Pennington* defense is available even if the government official is a participant. *United Mine Workers v. Pennington*, 381 U.S. 657 (1965); *Sun Valley*

Disposal Co. v. Silver State Disposal Co., 420 F.2d 341 (9th Cir. 1969); *cf. Harman v. Valley National Bank of Arizona*, 339 F.2d 564 (9th Cir. 1964).

[78]*California Motor Transport Co. v. Trucking Unlimited*, 404 U.S. 508, 513 (1972).

[79]As to the act of state doctrine, see *Timberlane Lumber Co. v. Bank of America*, Trade Reg. Rep. (CCH) (1977-1 Trade Cases) ¶ 61,233 (9th Cir. Dec. 27, 1976); *Hunt v. Mobil Oil Corporation*, Trade Reg. Rep. (CCH) (1977-1 Trade Cases) ¶ 61,246 (2d Cir. Jan. 12, 1977); *Alfred Dunhill of London v. Republic of Cuba*, 425 U.S. 682 (1976); *American Banana Co. v. United Fruit Co.*, 213 U.S. 347 (1909); *cf. Continental Ore Co. v. Union Carbide and Carbon Corp.*, 370 U.S. 690 (1962). As to the doctrine of sovereign compulsion, see *Interamerican Refining Corp. v. Texaco Maracaibo, Inc.*, 307 F. Supp. 1291 (D. Del. 1970).

[80]*See generally* Wheeler, "Antitrust Treble Damage Actions: Do they work?," 61 Cal. L. Rev. 1319 (1973).

[81]15 U.S.C. §§ 78 j, m, n (1970), respectively, and 17 C.F.R. §§ 240.10b-5, 240.13a-1, 240.14a-1 (1976), respectively. The SEC Report, *supra* note 1, contains, as Exhibit B, a summary of actions commenced by the SEC as of May 1976.

[82]*See, e.g., Meer v. United Brands Company, et al., Neugarten v. Goldman, et al. and United Brands Company*, and *The Walsh Agency, Inc. v. United Brands Co., et al.*, 75 Civ. 1738 (S.D.N.Y., consolidated amended complaint filed Sept. 11, 1976); *Levin v. Atkins, et al. and Ashland Oil, Inc., et al.*, C75-0095 L(B) (W.D. Ky., filed April 4, 1975) (domestic political contribution); *Lewis v. King*, 76 Civ. 2154 S.D.N.Y.; proposed Amended and Supplemental Complaint annexed to Notice of Motion filed Nov. 18, 1976).

[83]Courts have held that Section 18(a) provides the exclusive remedy for violations of Section 13(a) and that there is no implied private right of action under Section 13(a). *In re Penn Central Securities Litigation*, 494 F.2d 528, 540 (3d Cir. 1974); *Meer v. United Brands Company, et al.*, Fed. Sec. L. Rep. (CCH) ¶ 95,648 (S.D.N.Y. 1976). Consequently, the plaintiff must be a purchaser or seller of securities.

[84]In making a Section 14(a) claim, the derivative plaintiff faces the difficulty that the improper proxy solicitation must be "an essential link in the accomplishment of the transaction" of which the plaintiff complains. *Mills v. Electric Auto Lite Co.*, 396 U.S. 375, 385 (1970). Thus, defendants argue that the election of directors or other action taken by virtue of the allegedly deficient proxy materials, was not a cause of the illegal foreign payments. Stated more strongly, the argument is that the questionable payments were not authorized or approved by use of the proxy materials. *See, e.g., Hoover v. Allen*, 241 F. Supp. 213 (S.D.N.Y. 1965); *Epic Enterprises Inc. v. Brothers*, 395 F. Supp. 773 (N.D. Okla. 1975); *Walner v. Friedman*, Fed. Sec. L. Rep. (CCH) ¶ 95,318, at 98,612 (S.D.N.Y. 1975); *Seeburg-Commonwealth United Litigation*, Fed. Sec. L. Rep. (CCH) ¶ 93,802, at 93, 448 (S.D.N.Y. 1972); *see generally J. I. Case v. Borak*, 377 U.S. 426, 431 (1964).

[85]*See Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723 (1975) (Rule 10b-5); *see also* note 83 *supra* (Section 13(a)).

[86]One not unusual instance in which the corporation is a seller of securities is when it sells shares to directors and officers exercising options granted pursuant to stock option plans. See, for example, the complaints filed in *Levin v. Atkins, et al. and Ashland Oil, Inc., et al., supra* note 82, and *Lewis v. King, id.*

[87]*See TSC Indus., Inc. v. Northway, Inc.*, 96 S.Ct. 2126 (1976).

[88]*See Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1976).

[89]A derivative plaintiff must in his complaint "allege with particularity the efforts, if any, made by [him] to obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the

reasons for his failure to obtain the action or for not making the effort." Fed. R. Civ. P. 23.1. *See In re Kauffman Mutual Fund Actions*, 479 F.2d 257, 263 (1st Cir. 1973), *cert. denied*, 414 U.S. 857 (1973); *Brody v. Chemical Bank*, 517 F.2d 932 (2d Cir. 1975). The fact that the individual defendants are alleged to have participated in the transactions complained of or that the board of directors approved the allegedly injurious actions is not sufficient to excuse a demand on directors "absent self interest or other indication of bias," 479 F.2d at 265, such as bad faith, fraud or control by the alleged wrongdoers. The decision by a board of directors not to commence litigation against officers and directors participating in illegal foreign payments has been declared to be within its good faith business judgment and precludes a shareholder's derivative action. *Gall v. Exxon Corp.*, 418 F. Supp. 508 (S.D.N.Y. 1976) (denial of defendants' motion for summary judgment because issues of fact outstanding).

[90]*See* Harvard Note, *supra* note 45, at 1855 n. 45.

[91]*See, e.g., Gilbar et al. v. Keeler et al. and Phillips Petroleum Company*, Civ. No. 75-611-EAC (C.D. Cal., complaint filed February 24, 1975) (secret Swiss bank accounts, domestic political contributions and foreign payments). The Phillips' Board of Directors accepted settlement terms which called for restructuring of the Board and nomination of six named outside directors. *Notice to Stockholders of Phillips Petroleum Company Concerning Hearing on Confirmation of Settlement*, N.Y. Times, Feb. 23, 1976, at 40.

[92]Sec. Reg. & L. Rep. (BNA), No. 371 (Sept. 29, 1976), at A-8.

[93]Statement of SEC Chairman Hills Before the Subcomm. on Consumer Protection and Finance of the House Comm. on Interstate and Foreign Commerce (Sept. 21, 1976), at 12.

[94]*Wilson v. United States*, 221 U.S. 361 (1911); *Drier v. United States*, 221 U.S. 394 (1911). The principle applies also to a variety of non-corporate collective entities. See *United States v. White*, 322 U.S. 694 (1944) (labor union); *Bellis v. United States*, 417 U.S. 85 (1974) (law firm).

[95]*See* Exchange Act Release No. 13185 (Jan. 19, 1977), [Current] Fed. Sec. L.Rep. (CCH) ¶ 80,896. The accounting provisions of the Proxmire Bill and the SEC's proposed rules are considered in detail in the Supplement to this report.

[96]Delaware's statute, which is typical, provides:

"A person is guilty of falsifying business records when, with intent to defraud, he:

(1) Makes or causes a false entry in the business records of an enterprise; or

(2) Alters, erases, obliterates, deletes, removes, or destroys a true entry in the business records of an enterprise; or

(3) Omits to make a true entry in the business records of an enterprise in violation of a duty to do so which he knows to be imposed upon him by law or by the nature of his position; or

(4) Prevents the making of a true entry or causes the omission thereof in the business records of an enterprise." 7 Del. Code Ann. tit. 11, § 871.

cf. Model Penal Code (U.L.A.) § 224.4; *see also*: Ark. Stat. Ann. § 41-2306; Cal. Corp. Code § 3018 (West); Fla. Stat. Ann. § 817.15 (West); Hawaii Penal Code § 872; Me. Rev. Stat. ann. tit. 17-A, § 707; Mass. Gen. Laws Ann. Ch. 266, § 67 (West); Mich. Comp. Laws Ann. § 450. 1932; N.J. Stat. Ann. § 2A:111-9 (West); N.Y. Penal Law § 175.05 (McKinney); Ohio Rev. Code Ann. § 2913.42 (Page); Pa. Stat. Ann. tit. 18, § 4104 (Purdon); and Wis. Stat. Ann. § 943.39 (West). In addition, the majority of the other states contain similar prohibitions although the specific provisions of the statutes vary.

[97]Section 10 of the Federal Trade Commission Act, 15 U.S.C. § 50 (1970), is an example of federal legislation which makes criminal the falsification of records or reports required to be filed under specific federal provisions or the falsification of accounts and records by persons subject to such reporting provisions. One federal district court has ruled that in proscribing the falsification of accounts, records or memoranda by persons subject to Section 10 of the Federal Trade Commission Act, *supra*, the documents covered by that statute cover only those required to be kept under the Act or by order of the Federal Trade Commission and not all documents kept by persons subject to the Act. *United States v. Cannon*, 117 F. Supp. 294 (N.D. Ill. 1953).

[98]The language of these proposed statutory prescriptions has been, in large part, borrowed from a statement of general objectives for accounting controls set forth in Statement of Auditing Standards No. 1, § 320.28 (1973). *See* Exchange Act Release No. 13185, *supra* note 95.

[99]121 Cong. Rec. S19811 (daily ed. Nov. 12, 1975) (remarks of Sen. Javits).

[100]The Canadian government recently issued new guidelines applicable to its 43 publicly-owned, or crown, corporations, which in substance, it has been reported, instruct these corporations not to engage in business practices illegal under Canadian or foreign law. N.Y. Times, Dec. 18, 1976, at 3, col. 1. Sweden is considering legislation to make the payment of bribes to private persons subject to the same provisions of the criminal law as are applicable to bribes paid to government employees. Prop. 1975/76 :176. Iran now as a matter of practice requires firms doing business with the government or with Iranian corporations to furnish an affidavit specifying payments to "brokers, agents, finders, or persons . . . in or out of Iran (except suppliers or subcontractors [under] the contractual arrangements . . .)."

It has been noted that although nearly every country in the world has legislation prohibiting bribery of its officials, "this legislation can be difficult to enforce and has not proved to be a meaningful deterrent." Statement of Mark B. Feldman, Deputy Legal Advisor, U.S. Department of State, before the U.N. ECOSOC Intergovernmental Working Group on Corrupt Practices (Nov. 15, 1976), 75 Dep't State Bull. 696, 698 (1976).

[101]S. Rep. 265, 94th Cong., 1st Sess. (1975); *see* S. Rep. No. 94-444, 94th Cong., 1st Sess. (1975).

[102]Paper submitted by the United States delegation to the Commission on Transnat'l Corps. of the United Nations Economic and Social Council, 61 U.N. ESCOR Supp. (No. 5), Commission on Transnat'l Corps. (2d Sess. Mar. 1-12, 1976), U.N. Doc. E/5782-E/c.10/16, at 37-38 (1976) [hereinafter cited as U.S. Lima Paper]; *see also* statement of Robert S. Ingersoll, Deputy Secretary of State, before the Subcomm. on Priorities and Economy in Government of the Joint Economic Comm. (Mar. 5, 1976), 74 Dep't State Bull. 412-15 (1976) [hereinafter cited as Ingersoll Statement].

[103]U.S. Lima Paper, *supra*, at 37; *see also* Ingersoll Statement, *supra*.

[104]U.S. Lima Paper, *supra*, at 37; *see also* Statement of the United States delegation before the Subcommittee of the General Committee of the Organization of American States on the Behavior of Transnational Enterprises, OAS Doc. OEA Ser. G, CP/CG-606/75, Oct. 29, 1975 [hereinafter cided as U.S. Statement at OAS].

[105]U.S. Statement at OAS, *supra*, at 2; *see also* U.S. Lima Paper, *supra*, at 37.

[106]The U.S. Statement at OAS stressed "the obligation to treat [multinational] enterprises equitably and in accordance with international law." U.S. Statement at OAS, *supra*, at 2. *See also* U.S. Lima Paper, *supra*, at 37; Ingersoll Statement, *supra* note 102, at 414.

[107]Representatives of the U.S. enunciated this view at a meeting of a U.N. commission at Lima, Peru in March 1976. U.S. Lima Paper, *supra*, at 37.

The U.S. view that multinational corporations should be subject to mandatory standards with regard to improper foreign payments may be compared to its view that generally the activities of multinational corporations should not be regulated by binding prescriptions:

> "The United States considers that any code of conduct relating to the activities of multinational enterprises should be indicative rather than mandatory and thus not seek to supersede existing law." U.S. Statement at OAS, *supra* note 104, at 2.

[108]G.A. Res. 3514 (XXX), 30 U.N. GAOR, Supp. (No. 34) 69-70, U.N. Doc. A/10034 (1976).

[109]The Economic and Social Council also prepared a study on the matter released on June 11, 1976. *See* "Measures against corrupt practices of transnational and other corporations, their intermediaries and others involved," Report of the Secretary-General on Transnational Corporations, Agenda Item 13, U.N. Doc. E/5838 (1976).

[110]U.S. Lima Paper, *supra* note 102, at 38.

[111]ECOSOC Res. 2041 ("Corrupt practices, particularly illicit payments, in international commercial transactions"), 61 U.N. ESCOR (61st Sess.) Supp. (No. 1) 17, U.N. Doc. E/5889 (1976).

[112]The Working Group held its first meeting on November 15, 1976 at which the U.S. reiterated its view "that the illicit payments problem can only be solved by collective international action based on a multinational treaty to be implemented by national legislation." Statement of Mark Feldman, *supra* note 100, 75 Dep't State Bull. 696, 698.

The U.S. spokesman noted that the U.S. had concluded bilateral agreements with 12 of the law enforcement authorities of countries for the exchange of information and had "cooperated with other governments who have established new requirements for the disclosure or regulation of agent's fees paid in connection with sales to or contracts with government agencies." *Id.*

[113]"Behavior of Transnational Enterprises Operating in the Region and Need for a Code of Conduct to Be Observed by Such Enterprises." OAS Doc. OEA Ser. G, CP/RES 154 (167/75), corr. 1, July 10, 1975, *reprinted in* E. McDowell (ed.), *Digest of United States Practice in International Law 1975*, at 602-03 (Dep't of State 1976).

[114]*Id.*

[115]Permanent Council, Organization for Economic Cooperation and Development [hereinafter "OECD"], "Declaration on International Investment and Multinational Enterprises," OECD Press Release (June 21, 1976), PRESS/A(76) 20 Annex, General Policies ¶¶ 7, 8, 9; *reprinted in* 75 Dep't State Bull. 83-87 (1976).

[116]*Id.*, Guidelines for Multinational Enterprises ¶ 6.

[117]*Id.*, Guidelines for Multinational Enterprises ¶¶ 10, 11.

[118]*Id.*, Guidelines for Multinational Enterprises ¶ 8.

[119]*Id.*, Guidelines for Multinational Enterprises ¶ 9.

[120]Permanent Council, OECD, "Declaration on International Investment and Multinational Enterprises," *supra* note 115, Annex, Part V ("Review").

[121]*See* note 101 *supra*.

[122]ICC Contract No. 120 (July 2, 1976), at 2.

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[123]Economic Committee, ECOSOC (771st Mtg., July 27, 1976), U.S. Doc. E/AC. 6/S R. 771 (1976).

[124]International Codes of Marketing Practice, ICC Pub. No. 275 (1974).

SUPPLEMENT

ACCOUNTING AND AUDITING MATTERS

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INTRODUCTION

The existence of intentional concealment activities has, understandably, produced a critical response from private and governmental sectors alike and a focus, quite apart from the question of foreign payments, on the reliability of information issued by American corporations generally. The concern is straightforward: if such corporations engage in concealment activities relating to foreign payments because such payments are illegal or embarrassing, the reliability of other important disclosures, including statements in tax returns and securities prospectuses, may be undermined.

The danger perceived is obviously significant, but the reaction has perhaps exceeded what is justified by the evidence. For example, there has been little, if any, analysis as to whether the corporations involved in concealment activities considered themselves, at least at the time of the original concealment, under a legal obligation to make public disclosure to their shareholders of the questionable foreign payments. When the Securities and Exchange Commission (the "SEC") made clear that it considered disclosure necessary, the response was in general cooperative and encouraging.[1]

Nevertheless, both the Proxmire Bill[2] and the SEC's recent proposed rules[3] have attempted to provide a statutory structure intended to assure honest reporting of corporate transactions in general. This goal is certainly worthy, but the suggested provisions are in large part vague and tainted by ambiguity in important respects. They raise substantial questions as to effectiveness, while suggesting that further significant regulation and expense will follow without, perhaps, any compensating advantages.

For purposes of our discussion here, the relevant provisions of these proposals have been divided into three groups according to the aspect of accounting operations affected: (1) internal accounting controls, (2) accuracy and falsification of internal books and records and (3) relations with independent auditors.[4]

1. *INTERNAL ACCOUNTING CONTROLS*

Section 13(b)(2)(B) of the Securities Exchange Act of 1934 (the "1934 Act"), as proposed to be amended by the Proxmire Bill, requires issuers to establish an "adequate" system of internal accounting controls to provide reasonable assurances that certain management and accounting objectives will be achieved.[5] The SEC has indicated that the proposed amendment to Section 13(b)(2)(B) was motivated by a desire to improve

the integrity and reliability of the books and records of United States issuers and to "help foster a climate" in which attempts to evade systems of corporate accounting would be frustrated by adequate internal controls.[6]

The provisions of Section 13(b)(2)(B), which are discussed in detail below, appear to be so general and vague as to be of little practical use in implementing the intended objective. At best they constitute an exhortation to management to improve accounting operations even though management already has substantial practical business incentives for improving controls.

Such provisions should not be adopted without a factual basis for concluding that a significant number of issuers have failed to adopt adequate internal accounting controls. The problem which has been brought to light with respect to questionable foreign payments is not that there were inadequate accounting controls, but that the accounting controls which existed were, in certain cases, knowingly and wilfully disregarded and circumvented. It is basic among accountants that even well designed accounting and auditing systems can be defeated by purposeful evasion. It is not clear, moreover, what useful guidance would be furnished to management and accountants by rules and regulations of general application of the sort proposed. Both management and accountants are already familiar with applicable general principles. Converting such principles into regulatory requirements will not change the fact that the appropriateness of particular internal accounting controls is a matter of judgment for expert personnel.

Perhaps more important, the proposed provisions do not reflect any focus on the essential traditional securities law requirement of a material impact on investors. To adopt legislative provisions of this type would thus afford a foundation on which the SEC could issue rules and regulations in an extended area of business regulation, a step which should be carefully tested before taken.

Finally, existing law may have more force than the proposals. If corporate assets are lost through undetected fraud or similar misbehavior because controls required by reasonable business judgment were not provided, management would be liable for waste under traditional principles of corporate law.

A. *Controlling the recording of transactions*

Proposed Sections 13(b)(2)(B)(ii) and 13(b)(2)(B)(iv) would require issuers (i) to devise an "adequate system" of internal accounting controls

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sufficient to provide reasonable assurances that transactions will be recorded as necessary to permit the preparation of financial statements in conformity with generally accepted accounting principles, (ii) to "maintain accountability for assets" and (iii) to provide reasonable assurances that "recorded accountability" for assets is "compared" with existing assets at "reasonable intervals" and "appropriate action" is taken with respect to "any" differences.

Cetain of these phrases appear to be mere jargon[7] and others require further definition if they are to be useful for any purpose. If proposed Section 13(b)(2)(B)(iv) means that assets actually recorded on the books at a given time should be verified at reasonable intervals, the implication may be that existing regulations which require reporting companies to conduct audits at least yearly are replaced and that confirmation procedures and physical inventories must be conducted more frequently, perhaps by internal accounting staffs, but there seems to be little basis for making such a procedure a statutory mandate.

B. *Controlling unauthorized transactions*

The Proxmire Bill proposes adding to the 1934 Act a Section 13(b)(2)(B)(i) requiring issuers to devise an adequate system of internal controls sufficient to provide reasonable assurances that transactions are executed only in accordance with management's authorization and a closely related (if not identical) Section 13(b)(2)(B)(iii), that "access to assets" be permitted only with such authorization. These provisions probably derive both from the SEC's concern with identifying the individuals actually responsible for authorizing questionable foreign payments and from a feeling that foreign managers, salesmen and agents often proceed without the knowledge or control of home office executives.

The provisions proposed, however, are very broad, extending to authorizations for all transactions. While careful definition of the authorization for transactions of an issuer might be a characteristic of good management, it is difficult to perceive why the SEC would wish to or should become involved in questions of corporate authorization on so broad a scale. We observe, for example, that such questions do not necessarily relate to the SEC's traditional concern with communications to investors.

The two proposed sections, moreover, are not by their literal terms related in any specific way to improper or questionable payments and we believe that a more direct approach might be more productive. The SEC has proposed rules which would require reporting corporations within

certain guidelines to state in proxy materials their policies with respect to transactions involving improper or questionable activities.[8] The SEC could also require such reporting in other 1934 Act filings and could require a description of management's procedures for communicating such policies to employees and for enforcing them. Under such proposals, the definition of what is "questionable" and what procedures are "appropriate" for a given corporation will properly be left to the management of the particular corporation, subject to the reactions of shareholders, investors and others when the policies were announced. While requiring issuers to disclose their policies would not guarantee that these policies would be carried out, it would assure wide communication of management's policies and would seem likely to allow ordinary, existing procedures to bring to light whether transactions were carried out in accordance with those policies.

C. *Ambiguities in provisions relating to accounting controls*

The proposals of the Proxmire Bill which impose on management the above-noted duties to establish a system of accounting controls for record-keeping and the prevention of unauthorized transactions leave open an unacceptably large number of serious questions as to the content of these duties. If management discovers questionable payments, the proposed language might be read to make responsible officials liable because they did not previously schedule more frequent independent or internal audits. If such an interpretation were adopted, then management might feel it necessary to spend resources for internal controls not useful for the corporation's business in order to avoid possible liability created by the legislation. For example, a staff of lawyers might be added to the internal accounting department to supervise the procedures and new requirements, whatever they are.

The proposed language also creates new ambiguities for accountants. Their comment letters prepared for the purpose of assisting management to improve might become an "expertised" record of management's failure to comply with the law. Auditors may feel that they must report their offered, but not accepted, criticisms to the SEC.

A final overriding ambiguity is what potential rights of action the proposed language may create for enforcement either by SEC injunctive actions or shareholder suits. It is not clear what standard would be used to evaluate management's conduct with regard to the proposed accounting requirements. It would seem however, that no standard higher than a business judgment rule should be imposed.

II. *ACCURACY AND FALSIFICATION*

Proposed Section 13(b)(2)(A) would require an issuer to keep books, records and accounts which accurately and fairly reflect the transactions of the issuer. Proposed Section 13(b)(3) would make it unlawful for any person to falsify any book, record, account, or document which is made or required to be made for any accounting purpose.[9]

A. *Accuracy*

The report of the Senate Banking Committee on S. 3664 notes that concern has been expressed that the use of the word "accurately" in proposed Section 13(b)(2)(A) may connote a degree of exactitude which is unrealistic.[10] While the term "accurately" would probably not be interpreted to mean exact precision, we believe the concern is well placed.

The concept of accuracy must necessarily include a limiting concept of relevancy to a particular purpose such as is served by the concept of materiality with respect to financial statements. There is no generally accepted concept of relevancy applicable to the accuracy of underlying records and individual accounting entries because the traditional procedure has been to sift through the underlying data and to apply a judgmental concept of materiality only when preparing ultimate financial statements. It is not practicable, and probably not meaningful, to apply a standard of materiality to individual entries or to individual transactions.

One would expect, moreover, that the terms "books," "records" or "accounts," which are not defined, would be interpreted broadly, especially the term "records." It may well be that virtually every piece of paper or piece of information capable of being reduced to writing, whether in computer form or otherwise, would be deemed a "record" for purposes of the proposed legislation.[11] Such a broad definition would increase the need for a limiting concept of relevancy in connection with the word "accurately."

Proposed Section 13(b)(2)(A) states that books should "accurately and fairly reflect transactions" of an issuer. These words may indicate an intent to require an expansion of individual descriptive captions and increased documentation used in internal accounting to identify particular transactions. This may cause serious practical problems for businesses, because they use bookkeeping personnel not trained to make determinations of materiality to record ordinary transactions, most of which are not material in amount. The materiality of individual items properly should be

determined by trained personnel in the context of preparing ultimate financial statements.

Increased documentation of transactions creates a more easily obtained evidentiary record for law enforcement purposes, but whatever benefits may accrue to enforcement officials would appear to be far outweighed by additional and, in most cases, unnecessary costs entailed by excessive recordkeeping. Furthermore, legal sanctions are questionable when imposed for technical defects in records rather than for the commission of the offense intended to be disclosed by the records.

In addition, it may be noted that proposed Section 13(b)(2)(A) may duplicate existing state laws.[12]

B. *Falsification*

It goes without saying that raw data used in management decisions and financial reporting must be honestly assembled and not purposely distorted. Not only is this a practical business consideration, but it is also an ethical one; its importance is reflected by the wide adoption of criminal law provisions which prohibit the alteration or omission of accounting data with an "intent to defraud."[13] We question the wisdom of enacting, except in connection with the disclosure legislation proposed in this report, federal legislation which would detract from state courts as the traditional forums for the handling of problems of falsification of corporate internal records.

Although proposed Section 13(b)(3) is similar to existing provisions of state law, it does not expressly provide for the element of intent to defraud except insofar as the wilfulness requirement in Section 32(a) of the 1934 Act, which applies only to criminal violations, would be applicable. Frequently, scienter or similar requirements are deleted from civil provisions to permit statutory allocation of risk of loss. Thus, the due diligence defenses of Section 11 of the Securities Act of 1933[14] are not available to issuers because the statutory scheme holds them responsible for materially inaccurate financial presentations even if the errors result from innocent mistakes. The policy behind the statute is that issuers should bear the risk of loss caused by the material inaccuracy. Similar considerations do not apply to a falsification statute such as Section 13(b)(3) which is applicable to "any person." We believe it would not be appropriate to permit either issuers or investors to sue bookkeepers, accountants or other employees under federal law for mere mistake and we would, therefore, require the "intent to defraud" element in the statute for civil as well as criminal purposes.

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Proposed Section 13(b)(3) also prohibits anyone from falsifying any "book, record, account, or document, made *or required to be made* for any accounting purpose. . ." (emphasis added). It is not clear what is meant by falsifying a record "required to be [but presumably not actually] made." The SEC has indicated that the words were intended to cover "the failure to make entries, or the failure to obtain or create documents, necessary for proper accounting records,"[15] but we believe that provisions of state law provide a better model.[16]

III. *RELATIONS WITH AUDITORS*

Proposed Section 13(b)(4) of the Proxmire Bill would make it unlawful for any person to make a materially false or misleading statement or to omit a material fact necessary to make not misleading statements made to an accountant in connection with an audit.[17] We believe that proposed Section 13(b)(4) as it is currently drafted raises several questions which cast significant doubt on its inherent fairness and on its ultimate ability to add to the reliability of corporate financial reports.

One question raised concerns the impact of its failure to include any requirement of intent to deceive. With respect to criminal liability, it is true that Section 32(a) of the 1934 Act requires a wilful violation before such liability may be imposed, but there is some ambiguity as to the extent of the knowledge of the misrepresentation which is required before there is a "wilful" violation. It would therefore seem preferable to specify the requisite degree of scienter in Section 13(b)(4). Civil liability perhaps should not be imposed in the absence of a scienter requirement in the light of *Ernst & Ernst v. Hochfelder*[18] and the considerations discussed at pages 62-63 *supra.*

Another question regarding the fairness of the section is raised by the possibility that it may be applied in circumstances which lack the usual warnings that a person's conduct may be subject to criminal sanctions. Parties potentially liable under Section 13(b)(4) may have a wide variety of contacts with accountants, ranging from very general informal oral communications to narrowly defined formal written representations. In the former case there may be inadequate indication of the need for careful reflection and the seriousness of a failure to meet that need. This is true, for example, when only private persons are involved, when there is no oath, affirmation or certification or when no certification or other writing is required. Section 13(b)(4) liability, at a minimum, should be restricted to written materials in order to alleviate evidentiary problems.[19]

It seems advisable, moreover, to require an intent to deceive or knowingly misrepresent even in the case of written statements. For example, one important written statement given by accounting officers to the auditor is the audit representation letter. The letter is usually exacted as a condition to certification, is broad in scope and is drafted by the accountant who has a self-interest in its contents. Among other things, such letters are designed to establish, as between the accountant and the accounting officers, the responsibility for any possible defects in the audit, although they may also elicit and confirm facts. It would not seem appropriate to make such a letter the basis of liability in the absence of an intent to deceive.

The unrestricted manner in which Section 13(b)(4) imposes liability on "any person," even on one unrelated to the issuer, also raises questions about its inherent fairness. It seems hard to justify holding independent and outside third parties to the same standard of care and subjecting them to the same liability as parties who may have substantially greater access to information concerning the issuer and incentive to obtain such information, such as the issuer's officers, directors and employees, particularly in the case of statements volunteered in good faith. In recognition, perhaps, of the inequity present in Section 13(b)(4), the SEC's proposed Rule 13b-4 imposes liability for false and misleading statements or omissions to an accountant only on the issuer's directors, officers and shareholders.[20]

There is doubt about whether Section 13(b)(4) will contribute to its underlying purpose–strengthening the reliability of the auditing process. Generally, the accurateness and completeness of an accountant's review is promoted if the accountant has access to sources of information and verification outside the issuer and also if officers and employees within the issuer are encouraged to communicate freely. It is doubtful that Section 13(b)(4) will promote either of these objectives in its present form. If well advised, parties who have no obligation to communicate with auditors, rather than opening themselves to criminal or civil liability, may simply refuse to discuss any matter with an issuer's auditors. Persons associated with the issuer who have an obligation to talk with auditors may attempt to restrict their exposure by communicating as little as possible.

In cases in which management has adopted and intends to enforce a statement of policy concerning improper and questionable foreign payments, there is an already existing sanction–discharge–against an employee's misrepresentations to the auditors. If members of management

itself are involved in the practices sought to be concealed, their involvement will probably be material according to traditional disclosure requirements. In such cases, members of the management of an issuer with publicly traded shares will be exposed to liability under Rule 10b-5 and similar existing provisions, and it would appear that the proposed provisions are therefore unnecessary.[21]

D. *Conclusions*

1. The SEC has traditionally focused on regulations related to the purchase and sale of securities and on ultimate communications of material facts to holders of securities and potential investors. The adoption of the proposals would involve the SEC in internal corporate affairs and the assembly and recording of raw accounting data, whether or not the data is actually presented to investors and without regard to its materiality to the considerations of investors. The proposed legislation seems to involve the SEC in seeking to improve internal corporate operational performance. It raises serious questions as to the propriety of federal regulation in an area traditionally reserved for the states and creates the possibility that the SEC would be diverted from its traditional objectives.

2. The accounting proposals are replete with vague and ambiguous terms; they impose undefined duties and attendant liabilities on a wide range of individuals; and, although they were drafted to strengthen existing accounting controls, there is little, if any, assurance that they will be successful.

For the foregoing reasons, the Ad Hoc Committee recommends against adoption of the accounting and recordkeeping provisions discussed above.

FOOTNOTES TO SUPPLEMENT

[1]In March 1974 the SEC published a statement expressing the views of its Division of Corporate Finance that foreign payments involved matters of significance to public investors, the nondisclosure of which would entail a violation of the federal securities laws. *See* Exchange Act Release No. 5466, 39 Fed. Reg. 10,237 (1974). Over three hundred corporations have since disclosed instances of such activities, which have ranged from minor facilitating payments to substantial sums paid as bribes to foreign governmental officials. *See* Exchange Act Release No. 13185 (Jan. 19, 1977), at 3-4, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,376 [hereinafter cited as Release No. 13185].

[2]S. 3133, which adopted both a criminalization and disclosure approach to the problem of questionable foreign payments, was introduced in the 94th Congress by Senator Proxmire, who also introduced S. 3418 on behalf of the SEC, which related to auditing and accounting matters. A consolidated bill, S. 3664, as reported out of the Senate Committee on Banking, Housing and Urban Affairs (the "Senate Banking Committee"), was adopted by the Senate on September 15, 1976. S. 3664 was introduced in the House of Representatives as H.R. 15481, but was never reported out of a subcommittee of the House Committee on Interstate and Foreign Commerce. S. 3664 and H.R. 15481 have been reintroduced in the 95th Congress as S. 305 and H.R. 1602, respectively. S. 305 and H.R. 1602 are collectively referred to herein as the "Proxmire Bill."

[3]The SEC has recently proposed certain rules under Sections 13 and 14 of the Securities Exchange Act of 1934. Release No. 13185, *supra* note 1. The rules proposed under Section 13 relate to accounting and auditing matters (the "proposed accounting and auditing rules"); those proposed under Section 14 would impose a new requirement on issuers to report questionable payments policies in proxy material (the "proposed proxy rules"). The SEC's proposed accounting and auditing rules are based on and, in general, track the language of Section 102 of the Proxmire Bill, the section in the Proxmire Bill which relates to accounting matters and which derives from S. 3418. Pertinent differences between the provisions of the Proxmire Bill and the SEC's proposed rules will be noted during the discussion of the Proxmire Bill which follows.

The SEC has stated that it "believes that . . . [its] proposals [are] within the reach of the Commission's general rule-making authority under Section 23(a) of the Securities Exchange Act," Release No. 13185, *supra* note 1, at 7, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,378, and presumably is prepared to adopt them with or without adoption of the Proxmire Bill. The proposed accounting and auditing rules in their present form, however, would literally seem to be applicable whether or not there is a demonstrable connection in any given case to a purchase or sale of a security, to the filing of an SEC report or to a communication to shareholders. It would appear, therefore, that the SEC's jurisdictional basis for the proposed accounting and auditing rules, apart from the proposed legislation, is at most an assertion of powers "incidental" to its traditional jurisdiction under the securities acts and warrants careful and perhaps skeptical examination.

[4]It should be noted that we have omitted discussion of the provisions of S. 3379, a bill introduced by Senators Church, Clark and Pearson, relating to accounting and auditing matters. S. 3379 was rejected in the 94th Congress by a wide margin and we do not anticipate that such proposals will be reintroduced in the 95th Congress.

In addition, except as noted here, we have not discussed the provisions relating to accounting matters of S. 3741 and H.R. 15149 introduced in 1976 on behalf of the President's Task Force on Questionable Corporate Payments Abroad. Such

provisions refer only to recordkeeping requirements specifically related to the reporting requirements of S. 3741. These bills, collectively referred to herein as the "Task Force Bill," were introduced, but not acted on, in the 94th Congress.

Section 4 of the Task Force Bill delegates to the Secretary of Commerce the authority to "promulgate rules and regulations requiring [a] person [required to report under the Bill] 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." The legislative history does not reveal what type of accounting is envisaged, but in the light of the reporting requirements, it can be anticipated that the regulations would require the maintenance of a "reportable payments account" by all companies which make payments falling within the scope of the legislation. If more is envisaged, the Secretary would have to consider the extent to which the burdens of expense and inconvenience outweigh the efficacy of the recordkeeping procedures.

Sections 6 and 7 of the Task Force Bill provide civil or criminal penalties for failure to file a report or to maintain the required records and for omitting or falsifying information in records. These provisions raise questions similar to those raised with respect to proposed Sections 13(b)(2)(A) and 13(b)(3) of the Proxmire Bill (*see* pp. 62-64 *supra*).

[5]The SEC's proposed Rule 13b-2 contains identical requirements to those proposed in the Proxmire Bill as Section 13(b)(2)(B), although the proposed rule attempts to provide some guidance as to the meaning of the term "reasonable assurance" and recognizes that management must balance costs against benefits. Release No. 13185, *supra* note 1, at 14-15, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,379-80. As discussed in the text of this Supplement below, however, the words "reasonable assurance" appear to be the least ambiguous of the various terms used.

[6]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, May 12, 1976 [hereinafter cited as SEC Report].

[7]The SEC's proposed proxy rules suffer from similar defects. Proposed Item 6(d)(1) would require issuers to state:

> "the material facts pertaining to the *involvement* of [directors and executive officers of the issuer] in . . . the disbursement or receipt of corporate funds outside the *normal system of accountability*; . . . or any other matters of a similar nature involving disbursements of issuer assets" (emphasis added). Release No. 13185, *supra* note 1, at 24, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,382-83.

[8]Release No. 13185, note 1 *supra*; *see* note 3 *supra*. The proposed proxy rules do have certain unacceptable ambiquities, for example, the scope of the term "involvement," and may be subject to other criticisms.

[9]These provisions of proposed Sections 13(b)(2)(A) and 13(b)(3) are reflected in the SEC's proposed Rules 13b-1 and 13b-3, respectively. However, it should be noted that Section 13(b)(3) prohibits falsification of any book, record, account or document made "for any accounting purpose," while proposed Rule 13-b would prohibit falsification of any book, record, account or document "made or kept pursuant to Rule 13b-1 of this regulation." Proposed Rule 13b-1 does not presently contain any specific designation of the materials which are or might be required thereunder or of the form which such materials might be required to take.

[10]Senate Comm. on Banking, Housing and Urban Affairs, "Corrupt Overseas Payments by U.S. Business Enterprises," S. Rep. No. 94-1031, 94th Cong., 2d Sess. 11 (1976).

[11]"The word 'transactions' in the proposal encompasses accuracy in accounts of every character . . . ." Release No. 13185, *supra* note 1, at 9-10 n. 7, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,378.

[12]Virtually every state presently requires books and records which are "correct and complete." *See* statutes cited in Model Bus. Corp. Act. Ann. 2d § 52 ¶ 6 and Supp. 1973. The widely-adopted relevant provision of the Model Business Corporation Act provides that "each corporation shall keep correct and complete books and records of account . . . ." *Id.* § 52. Other statutes use different wording, but are comparable. For example: "accurate books and records of account" (6-A Me. Rev. Stat. Ann. tit. 13-A, § 625); "correct and complete books and records of account" (Ark. Stat. Ann. § 64-312); "adequate and correct accounts of its properties and business transactions" (18 Okla. § 1.70); "appropriate, complete and accurate books or records of account" (Penn. Stat. Ann. tit. 15, § 1308). Presumably, foreign jurisdictions have similar laws (see, for example, HGB § 38, Akt G § 148 *et seq.*, Gmb HG § 41 *et seq.*, Gen G § 33 *seq.* and AO § § 160-162 for comparable laws of West Germany; and Art. 340 of the Code des societes commerciales for comparable laws of France).

[13]Delaware's statute, which is typical, provides:

> "A person is guilty of falsifying business records when, with intent to defraud, he:
>
> (1) Makes or causes a false entry in the business records of an enterprise; or
>
> (2) Alters, erases, obliterates, deletes, removes, or destroys a true entry in the business records of an enterprise; or
>
> (3) Omits to make a true entry in the business records of an enterprise in violation of a duty to do so which he knows to be imposed upon him by law or by the nature of his position; or
>
> (4) Prevents the making of a true entry or causes the omission thereof in the business records of an enterprise." 7 Del. Code Ann. tit. 11, § 871.

See also: Ark. Stat. Ann. § 41-2306; Cal. Corp. Code § 3018 (West); Fla. Stat. Ann. § 817.15 (West); Hawaii Penal Code § 872; Me. Rev. Stat. Ann. tit. 17-A, § 707; Mass. Gen. Laws Ann. Ch. 266, § 67 (West); Mich. Comp. Laws Ann. § 450. 1932; N.J. Stat. Ann. § 2A:111-9 (West); N.Y. Penal Law § 175.05 (McKinney); Ohio Rev. Code Ann. § 2913.42 (Page); Pa. Stat. Ann. tit. 18, § 4104 (Purdon); and Wis. Stat. Ann. § 943.39 (West). In addition, the majority of the other states contain similar prohibitions although the specific provisions of the statutes vary.

[14]15 U.S.C. § 77k (1970).

[15]SEC Report, *supra* note 6, at 66.

[16]*See* statutes cited in note 13 *supra*; *see also* Model Penal Code (U.L.A.) § 224.4. *Cf.* Federal Trade Commission Act § 10, 15 U.S.C. § 50 (1970).

[18]Section 13(b)(4) provides:

> "It shall be unlawful for any person, directly or indirectly
>
> (A) to make, or cause to be made, a material 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 light of the circumstances under which they were made, not misleading
>
> to an accountant in connection with any examination or audit of an issuer. . . ."

The wording is based on, but slightly different from Rule 10b-5, 17 C.F.R. § 240.10b-5 (1976), and Section 14(e) of the 1934 Act, 15 U.S.C.A. § 78n(e) (1970), and, if adopted, should be conformed thereto to the extent possible.

[18]425 U S. 185 (1976).

[19]Of course, fraudulent oral statements to auditors would still result in liability to the extent provided in existing law, if, for example, made in connection with the purchase or sale of securities. 1934 Act § 10(b), 15 U.S.C. § 78j(b) (1970) and Rule 10b-5, 17 C.F.R. § 240.10b-5 (1976); *see* Release No. 13185, *supra* note 1, at 23, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87, 382.

[20]Release No. 13185 *supra* note 1, at 21-22, [Current] Fed. Sec. L. Rep. (CCH) ¶ 80,896, at 87,381-82. It would seem more appropriate to incorporate such a restriction in Section 13(b)(4) itself, if it is to be adopted.

[21]Other questions of a less serious nature which are raised by proposed Section 13(b)(4) are the meanings to be given to the terms "examination" and "accountant." The American Institute of Certified Public Accountants has suggested withdrawing the term "examination," because it has no technical meaning in accounting literature. In addition, the term "examination" may be objectionable because it would appear to be so broad as to include almost any review of any issuer's affairs, even a very limited or informal one, or one undertaken by internal staffs. Similarly, the term "accountant," in the context of an "examination," may well be taken to include accountants who are employed by the issuer. Misrepresentations made to employee-accountants by other corporate personnel would appear to be an internal corporate matter and not appropriate for inclusion within the scope of Section 13(b)(4).

Mr. ECKHARDT. On your last point with respect to the question of acquiescence, I have some doubts about that term myself. Suppose we used the term aid and abet. Would that be satisfactory?

Mr. VON MEHREN. It seems to me the way to cure it is as you have suggested, which is to tie it into 18 U.S.C., Section 2.

Mr. ECKHARDT. I think tht might be a good process. Thank you very much.

Mr. Schell, how do you prefer to proceed?

Mr. SCHELL. Unless Mr. Kennedy has remarks to make——

Mr. KENNEDY. I do not.

Mr. VON MEHREN. I think the understanding was that Mr. Schell and I would give our statements and then open ourselves up for questions.

STATEMENT OF ORVILLE H. SCHELL

Mr. SCHELL. Mr. Chairman, I shall be short and I hope sweet. I am Orville Schell. I am a lawyer in New York and a partner in the firm of Hughes, Hubbard and Reed. I speak here today for another ad hoc committee—that seems to be a favorite word—an interdisciplinary committee of independent certified public accountants representing nine of the largest firms in the country and 10 lawyers from the cities of Washington and New York.

I have here, if I may pass up to you, Mr. Chairman, the list of the names of the committee which I gave to your counsel over the telephone the other day. You will know some of them, I am sure.

Mr. ECKHARDT. Thank you, sir.

Mr. SCHELL. I am not going to read my statement because perhaps I am a little bored in reading it, myself, and I think it is a fine statement and will speak for itself and save us a lot of time and get us to lunch sooner.

I am certain, Mr. Chairman, that you are very grateful to Mr. von Mehren and Mr. Kennedy and their committee for the close and excellent consideration of the question of foreign payments and the applicable laws. The report is typical of the Association of the Bar. Having praised them in that respect, I want immediately to disassociate differentiate myself from them in spite of my past connections with and affection for that great association.

Our committee is a separate committee, has worked separately; it has come to its own conclusions, albeit they are somewhat similar to the ones contained in the Bar Association's report. But we are a separate committee.

We were formed in January, the thought being that there are a lot of people working on the subject—Dr. Adams referred to a number of them this morning—and there seemed to be rather slow progress. We felt that by an interdisciplinary approach to this very difficult problem, close analysis, we could perhaps arrive at what might be a practical solution to the problem that might be suggested to just such groups as this committee here today. So we have been hard at work on the problem. I have a few thoughts to express, and that is why I am here.

Our recommendations, Mr. Chairman, are nothing new. Indeed, this subject has been plowed and replowed, as you well know, both in the Senate, in the Congress and in foreign bodies ad nauseum.

There emerge two principal approaches, the so-called criminalization approach and the disclosure approach. Each one has obviously a number of permutations and combinations, but essentially those are the two approaches.

I present the report or statement of our committee to you, sir, as a carefully reached conviction of a group of senior accountants and lawyers, who may I say immodestly, have had considerable experience and who are just as determined as Mr. Adams and many other people to see that corporate arrogance expressed in bribes to officials in foreign countries is stopped.

My first general point, sir, is this: Our group urges that H.R 3815 not be adopted. We urge this in the sense that your committee reject the concept of making the active payment to a foreign official a substantive U.S. crime.

Our report is replete with reasons, many of them already stated here today and a few of them not stated. We see no way that the objectives of stopping payments can be obtained by tinkering with the language of the bill. We, are of course prepared to discuss this as lawyers, but we do not see anything to be gained by that process.

We have no objection in principle to the application of criminal sanctions to acts by corporations and their management considered to be immoral and against the public interest, designed to deter those immoral acts. When, however, it appears that the enactment of a criminal bill will not effectively act as a deterrent and has other probably serious consequences and when there is another

course of action which gives real promise of solving the problem, we opt for the latter course.

We believe that the other course is a disclosure statute and that is our recommendation. In recommending a disclosure statute, we are not saying "Go easy, don't be tough." We are saying "Legislate to stamp out the practice and do so in the most effective way." We believe the disclosure route is that way.

As I said, I am not here to give you a new miracle drug, but what I think we have to offer to this committee is a demonstration that the disclosure system will work to stop the payments. So far as I know, the material that I will present to you is new to the hearings on this subject.

Let me give you our logic.

[Testimony resumes on p.150.]

[Mr. Schell's prepared statement follows:]

Statement of Orville H. Schell
Co-Chairman of the Ad Hoc Inter-Professional
Study Group on Corporate Conduct

Mr. Chairman, Members of the Subcommittee:

My name is Orville H. Schell. I am a member of the Bar of the State of New York and a partner in the firm of Hughes Hubbard & Reed of New York City where I have practiced law since September 1933. My field over the past thirty years has been generally corporate law, with emphasis in the past fifteen years on international business transactions. Both in my law practice and as a corporate director I have observed first hand over recent years the serious problems presented by payments made to foreign government officials by U.S. corporations.

I appear today on behalf of an Ad Hoc Committee of lawyers and certified public accountants, of which I am Co-Chairman, and which calls itself the Ad Hoc Inter-Professional Study Group on Corporate Conduct.

This group was formed early in January 1977 by the chief executive partners of the nine large independent accounting firms of the United States and ten active members of the Bar from Washington and New York. The lawyer members include senior partners from large law firms in both cities, members of the legal academic community,

individuals who have held high positions in former administrations in Washington and past presidents of the organized Bar. Each member of the Committee, both the CPAs and the lawyers, has had considerable and direct experience with the numerous and difficult problems presently facing U.S. corporations in meeting their social responsibilities in the modern economy both domestically and internationally. As a group we have no sponsor in this statement or other affiliation, we represent no other group, no client and no interest other than a sense of our own professional responsibilities.

In coming together we assumed that an objective and professional analysis and understanding of these problems could lead the way to solutions. We felt that this could best be done by the two professions on an interdisciplinary basis and we dedicated ourselves to that task. It has been our hope that, after analysis and understanding of these problems, we would be able to offer our findings and recommendations to bodies such as this Subcommittee. That is why I am here today.

Our Ad Hoc Group chose as its first task the question of payments made by U.S. corporations to foreign officials. We did so believing that it was a serious and complex problem in need of an early solution.

At the outset we unanimously agreed that improper payments made to foreign government officials by U.S.

corporations as disclosed over recent years have adversely affected vital interests of the United States and should be stopped. We took as our first task, therefore, the formulation of an effective program to accomplish that end.

We first looked carefully at the events over the past three years when many payments to foreign officials have been disclosed on a voluntary and involuntary basis. We particularly analyzed the types of payments. We found that there were many different types of payments, which fall into three general categories. First, are payments made to persuade a government official to exceed his authority or fail to exercise his bounden duty--more succinctly, "bribes". Second, there are the so-called facilitating payments, made to encourage government officials to carry out their assigned responsibilities, their ministerial duties (payments often small in amount). And third, there are payments that are extorted from the payor by a government official through improper application of the power of his office. In each of these categories there are numerous subdivisions. The most illusive and subtle of these is the subject of payments made to or by local agents and other intermediaries, since we have found that sometimes such

payments are quite proper and sometimes not, are sometimes at company initiative and sometimes are extorted, are sometimes controllable and known to the U.S. corporation and sometimes not. It was clear that any effective solution must take into account these vastly different types of payments and no program, regulation or statute could be effectively administered which merely outlawed "improper payments". To be effective, for example, a criminal statute, such as the one before this Subcommittee, would have to be most meticulous in defining the payments intended to be proscribed.

We have also looked at the overall response of U.S. corporations to the disclosure of foreign payments made pursuant to the reporting requirements and publicity generated by the Securities and Exchange Commission over recent years. A most important fact emerges. When outside directors (and audit committees), who were not aware that corporations were making such payments, were presented with evidence (after investigations which they often demanded in their corporations) that such payments had indeed been made, they reacted and acted immediately. They forbade future payments and adopted corporate policies which at the least proscribed payments constituting bribes and in most cases forbade any payments whatsoever, whether a bribe or a facilitating payment, or whether or not the payment might

be illegal under the law of the country where made. This essential fact--this reaction and action by U.S. corporations--is important for the real purpose of all proposals in this field is to change behavior and the most effective way to do that may well lie not in criminal sanction but in a program which assures that boards of directors, particularly outside directors, are made aware of the transactions, thus calling into play the response we have already witnessed. A program embodying a tough, clear requirement that all U.S. corporations disclose their payments to foreign officials (on a generic basis, without giving names or countries), combined with controls to provide maximum practical assurances that payments to foreign officials are properly reflected on the books of the corporation, should provide such assurances. Such legislation should include criminal penalties for failure to comply.

We have given serious consideration to the proposals contained both in S. 305 and in the Bill now before this Subcommittee, H.R. 3815, that the act of improper payment itself be made a U.S. crime. The "foreign payments" problem is a serious disease with obvious moral implications and we recognize it requires strong medicine. We have nevertheless come to the conclusion that the criminalization approach (one which appears on the label to be indeed strong

medicine and has great appeal) should not be adopted. In rejecting the criminal approach, we do not do so because we have any reluctance to restrain an immoral course of conduct through criminal sanctions. Our point is that in this case we believe that the criminal sanctions proposed will not provide the strong medicine needed. Moreover, we feel that the enactment of the criminal bill will be counter productive and create serious problems for the United States in the conduct of its foreign relations and its foreign commerce.

In our view a criminal provision will not be effective to deter any person who is determined to make improper payments. Such a law would be unusually difficult to enforce and convictions would be few and far between. Thus any in terrorem effect of the law created at its enactment will soon be lost. A law deters not by words but by the perception of those intended to be deterred that it sends people to jail. Few convictions also would mean that the bite of the law would affect only a few, if any, allowing most to go free.

There are many additional reasons why the law will be difficult to enforce. Here are a few examples.

At best, bribery cases are difficult to prosecute. They require proof of intent (scienter) and convictions are rare even in cases where all the alleged acts take place in the U.S. Where the actual payment is

outside the U.S., where there is a foreign payee and, where much other vital evidence may be beyond the reach of the prosecutor's subpoena, or his grant of immunity for voluntary testimony, the difficulty of proof is geometrically increased. To put it in a slightly different way, cooperation with U.S. prosecutors by the government and police officials of the countries of the allegedly unlawful payment will often be unenthusiastic.

Payments made through agents or other intermediaries present additional hurdles to be surmounted. Moreover, these kinds of payments made through local agents and not known to the corporation's management raise the serious question of whether an agent's intent to bribe, even if proved, can be imputed to the corporate officers so as to make them guilty of a crime.

Considerable effort by many dedicated people has been expended in an effort to define with precision the kinds of payments that should be proscribed. There has been little agreement except that the question is complex. The SEC itself has been unwilling or unable to do so. The dilemmas and subissues are many. For example, what should be done with payments which have been extorted? Is extortion a defense? How and where do you draw the line, or should you, between "bribes" and "facilitating payments?" A U.S. prosecutor who attempts to obtain a conviction under

a statute that has only a broad general definition of the payments outlawed will have an unenviable job.

One of the critical criteria of the crime under HR 3815, is the constitutionally essential use of a "means or instrumentality of interstate commerce." Therefore an additional problem of enforceability, or perhaps better of effectiveness, inherent in HR 3815, is this jurisdictional aspect. It is a problem because multinational corporations inevitably have foreign subsidiaries with varying degrees of autonomy who may make such payments without any involvement in interstate commerce. To attempt to deal with this problem by giving the law a true extraterritorial effect and applying it to foreign nationals would present major problems for U.S. foreign policy, as discussed by other witnesses and recognized in the Committee mark up of the Senate bill.

It is our belief that the criminal statute before the Committee and indeed any criminal statute that might be designed to end these improper payments will operate haphazardly and be full of holes, since the transactions covered are outside the United States. The result, then, could be that the designing criminal can avail himself of the holes and avoid the statute, while occasionaly the innocent and unknowing American businessman will find himself suddenly committed as a felon.

Beyond the problem of the effectiveness of the law, the criminal approach presents other difficulties. One just mentioned, of course, is its extraterritorial effect.

If the U.S. unilaterally proscribes all overseas payments without comparable action by other industrial countries, American companies and their workers will be put at a competitive disadvantage in foreign markets. Our group believes that this risk is real and that therefore there must be an international solution to the problem. A unilateral criminal approach in the United States does not lend itself to an international accord on this subject. Responsible businessmen and their professional advisors who desire to see this evil eliminated want to have any final international solution one which is clearly enforceable and does not result in unfair competitive advantage to the corporations in any country. Such a solution requires the cooperation of other industrial countries, their concurrence and action. It is our view that a unilateral criminal approach in the United States would deter rather than encourage such cooperation. There are indications, however, that a disclosure system would be welcomed by or at least acceptable to the international community.

Presumably such powers as the SEC now has to require disclosure of foreign payments by registered corporations will continue. If the Congress passes a law

criminalizing the act of payment, every request by the SEC for information on that subject will amount to a criminal investigation with all attendant delays, problems and personal risks. It could well bring any voluntary disclosures to an abrupt halt. It quite probably will lead employees being investigated to invoke their constitutional rights to remain silent and, this in time, will seriously obstruct future efforts of American corporations to police the policies against such payments which their boards of directors have adopted.

For these reasons, we feel that the Congress should not pass a law which makes the overseas payment a substantive criminal offense under U.S. law. We recommend the disclosure approach, criminally enforced, as being the more effective therapy and the one that has fewer negative side effects.

We submit, then, the following as the major points for any "foreign payments" program:

1. It is essential to establish without delay procedures which will eliminate improper payments by U.S. firms to foreign officials designed improperly to influence their official actions. This action should be taken not solely for the reason that the payments are immoral, but also because of their adverse effect on vital interests of the United States.

2. The experience of the last three years has revealed that a requirement for generic reporting of illegal payments overseas has tapped a sense of corporate responsibility, both in the top management of U.S. corporations and in their outside directors (audit committees), that appears to have all but eliminated improper payments to foreign officials.

   Data gathered by the Ad Hoc Study Group support these conclusions. These data also support the conclusion that having adopted policy codes against such payments, management and directors have set up controls within their corporations to assure compliance with the policy and have strictly enforced the policy.

3. Such procedures:

   (a) Should be established by legislation;

   (b) Should contain a clear statement that "improper payments" to foreign government officials are contrary to national policy. This must include a careful definition of an improper payment (to the extent possible) as being one made to persuade a foreign official to exceed his authority or fail to exercise his responsibility--in other words, a "bribe" whether or not contrary to the law of the country where made. So-called facili-

tating payments made to persuade an official to carry out his bounden duty should not be considered as improper but should (above a stated amount) be reported as part of any disclosure program;

(c) Must be capable of ready and effective enforcement;

(d) Must avoid to the extent possible an adverse effect on U.S. interests, such as foreign relations, fiscal policies and the flow of foreign commerce;

(e) Since U.S. corporations must compete in foreign markets with corporations of other industrial nations, such as those of Western Europe and Japan, there must be an international solution and thus any procedure must be amenable to adoption and comparable enforcement by other governments with respect to the conduct of their firms overseas;

(f) Must recognize the absolute necessity to work through local agents in the conduct of business overseas as a standard and normal procedure since:

(i) In certain foreign countries the use of such agents is required by law or regulation;

(ii) Medium and small U.S. businesses, and even large corporations, cannot carry the cost of a branch or office abroad staffed by its U.S. personnel;

(g) Must assure that U.S. corporations utilizing agents overseas will establish proper effective internal procedures to so see to it that their actions are consistent with the Company's policy against improper payments to foreign officials.

(h) Should provide for "generic reporting" (total amounts without identification of country or payee) by U.S. corporations and their U.S. or foreign subsidiaries where there is over 50% stock ownership of:

(i) All payments above a stated minimum made by them to foreign officials; and

(ii) All payments of commissions or of similar nature to agents or other intermediaries overseas.

The report should be made by all U.S. corporations, public and private, not just those subject to the jurisdiction of the SEC. Reports should be filed with an appropriate agency of the government and made public.

(i) There must be reasonable assurances that payments to foreign officials and agents will be properly reflected on the books of the corporation.

(j) When a corporation acquires a company the acquiring corporation shall be required within a reasonable period of time to regularize the application of the above standards to the acquired corporation.

(k) Should include criminal penalties for intentional violation of reporting and accountability provisions of the legislation.

4. Energetic efforts should be pursued to seek and arrive at bilateral (or multilaterial, if feasible) agreements with the Governments of Western Europe and Japan requiring their establishment of a similar system of generic reporting for corporations organized in each of such countries. Such bilateral or multilateral

agreements should provide a procedure whereby the Government of one signatory can bring to the attention of a second signatory a possible violation of the corporation within the jurisdiction of such other Government in order that competition among corporations organized in the jurisdictions of the signatory governments may be carried out without the use of illegal payments to gain competitive advantage. Means must be found and incorporated into such agreements for assuring imposition of sanctions by foreign governments on their corporations who fail properly to disclose in accordance with the international disclosure program.

5. Criminal sanctions can and should be applied for failure properly to comply with the disclosure requirements.

In conclusion, I urge that this Committee, which I realize has already spent considerable time on this whole question, nevertheless carefully review the wisdom of approving HR 3815 in its present form. I particularly urge that you give the most careful consideration as to whether the criminal provisions will really do the job that so desperately needs to be done. You should carefully consider a disclosure program to see if that indeed is not the most effective course to follow.

In considering this whole matter, I would also urge that your Committee seek the testimony of men and women who have had substantial experience as employees, corporate managers, lawyers and accountants working overseas or in the U.S. import or export trade so vital to our national economy. A fruitful source of information would be the Chairmen of the Audit Committees of the Boards of Directors of multinational corporations.

I greatly appreciate the opportunity to appear here today and your courtesy in hearing me. Needless to say, if you feel there is anything further our group can do to be of help, we shall be delighted to do so.

Mr. ECKHARDT. Mr. Schell, do you propose any particular statutory language with respect to disclosure?

Mr. SCHELL. My written statement does, sir. We have given you a number of points for an overall program to stop this practice. We propose a generic form of disclosure of all payments, including grease payments.

Mr. ECKHARDT. What would be the penalty for failure to disclose?

Mr. SCHELL. A criminal penalty.

Mr. ECKHARDT. In what amount?

Mr. SCHELL. Sir, I would have to leave that up to the better judgment of the Congress. I would make it just as high as you possibly can go.

Mr. ECKHARDT. What do you do about the problem that Mr. von Mehren raised with us of proof of the fact which occurred overseas? How does the company accused of failure to disclose get access to witnesses respecting the alleged act which the SEC or the Justice Department accuses him of? Don't you have the same problem there that you have had in other instances?

Mr. SCHELL. No, Mr. Chairman. I think it is a matter of degree. To prove a crime, you have a far higher degree of necessary proof to go to the jury and get a conviction. Where you have a multinational corporation based in this country with even foreign subsidiaries, the disclosure statute would place upon the management of that corporation the direct obligation to disclose all payments of that family of

companies. The enforcement and the obtaining of evidence with respect to those payments is an easier matter under those contexts we believe than it is in a criminal case.

I would like to make one more point, Mr. Chairman.

Mr. ECKHARDT. Let's get this settled first. Say Acme Company does what I described a moment ago. It is selling insecticides in Egypt and it engages in paying to some official of the Egyptian Government some sum of money for the purpose of getting that official of the government to influence the purchase by the proper authority of Egypt of this particular insecticide. But it does not engage in anything else.

Rather let's put it this way: Let's assume this is alleged but we don't know that it existed. The company says it did not exist. They say in fact they followed the ordinary routines there and they did not pay any money, the official did not pay any money, the act did not occur and therefore we didn't disclose it. But the Justice Department contends that it did occur. It not having been disclosed, it triggers the penalty.

Now how is the Acme Company going to get access to witnesses in Egypt that will bring in defensive testimony to testimony brought in by the Justice Department? How is it going to get process? Don't you have exactly the same problem that you would have now?

Mr. SCHELL. The Acme Company has very ready access to the files and records of its subsidiary companies abroad.

Mr. ECKHARDT. All right, I agree. But that, it seems to me, rebuts Mr. von Mehren's statement that this should not be an illegality because of the difficulty of getting process against witnesses. It seems to me you have the question of process against witnesses in both cases.

Mr. SCHELL. The experience with disclosure over the past 3 years has indicated that the question of the making of payments at all levels of corporations has not only been forbidden in 96 percent of the cases for corporations, but it is receiving the most careful scrutiny of audit committees of outside directors, of top management and of outside auditors. Controls are being put in place in corporations that require that transactions be reported.

Now, it is perfectly possible that a payment could be made and never detected. But in my own experience, I know of just such payments that were made following the institution of a policy and it was detected as a result of the controls put in place and the men were fired. So there is great reliance.

Mr. ECKHARDT. It may be true that we don't need any law. Maybe we shouldn't do anything. What I am asking you is this simple question: If you are going to make it illegal not to disclose a payment abroad and if the contention is that no such payment was made, you have the same problem with respect to obtaining evidence in defense of your position that no such payment was made as you have in the case where we make it illegal to make the payment itself.

Mr. SCHELL. I have taken a lot of time and I know Mr. von Mehren is eager to answer. I will come back to that because I can answer it.

Mr. VON MEHREN. Let me just say a word on it and then I would like to ask Mr. Kennedy to expand a little bit.

There is a distinct difference between the type of proof that would be required. Under your proposed bill, you have to prove the corrupt nature of the payment. You have to prove a state of mind.

Under the disclosure approach what we are saying, what the ad hoc committee of the city bar said, was that you have to report all payments made directly or indirectly to government officials and if you don't report them, then you will be subject to prosecution for failure to report.

There all the prosecution has to prove is the fact that a payment was made and the failure to report it. There is no problem as to the state of mind.

Now it is a far simpler matter both from the point of view of the prosecution to establish such a crime and for the defendant to get the evidence and defend against the prosecution in that situation. Nobody can guarantee to anyone that all of these payments will be stopped by any approach.

All that we say in the ad hoc committee of the city bar is that the disclosure approach coupled with a criminal penalty for failure to keep the proper records and to make the disclosure will be more effective than making it a crime to make the payment itself.

I tried to bring that out in terms of the bill of this subcommittee because either everybody is going to avoid the reach of your bill simply because the instrumentalities of interstate commerce won't be used or the problems of proof are going to be such that although you may have many indictments, you are likely to get very few convictions, in my judgment.

Mr. Kennedy. I would like to reenforce the points Mr. von Mehren made.

The crime you define in a reporting and disclosure provision is a much simpler crime with fewer elements of proof. If you are looking at it from the point of view of a U.S. Attorney who has been given the facts and has to frame an indictment and develop his case, the crime in a disclosure provision is a simple one, namely, that a payment was made directly or indirectly for the purpose of influencing a foreign government action.

Mr. ECKHARDT. I have a question at this point:

Mr. KENNEDY. If I could pursue it, the crime is the failure to report and the related crime is the failure to keep a record. You don't have to prove a corrupt motive.

Mr. ECKHARDT. Now just a moment. May I ask you this: I thought you said a moment ago that it was a failure to report a payment for the purpose of influencing an action of another government?

Mr. KENNEDY. Yes, but——

Mr. ECKHARDT. But don't you have the question of whether or not the payment was for the purpose of influencing the govenment or was simply to facilitate a process of the action involved? And don't you have the same fact question involved there that we have in this statute?

Mr. KENNEDY. No. I submit, sir, that what you have done in H.R. 3815 is track the conventional bribery language—and if you are going to go the route you are going, this is proper to do—of a

corrupt motive. You never reach the question of motivation or corruption or subjective intent or state of mind in a reporting or disclosure statute.

Mr. ECKHARDT. I disagree with that because you have to decide whether or not the payment was an innocent payment or a payment merely to entertain or to put the person in a good state of mind with respect to whether or not he would facilitate the corporation's business or whether it was paid for the purpose of inducing him to influence a foreign government. It seems to me you come back right to the same question: What was the payment?

Mr. KENNEDY. Could I take it in a very concrete context?

In a very concrete context, let's suppose an agent is retained abroad to assist a company in obtaining a large order from a foreign government agency which happens to be running one or another economic activity.

What would be involved in proof that that was an improper payment within the meaning of your bill? You would have to prove that the principal, the retaining company in the United States, had retained the agent with knowledge that the agent was going to pass on some of the commission to a government official for the purpose of influencing that government official's action.

In a disclosure statute, what you would require is simply that where agents were retained for the purpose of representing a U.S. principal in connection with that transaction, that fact would be subject to a generic disclosure. You would not have to prove knowledge of the way the money was going to be utilized by the agent or the purpose or intent.

In a disclosure statute where you had a recordkeeping implementation, you would simply require that records show that an agent was retained for this purpose.

Now, in other words, you reach, through the reporting and disclosure mechanism, a number of transactions with potential for abuse and if there is an intent to use these transactions in an improper way, the reporting and disclosure mechanism and the recordkeeping mechanism is a discipline on that and a much easier discipline to enforce.

Mr. ECKHARDT. Let me pose an equally positive question.

Now suppose Orville Ferguson is employed to represent the Jones Arms Company in Italy and suppose he has an expense account and the company pays him an expense account for ordinary use over and above what he would have to expend in the United States. After all, he is living in Rome and the costs run high. He is called upon to give some degree of accounting for his expense account, but it is ordinarily in the nature of a per diem when he is engaged in furthering the sale of a particular item that the company is selling.

The Jones Arms Company report that it has paid him such an expense account and it contend that that is all it knew about the matter; that sure, it was $250 a day when he was engaged in this particular type of operation, but that this was reasonable. After all, a person working for that company in Rome amongst high officials in Rome was called upon to live like those high officials and this was perfectly reasonable. But in fact, Orville Ferguson used the expense account to lavishly entertain an official of the Italian

Government who in turn influenced other officials or at least that is what the Justice Department alleges. There is a question of fact there. Was he merely paid the expense account and did he merely live like the Romans lived or did he in fact use the $250 corruptly to influence the Italian Government to purchase the particular item that his company was selling?

Now it seems to me that the question of whether the report was proper or improper and whether the company violated or did not violate the reporting requirement rest in that case on precisely the same basis that the question would rest as to whether he engaged in illegal activity in Rome while he was there. In order for the company to prove that the reporting was proper and adequate, it must prove that Orville Ferguson in fact merely used the money for his own living expenses and did not use it for the purpose of influencing an official of the Italian Government. Now don't you have a question of fact that has to be proved in order to defend against an allegation that there was a false reporting involved in that case?

Mr. KENNEDY. I would not think so, sir.

Mr. SCHELL. I would like to speak to this, also.

Mr. KENNEDY. All right, let me respond to this.

In your Roman case, if you take the context of H.R. 3815, you have to show knowledge of the person retaining the agent, as I would read the bill, that the agent intends to use some money transmitted to him for a corrupt purpose and also you are going to have to meet the other elements of proof defined in your bill. You can frame a reporting and disclosure requirement and it depends on how you frame it.

Mr. ECKHARDT. I wish you would frame it and let me have it so we can decide what it would require.

Mr. KENNEDY. You can frame a reporting and disclosure requirement which says that—assuming no impropriety at all—which says that where agents are retained and paid large commissions you have to make a disclosure. It is in that area that you have all the sensitive problems.

Mr. ECKHARDT. Would the reporting of the $250 expense account satisfy the reporting statute no matter how the $250 per day was used? Would the mere reporting that the company expended $250 per day in connection with Orville Ferguson's expense costs, would that satisfy the reporting requirement even if he used the $250 a day for the purpose of influencing an official of the Italian Government to exercise influence on the purchasing agent of Italy to buy the company's product?

Mr. KENNEDY. It depends on how you frame it.

Mr. ECKHARDT. If you frame it in that way, there is no penalty at all because all the company has to do is account for the amount of money spent overseas and regardless of how it is used ultimately—

Mr. KENNEDY. The framing of the hypothetical in the $250 a day, the reality of the case is that the sensitive arrangements are where the fees are in the hundreds of thousands of dollars.

Mr. ECKHARDT. All right, let's make it in that area. If you report the amount of payments was necessary for promotional activities,

does that satisfy the requirements of the reporting statute? No matter how the money was in fact spent?

Mr. KENNEDY. Yes, because if there was no knowledge of an abuse of that, yes, it would. It depends on whether there is knowledge of the way in which the money would be paid.

Mr. ECKHARDT. So even if the company falsely and knowingly reports $100,000 or $500,000 was spent within a period of 3 months and goes into great detail of how that was used for promotional purposes and all of this detail is false, nevertheless this would satisfy the reporting requirement?

Mr. KENNEDY. No, sir, I did not suggest that. If there is knowledge that the payments are passed on, that would have to be reported.

Mr. ECKHARDT. Then if it is not reported and the company says that these were innocent expenditures for the purpose of promoting the product, don't you face then the question that I was mentioning before; Is the company telling the truth? Were the funds used for honest, permissible promotional purposes or were they used as a bribe?

Mr. KENNEDY. You would have to show only a knowledge that some of the money would be passed on. You would not have to show corrupt motive. You would not have to show some of the other requirements that are in the statute.

Mr. ECKHARDT. You may be suggesting a good method. As a matter of fact, it could be pretty strict if we followed that line. But I think we get closer and closer to the provisions of the bill except that we might change the bill from a criminal penalty to a civil fine.

Mr. VON MEHREN. I might say that we have described at pages 16 and 17 of the report of the ad hoc committee the outline of a disclosure system. One of the fundamental aspects of that outline is that you have to report payment not on the basis of the purpose for which the payment is made but rather on the basis of whether or not it goes directly or indirectly to a governmental official.

Then we have a separate treatment of the payments made to agents. Those have to be reported if they meet certain tests, again irrespective on what the intent was.

Mr. SCHELL. Mr. Chairman, may I speak to that, I hope not to further confuse the situation.

On page 13 of my statement is the suggestion of our group. It is very simple. It is this: All payments made to foreign officals, all payments made to agents must be reported, irrespective of what they are intended for or how they are used. The purpose is to get the aggregate amounts or such payments up through the corporation and out to the public. We make no suggestion for differentiation between grease payments and bribes.

I do make this difference myself as a matter of philosophy, but we feel that the important thing is to bring this information up through the corporation and having done so, it is our view—and I have facts here I think to demonstrate that—that the American corporation is so oriented and so organized and so controlled today that that such information will be very meaningful.

As a director of a corporation, if I see a figure on agent's payments or on payments to officials, I am not going to just say,

well, that is a dandy figure. I am going to get in there and see what they are. Audit committees are going to get in there and see what they are, as are outside auditors.

If there is one thing today that is changed, it is this: For many years audit committees of boards blanched when they heard the word 'defalcation'. The slightest amount of money that was taken out of the till was pursued. Today that same attitude is taken with regard to these kinds of payments. So it is a very simple situation.

You are quite right when you say that money could have been used to bribe the daylights out of anybody. What we are interested in is getting the fact of the payment surfaced and have a very severe penalty for failure to do that.

Mr. ECKHARDT. But the thing that I am getting at is that a payment may have been made to an official or an employee of the company overseas which was known to be intended to be expended by him illegally.

Mr. SCHELL. That is right.

Mr. ECKHARDT. Now the question I am getting at is this: Is the company required to report all expenditures overseas even if the expenditures overseas go to its own employees or must it only report under your reporting requirements that which it alleges have gone to officials of the foreign government? The thing is that you come right back to the question of where the money actually ended up. If the only requirement is to report expenditures to an employee of the foreign government, the question arises whether or not those payments were made to the foreign government ultimatly. It seems to me you have the same question of proof. Now you may be right. All of you may be right that the reporting type of proposal is better than the criminal type of approach. The only thing I am urging to you is that your arguments concerning the difficulty of proof exist in both cases because in the case that you describe, the difficulty of proof arises in where the payments ultimately lodge.

Mr. SCHELL. No, sir.

Mr. ECKHARDT. The thing about it is the company says we didn't pay anything to the Italian officials. We don't know what happened to it after Orville Ferguson got it. The Justice Department says, "Yes, you did and you violated the reporting statute because you knew Orville Ferguson was called upon to give that money to the official of the foreign government.

Mr. SCHELL. That name, Orville, caught me up a little short.

Mr. ECKHARDT. That is your first name, I am sorry.

Mr. SCHELL. It is a name often used in the dime novels to characterize dastardly men.

Mr. ECKHARDT. From now on I will use Chauncey.

Mr. SCHELL. The simplicity and possibly oversimplicity of this system, and I think Mr. Kennedy put it very clearly, is that you don't have to prove intention or where the money went ultimately. You have only to show that the money went to a foreign official.

Now, if the president of a corporation puts a lot of cash in his pocket and takes it to Italy and slips it to the manager of that company and that manager of that company then gives it to the foreign official there has to be some record back home of that one. That is for sure. Because even a president doesn't get the money without a voucher.

But if an international manager sends some money to a fellow to do ostensibly legitimate things, and I think this is your case, and he then pays it to a government official and denies it, of course you are not going to pick that up unless you have proper controls within the company to see where that kind of money went.

I think what I am saying, and I am not an accountant, is that to a tremendous extent controls are being put in place today to have transactions say what they are and not call them things that they are not. And that gets, of course, into this bill as in the Senate, the Proxmire bill, but that is not in your bill today. I happen to feel that the so-called accountability requirements those ought to be in regulations, but the burden of my point is merely to surface to the fullest extent humanly possible.

The facts and the experience of the last 3 years has demonstrated how well disclosure has worked. Our group has done a study of 85 corporations all over the country. We have found in every one a policy statement outlawing improper payments has been adopted, some as Dr. Gordon said, minimal, some complete in their prohibitions.

I have copies of 26 statements here that I should like to leave with you, if I may. The evidence collected by the accounting members of our group, they have gone all over the country to their engagement partners shows that these policies are being enforced.

Mr. ECKHARDT. May I ask you at this point, do you purport to represent accountants here as well as attorneys?

Mr. SCHELL. I represent a group of people, fellows who have gotten together on a pro bono basis. We happen to be accountants and lawyers and are pooling our experience because we feel this is a serious question, and we want to see it stopped, and we would like to see the best possible method used. We come to you and urge legislation to require disclosure intention or urge reporting.

Mr. ECKHARDT. You, unlike Mr. von Mehren, are not representing any official group of lawyers or accountants but only those you list on your list you supplied us?

Mr. SCHELL. Exactly. And we represent no one as a group. We have no affiliation. As my statement says we represent only our own sense of our professional responsibilities. Mr. von Mehren is a member of our group.

Mr. ECKHARDT. Let me ask you another question about your proposed reporting requirements and I have some difficulty because I don't have the specific statute before me that you may propose.

Mr. SCHELL. Yes, I realize that.

Mr. ECKHARDT. Let us suppose that there are two violations of reporting requirements. In the one case, the Acme Company did, in fact, provide certain expense allowances to its representative, Mr. Chauncey Ferguson, and indeed it knew that those moneys were going to be used in part for entertaining some official in Italy, a person whose duties were totally clerical. The moneys were to be used in the sense of the mordida, that is to encourage him in the nature of a tip to permit the processing of the Acme Company contracts in the manner in which they ought to be processed and in the manner in which they were processed for all other companies. However, the company probably was guilty of a technical violation

because it did, in fact, know that these moneys customarily went in small quantity for entertainment and it did not disclose that fact other than that this money was expended for the purposes of additional cost of living for Ferguson in Rome, Italy.

Now let us suppose another company, which we will call it the Jones Ammunition Company, did a much worse thing. It actually expended very large sums of money and failed to account for them when they were, in fact, paid for bribes for that company to buy the ammunition of the Jones Company rather than the ammunition provided by the Japanese or the Germans. It was not engaged in a mordida at all. It was engaged in an attempt to get the Italian official to use his influence to purchase from this company even though at a higher price and to the disadvantage of his government.

Both companies have been guilty of a failure to report that such funds were paid. I assume from the manner in which you describe the statute that since the question of culpability is not to be considered, the Acme Company and the Jones Company would be subject to exactly the same thing?

Mr. SCHELL. Yes, sir. This is where perhaps we depart from the association.

Mr. VON MEHREN. Not at all.

Mr. ECKHARDT. Mr. von Mehren agrees, and I think the answer is logical from the standpoint of the basis of your contention.

Mr. VON MEHREN. I was going to add, the second company, however, is going to get hit with a lot of other problems once these facts surface. They are going to have probably the IRS after them, the SEC, et cetera. So even though the penalty, for the failure to make the required disclosure under the system that we would propose may be the same the total impact is different; and, of course, the judge always has some discretion as far as the fine or whatever other punishment may be imposed. In the second case, the total consequences are obviously going to be far more severe for the second corporation than for the first corporation.

Mr. SCHELL. I think Mr. von Mehren has made one of my points for me, too, and that is the surfacing of the information. The controls within a corporation today, in my view, would make it, except for the most dreadful backslider, almost impossible for large sums of money to go to an official of the Italian Government without being identified.

We place great reliance on that, Mr. Chairman. I have to say that. I think the data of the experience of the reaction and action by outside directors over the past 3 years supports that, and that is one of the keystones of the proposal that my group makes.

Mr. ECKHARDT. Now, I want to go into a line of questions and I want to predicate it by saying I, myself, have been actively engaged in the practice of law before I went to Congress. I am one of those who believes everyone is entitled to representation and that there should be no necessary opprobrium to any person who represents a client.

I want to make that clear from the beginning. However, I think from the standpoint of the very disclosure principles you describe here, the interest of any person appearing before a committee is also something that should be disclosed. I understand that you, Mr.

von Mehren, appear here for what do you call it, the Association of the Bar of the City of New York?

Mr. VON MEHREN. The ad hoc committee of that association.

Mr. ECKHARDT. And Mr. Schell is here representing a specific committee, members of which he has listed, and you, Mr. von Mehren, are a member of it. I also understand that lawyers frequently leave their client at the door, but their clients are ordinarily at the door when they come out. I do think it is important to know who one's clients are in cases of testifying before these committees. Frankly, I expect partisanship before this committee. I have always seen it on both sides and there is nothing that I suggest here that would indicate that having a partisan interest or position is necessarily bad. But both of you do represent clients or do have interests involving persons who have made disclosures with respect to payments that might be improper, do you not?

Mr. VON MEHREN. You are talking about my law firm, or me, myself?

Mr. ECKHARDT. Either way.

Mr. VON MEHREN. Let me say as far as I am concerned personally, first that I did not discuss with any client the progress of the work of the ad hoc committee. I did not show a draft of the report to any client——

Mr. ECKHARDT. I am really not getting into that. Let me ask a specific question.

Mr. Kennedy, you are general counsel——

Mr. KENNEDY. No, sir; not general, just counsel.

Mr. ECKHARDT. For General Electric, are you not?

Mr. KENNEDY. Yes.

Mr. ECKHARDT. And, of course, they disclosed $550,000 payment over a 3-year period which might be considered to have been improper payments?

Mr. KENNEDY. Yes; this is, of course, an aggregate number for a large number of foreign subsidiaries and affiliates, a large number of companies. My recollection is that it was over a 4-year period. But I am not quite clear on that.

Mr. ECKHARDT. Mr. Schell, you are a director of Merck and Company.

Mr. SCHELL. Yes, Mr. Chairman. I have no reluctance whatever in any disclosures you want to have me make.

Mr. ECKHARDT. I would think you wouldn't.

Mr. SCHELL. You spoke of partisanship, and that took me back a little bit because I am certain you will think I am naive when I say this, but I am not partisan on this except to get the job done, and I think my record of public service in the past will bear out that I do have feelings in this direction. I am director of Merck and Company and on the committee that did the investigation of the payment once we found out about them. I am on the board of directors of a company which, looking to the future, has outlawed every single kind of payment, mordida, grease, whatever you want to call it.

Mr. ECKHARDT. But they did have overseas payments they disclosed of $3.7 million.

Mr. SCHELL. The figure is a very gross figure because, frankly, we leaned over backwards and as our audit report will show, threw

everything in there we possibly could. We didn't want to have any possible error made. We erred on the high side.

Mr. ECKHARDT. I really didn't intend to use the term partisan in that sense. I want you to fully understand that if this committee is to work out a means of solving problems, it has to have people before it who know about those problems and the fact that you do is certainly no reflection on any of the witnesses.

Mr. SCHELL. I am perfectly relaxed. My firm in New York has represented numerous corporations that have had this type of problem.

Mr. VON MEHREN. The same is true of my firm, too.

Mr. SCHELL. I am also former president of the Association of the Bar. I think that I have been able, through my work on this Ad Hoc group, in the course of which I have shined up my pants and skinned off my nose, so to speak, and, at my own expense to make a substantial contribution. I have seen this problem from the inside, and I have been a director who was shocked when he found the pervasive nature of these overseas payments not only in my own company but in so many other corporations. I consider it immoral, but I go way beyond there to the other really terribly adverse effects it has on world commerce and our relations with other nations.

It is these reasons that that prompted me and a few others to say this is a problem that is going to come before the Congress; this is a problem that has to be solved; perhaps men of goodwill in the two professions who have dealt with it and must deal with it in the future—and when I listened to the colloquy this morning on the question of when is a payment and when is it not a grease payment, I am reminded of discussion in our own audit committee where we formulated our policy and decided that we would outlaw everything.

We had an experience recently where some I think 10,000 vials of sterile medicine were on the dock or airport in some far eastern country. It had been customary to pay a few hundred dollars to get it in. It wasn't paid, and the minister of health said, 'Open them up for inspection.'

So it is tough. I might also say that I had a direct experience some years ago in the Far East, where I was negotiating a deal on behalf of a client. I was asked for a payment under the table and from under the table over to Switzerland. I refused. Whereupon the person with whom I was negotiating said, 'Won't you bring in Mr. So-and-so from Switzerland?' He was our competitor with his hand on his billfold. We lost the business, and they got it.

But you feel good about those things when you do them. I don't want to give the impression that I am perhaps the only one on our Ad Hoc Committee with this point of view. We all share it. My colleagues have taken time out from very busy lives and in a very dedicated way to try and find a solution to this problem. We all feel that way or we would not have spent the time we did it.

Mr. ECKHARDT. The subcommittee very much appreciates your testimony. I think it is always rather easy to define the very bad situation which may exist at any given time in this particular area and what would be the ideal situation or very much better situation. The real problem is how to the get from here to there and that

is what this subcommittee is trying to determine. And that is what your testimony indicates you are concerned with.

Mr. SCHELL. I would be less than frank to say that as an individual and speaking as an individual, I would throw them all in jail.

Mr. ECKHARDT. Maybe that is a good note to adjourn here for lunch.

Mr. SCHELL. I just don't think the proposed bill is going to work.

Mr. ECKHARDT. The subcommittee is adjourned.

[Whereupon, at 2 p.m., the subcommittee adjourned, subject to the call of the Chair.]

UNLAWFUL CORPORATE PAYMENTS ACT OF 1977

THURSDAY, APRIL 21, 1977

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. Bob Eckhardt, chairman, presiding.

Mr. ECKHARDT. The Subcommittee on Consumer Protection and Finance will resume its hearings.

Without objection, the Chair wishes to place in the record, as though read, the statements of Congressmen John E. Moss of California, Michael J. Harrington of Massachusetts, and Stephen J. Solarz of New York.

[Statements of Congressmen John E. Moss, Michael J. Harrington, Stephen J. Solarz follow:]

STATEMENT OF HON. JOHN E. MOSS, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF CALIFORNIA

Mr. Moss. Mr. Chairman, memebers of the Subcommittee on Consumer Protection and Finance; it is with pleasure that I accepted your invitation to testify on H.R. 3815, the "Unlawful Corporate Payments Act of 1977." I welcome this opportunity to present to this subcommittee evidence and conclusions developed by the Subcommittee on Oversight and Investigations which clearly call for legislation of this type.

The need for this legislation is no less today than it was when the existence of illegal domestic campaign contributions was first brought to light by the Watergate Special Prosecutor's office. It is not less today than it was when I testified before this subcommittee last September, on a bill similar to the one under consideration today. At that time, I reported that more than 200 corporations had disclosed illegal or questionable foreign or domestic payments to the Securities and Exchange Commission (SEC).

Today, that number of companies making such disclosures has reached over 300. At the time of my testimony last fall, the Commission had brought 20 enforcement actions against firms making illegal or questionable payments. Today the number of enforcement actions is 31.

A cessation of these revelations is not in sight. Obviously, a large portion of corporate America believed that compromising the credibility and the morality of the corporation and its stockholders was well worth the risk of being caught. Perhaps this is the reasonable course of action to take when detection only means a $10,000 fine or more than likely an injunction against furthering the particular action.

Though it would be naive to think that passage of this legislation would bring an end to unlawful corporate payment, I must believe that faced with the possibility of, depending on the severity of the violation, a $1 million fine, a "let's take a chance" attitude would not be an attractive one to take. The thoughts of a corporate officer to authorize or acquiesce in an unlawful payment must surely be diminished should he or she be faced with the real possibility of a $10,000 fine and 5 years of imprisonment.

I think it is important to address some of the concerns expressed about this piece of proposed legislation.

Even the general purpose of this type of legislation—to prohibit the bribery of foreign officials—has been criticized. Many corporate officials claim that to stop questionable payoffs would mean lost business to the company; that the company would be at a competitive disadvantage with exporting nations which continue the payments as if it were a way of business life.

This assumption can not be made. A recent survey conducted by the Wall Street Journal indicates that these claims may have been unjustified. The 25 corporations surveyed had each disclosed making large questionable payments abroad.

Of the 25 firms, four said their sales had not been affected by discontinuing the payments. Ten said there was no significant loss or no perceived loss. Five said they were unable to tell and five declined to comment. One said it had left the area where it had found payoffs necessary. Surely, these firms would be eager to tell of the loss of business had it occurred. None had such tales.

However, to think that no loss of business would occur in every instance would be unrealistic. Can we allow this to occur? Yes, if that is the small price we must pay to return morality to corporate practice. Yes, if that is the small price we pay to show that U.S. firms compete in terms of price, quality, and service and not in terms of the size of a bribe. Real competition works. The vast majority of American companies have operated successfully in foreign countries without the need to resort to bribery.

It is said that simple "grease payments" are often a necessity and should not be declared unlawful. Section 2 of H.R. 3815 attempts to achieve this in stating that the term 'foreign official', "does not include any employee of a foreign government or any department, agency or instrumentality thereof whose duties are ministerial or clerical." I question the reasoning behind this exclusion; small payments may be necessary to persuade low-level governmental officials to perform functions or services which they are obligated to perform as part of their governmental responsibilities, but which they may refuse or delay unless compensated. We have seen cases where the payment of fees or commissions have reached staggering amounts, approximately $3.8 million above customary commissions

in the cast of ITT. We have also seen commission type payments merely being passed on to foreign officials.

I believe this issue warrants the careful consideration of this subcommittee. Regardless of your conclusions as to the lawfulness of these payments, I feel that if they are made, regardless of the size or purpose the disclosure of this type of payment must be made to the corporation's shareholders and the public. Further, the Department of State, on behalf of American stockholders, should use every effort to discourage the requirement of such payments by nations where this practice has become customary and prolonged.

Much of the debate surrounding this bill has focused on the issue of where the responsibility for civil investigation and enforcement should lie for cases involving unlawful payments by issuers of registered securities. I believe strongly that the responsibility should rest with the Securities and Exchange Commission and not with the Department of Justice. I will explain my rationale.

The SEC broke the ground in efforts to detect and prevent unlawful corporate payments. For the last several years, the Commission has been the major force among Federal agencies taking steps to restore integrity in American corporations. The Department of Justice does not have such a record. The SEC has learned much in this time period. Its expertise in this area is second to none, nor has that expertise been challenged. The Division of Enforcement of the SEC has gained a deserved reputation for its vigorous enforcement efforts. That division is respected by those subject to, or potentially subject to, its actions. Due to various reporting requirements contained in the securities laws, there already exists within the Commission the most complete and useful body of corporate financial information, and information on other corporate activities, which is in existence in any one place. Regardless of who is ultimately given the enforcement responsibilities under this bill, that information will remain with the Commission. It would seem foolish indeed for another body to compile the same information.

Perhaps the most important reason why the enforcement of this bill should be vested in SEC is the nature of the Commission as an independent agency. In an area such as this one, involving the relationships between this country's corporations and foreign nations, the potential influence which may be felt by an executive branch agency is obvious. Such influence, be it direct or indirect, could easily result in the nonuniformity of prosecution depending upon the foreign nation involved. The Securities and Exchange Commission has displayed in the past that it is less sensitive to pressure or influence from outside forces, whether they be political or economic. For these reasons, I believe that it is imperative that the responsibility to investigate and enforce violations of this bill be vested in the SEC.

I would now like to address some areas which are not contained in H.R. 3815, but which I believe warrant the attention of this subcommittee. These suggestions are based primarily on the study conducted by the staff of the Subcommittee on Oversight and Investigations, entitled "SEC Voluntary Compliance Program on Corporate Disclosure." One of the major findings of that study was

that in the majority of cases of illegal or questionable payments, there was a breakdown in the corporations' internal auditing or accounting controls. In my testimony before this subcommittee last fall on H.R. 15481, I addressed many of these problems and offered several recommendations for their cure. I stand by those recommendations today. As you are aware, Section 1 of H.R. 15481 would have required 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.

This section is not provided for in H.R. 3815 because the SEC has proposed regulations to require the practices called for in Section 1 of H.R. 15481. I supported that provision last year, and I commend the Commission for its initiative to provide for such controls by a rulemaking proceeding. I bring this to your attention only because I firmly believe in the importance of such a provision, and to ask that this Subcommittee, as will the Subcommittee on Oversight and Investigations, carefuly oversee the implementation and enforcement of the proposed regulations, in order to determine whether statutory changes in this area might be necessary in the future.

Another conclusion reached in our Subcommittee's study on the SEC voluntary compliance program was that there is often times a lack of uniformity in the nature, the extent, and the manner of disclosure required under the Securities Act of 1933 and Securities Exchange Act of 1934. This lack of uniformity is a result primarily of the fact that there exists an inadequate standard by which to judge whether an act or transaction is "material" and thereby must be disclosed. The Subcommittee recommended that disclosure must, at a minimum, include a detailed description of the nature and purpose of the payment, the amount, the basis of its illegality (or the surrounding facts which make it questionable), and the identity of all corporate officials who participated or had knowledge of the transactions. Though H.R. 3815 does not address the disclosure question, I believe that the Subcommittee in its consideration of the question of unlawful corporate payments, might wish to consider a specific delineation of what is a "material" act or transaction under the securities laws. This might well be done by specifying a monetary amouont of a payment, above which a payment would be "material" and must be disclosed.

In closing, let me state that this bill has my support. I believe that it is a measure long overdue as a means to return trust in American corporation, and instill accountability by those corporations to their shareholders and the public. Thank you for this oportunity to share my views with you.

STATEMENT OF HON. MICHAEL J. HARRINGTON, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF MASSACHUSETTS

Mr. HARRINGTON. During the past few years, the debate on global corporate payments has tended to focus on one dominant aspect of the controversy-bribery to gain specific business advantages. The virtual avalanche of revelations demonstrating the scope and magnitude of international bribery understandably lent a sense of

immediacy to this particular problem above all other considerations. The disclosures which rocked and occasionally toppled governments on three continents contributed as well to the American crisis of confidence and thereby undermined our own government and institutions. American political leaders rightly sensed the priority attached to the issue and actively set about in search of a solution.

On the topic of corporate bribery to date, we have had hearings in the Senate and the House, received recommendations by a Presidential Task Force, and witnessed investigations by at least four agencies in the executive branch-the Securities and Exchange Commission, the Internal Revenue Serivce, the Federal Trade Commission and the Department of Justice. The broad consensus in the Senate on this issue was reflected in the passage last year of the Proxmire bill by a vote of 86-0. In the House, a similar effort was initiated but unfortunately time constraints prevented final passage of the legislation, a bill which I had the pleasure of supporting in testimony before this subcommittee. Finally, the Carter administration has voiced its strong support of legislation mandating criminal penalties for corporate bribery.

Thus, in the aftermath of the dismal record of American corporate misconduct overseas, H.R. 3815 is a commendable signal of official American intolerance of corporate wrongdoing abroad. It is a first step towards restoring a diminished public trust.

Yet there remains another aspect of the corporate payments problem that equally deserves our attention. Imagine the American sense of outrage if we were to discover that, for years, foreign corporations were regularly subsidizing our elections and making massive annual contributions to our political parties. Surely we would feel that the American democratic process had been impaired and the outcome distorted.

We would feel that our system of government had been tampered with in a fundamental way. Yet some American corporations have regularly contributed to foreign political parties, candidates, and media outlets, especially during foreign elections and foreign political campaigns. Such payments will not be affected by the pending legislation. Neither will the contributions have to be disclosed to the Securities and Exchange Commission, if they are consistent with the laws of the host country and not material to the firm's business. In most foreign countries, corporate contributions to political parties are legal.

If we criminalize corporate payments made to secure specific business advantages, as the pending bill does, should we not also address the problems posed by allowing corporate payments made for broader political purposes? While H.R. 3815 does hold American business to a higher standard of conduct by prohibiting outright bribes, it does not eliminate or discourage American corporate interference in the political or economic affairs of foreign countries. It dos not address the issue of American corporate contributions to foreign political parties to curry favor with, influence, or destabilize an incumbent foreign government. And, as we are all well aware, recent American history provides ample evidence of such efforts. Clearly, the issue of corporate political contributions abroad has not only ethical but serious foreign policy implications as well.

Even before the current wave of bribery disclosures, ITT's efforts in 1970 to block the election of Salvadore Allende was documented by two Senate reports. After the Central Intelligence Agency declined ITT's offer of corporate funds to stop Allende the agency promised "to advise ITT on how to channel its own funds." (*Covert Action in Chile, 1963-1973,* Staff Report of the Senate Select Committee on Intelligence, p. 58.) Later, ITT passed $350,000 to the Conservative Party candidate, Jorge Alessandri. Late last year, the *New York Times* reported that in 1970 Anaconda Copper Company offered to funnel $500,000 through the State Department to the same Conservative Party candidate.

In Italy a somewhat similar effort was undertaken by Exxon, the world's largest oil company. In testimony before the Senate Subcommittee on Multinational Corporations, Exxon executives acknowledged that, between 1963 and 1972, Exxon passed $59 million to the Italian Christian Democratic Party, the Socialist Democratic Party and the Socialist Party. During the course of these hearings, similar disclosures were made by other corporate executives. Mobil Oil representatives acknowledged providing $2.1 million to Itlian political parties in the early seventies. And from 1969 through 1972, Gulf Oil Corporation paid $627,000 to various Italian publishers controlled by Italian political parties.

These transactions should be considered within the context of parallel Central Intelligence Agency efforts to channel official U.S. dollars to the same parties. According to the final report of the House Select Committee on Intelligence, the CIA passed $75 million to Italian parties and politicians between 1948 and 1972. Of this sum, $10 million was spent in the 1972 parliamentary elections. And in January 1976, the *New York Times* reported that on December 8, 1975, President Ford approved a $6 million CIA expenditure for upcoming Italian elections.

Again in testimony before the same Senate subcommittee, Gulf Chairman Bob R. Dorsey stated that in Korea, Gulf made two massive contributions to the Korean Democratic Republican Party- $1 million in 1966 and $3 million in 1970. He acknowledged that over the years, Gulf made substantial contributions in Bolivia, Sweden and Canada as well.

Various press accounts have reported that other American corporations have contributed to foreign political parties in lesser amounts. According to these articles, the Continental Oil Company channelled $148,000 to unspecified foreign political parties. Firestone Tire and Rubber Co. provided $32,000 to an unspecified political party. And throughout 1973, a Philip Morris subsidiary in the Dominican Republic paid $1,000 monthly to the political party of President Joaquin Balaguer.

It is not my purpose here to enumerate all instances of either documented or alleged corporate political contributions, but rather to indicate briefly the dimensions of this aspect of a larger problem. The point is that, from all indications, these transactions were undertaken with a view toward making a long-term investment in a foreign political system, rather than to win a specific contract or to edge out a competitor.

The primary defense of American businesses with respect to such payments has been that corporate political contributions frequently are legal in the host country. As there are no prohibitions or reporting requirements on such payments, the corporations argue, American business cannot and should not be penalized for activites that are perfectly legal where they are undertaken.

Despite the factual accuracy of this argument, I continue to feel that serious and extensive considertion should be given to the issues posed by corporate political contributions abroad.

First, it is obvious that the foreign policy repercussions of such payments can be severe. In their support of one foreign political party over another, American corporate ativities can undermine official U.S. policy. Both Chilean President Allende and Venezuelan President Perez broke off talks with U.S. officials on compensation for nationalized property when they learned of corporate payments. Sen. Church contend that disclosure of the Exxon payments in Italy helped the Italian Communist Party score spectacular gains in the 1976 parliamentary elections. Numerous other examples could be cited but the point is clear. U.S. business contributions to foreign political parties can severely impair official policy. The U.S. Government, not private business, should conduct U.S. foreign policy.

Furthermore, consideration of corporate political contributions also bears on the question of government/corporate collusion for the channeling of corporate funds abroad, as documented by the Church report on ITT in Chile. Similarly, in the aftermath of the disclosures of Exxon payments in Italy, there arose widespread press speculation that the payments were actually a covert mechanism for CIA funding. Likewise, early this year the *Wall Street Journal* reported that government investigators were assembling "strong indications" that the CIA may have encouraged corporations to pay under-the-table cash to buy intelligence information for the U.S. Government. The fact that the intelligence community/corporate relationship has never been thoroughly examined is "the best indication of its sensitivity" the article notes. Thus, it is obvious that all efforts should be made to ensure that U.S. business abroad is not perceived either as a conduit or an agent of the Central Intelligence Agency. By allowing corporate contributions to foreign political parties to continue, it is doubtful that such speculation can be avoided.

Finally, the past few years have witnessed a tremendous outcry over countless CIA activities undertaken in friendly, democratic countries. Just as we oppose official covert or overt intervention in the internal affairs of these countries, we should likewise oppose even more strenuously similar actions undertaken by the private sector. Surely if the American public condemns foreign intervention by the American Government in the internal affairs of our allies, it is fair to say they will hardly condone a parallel effort by the private sector.

In light of these considerations, it seems to me that a sounder approach to the problem of corporate political contributions would involve strict and specific limitations on the kind of American corporate activities permitted on a foreign party's behalf (that is, paid political advertisements) coupled with stringent disclosure

provisions and/or clear prohibitions. It may be necessary to enact even tougher provisions than those included in the corporate bribery legislation, as this issue may become an increasingly important one. Since political payments for specific business purposes will clearly be prohibited by the new corporate bribery law, it is not unreasonable to suspect that American corporations may, in turn, increasingly rely on regular political contributions overseas to promote goodwill toward American foreign investment and to win the favor of foreign governments. A shift from international corporate bribery to international corporate political contributions is hardly a solution to the problem of corporate payments.

While I have not translated these ideas into legislation, allow me to summarize them briefly. First, corporate payments to foreign political parties, candidates and media outlets should be distinguished from corporate payments made for specific business purposes. Corporate payments to political parties should be the subject of even stricter disclosure and/or criminalization measures. Second, the Congress should enact a strong policy statement as well, opposing such contributions.

If we really believe in the concepts of non-intervention and self-determination for all peoples, then we ought to be willing to enact measures applicable to individuals found to be engaging in an activity which we supposedly have disavowed as an official instrument of U.S. foreign policy. Surely we should not permit, condone, or ignore corporate practices abroad which we ourselves would consider an outrage if they were to be engaged in by foreign nationals here at home. In my testimony last year before this subcommittee, I acknowledged that there is little one subcommittee can do, in its consideration of one particular piece of legislation, to restore the public faith in our national institutions. Yet we now have an administration whose prime foreign policy concern to date has been to restore morality and ethical principles to all of our international relations. Given the demonstrated commitment of the Carter administration to this goal, I feel strongly that the Congress and the Executive could successfully work together to explore, and attempt to resolve, many of the far-reaching problems of the improper payments issue which I have briefly outlined today. In theory,we have long recognized the principle of non-intervention in the internal affairs of other countries as a corrolary of democracy. Surely the Carter administration and the Congress can work together to restore this principle to its proper place in our political philosophy.

Companies listed in the Securities and Exchange Commission Report of May 12, 1976 to the Senate Banking Committee as having made political contributions to foreign political parties. This category does not include "Foreign Sales-Type Commissions" or "Payments to Foreign Officials."

Company and Foreign Political Contribution—

American Cyanimid Co.**—From 1971-75, payments of $10,000 to $20,000 annually. These were legal until 1974 and illegal thereafter.

American Home Products**—Contributions in four countries. The legality of some of the contributiuons appears questionable.

American Standard, Inc.—No illegal contributions. Legal contributions of less than $500 per year.

Baxter Lab**—Subsidiaries purchased $300 of tickets for fund raising dinner, and contribution of $120 were made to a political party. Both activities were legal.

Bristol Myers Co.—Preliminary results make company confident that no illegal contributions were made.

Castle & Cook**—$30,000 in two contributions that were legal where made.

Cities Service**—Expenditures of $30,000 for "political purposes." that were disguised on books and records of subsidiary. Company was informed that subsidiary believed that none of the funds were paid to government officials.

General Telephone & Electronics Corp.—Payments of approximately $182,000 over 5 years that were legal where made. One improperly recorded.

Honeywell—No illegal contributions.

Intercontinental Diversified Corp.—Contributions from 1971-75 as permitted by local law.

Koppers Co. Inc.—No illegal contributions.

Kraftco Corp.—Contributions totaling $8,500 from 1972-76 in countries where legal.

Merck & Co.—Payments totaling $157,684 from 1968-75 that were legal under local law but improperly recorded on books.

Rockwell Intn'l—$8,300 in Canada, where the contribution was legal.

Standard-Oil of Indiana**—From 1970-73, $617,000 in Italy. From 1970-75, $35,700 in Canada. The contributions were legal in these countries during the periods in question.

Sterling Drug—No illegal contributions.

United Technologies—No illegal contributions.

Warner-Lambert Co.—From 1971-1975, contributions of $15,300. The local managers were advised that the contributions were legal.

STATEMENT OF HON. STEPHEN J. SOLARZ, A REPRESENTATIVE IN CONGRESS FROM THE STATE OF NEW YORK

Mr. CHAIRMAN. Mr. Chairman, it is a great privilege and pleasure to testify before this subcommittee on one of the more important issues facing the 95th Congress. It is my hope that the Congress considers the elimination of American corporate payments overseas to be one of its principle priorities.

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 August, the House 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, when the Senate unanimously passed Senator Proxmire's antibribery bill by a vote of 86 to 0. Unfortunately, as you know, the House did not complete action on its antibribery legislation before the close of the 94th Congress. Hopefully with an early start in the 95th Congress this vital legislative proposal will finally become a reality.

With regard to Chairman Eckhardt's bill, H.R. 3815, I particularly endorse the section outlawing bribery by providing criminal penalties for payments overseas of up to 5 years imprisonment and a fine of up to $10,000 for individuals and $1 million for corporations. I believe that the stronger penalties proposed in H.R. 3815, as compared to previous proposals, are warranted in light of the overwhelming magnitude of the illegal payments and their subsequent repercussions. I also applaud the provision in the bill extending the coverage of the antibribery laws to businesses other than those registered with the SEC.

In my testimony today, however, I would like 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 examine 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 why 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 cite several examples.

Disclosures in the United States about business bribery overseas shook Japan in 1976 to its political foundation. The Japanese government experienced a severe strain due to its handling of the alleged Lockheed payoff scandal in that country. A very senior politician close to former Prime Minister Takeo Mike noted durng the crisis that ". . . with the Lockheed scandal the chips are down. The democratic system in Japan is in grave danger." Japanese opponents of the close ties between the United States and Japan were 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 was faced with unnecessary turbulence, and a relationship which is at the very heart of our foreign policy was potentially jeopardized.

U.S. 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 was forced 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 that 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. Allegations of payments by Lockheed served to advance the Communist cause in Italy where the Communist bloc was strengthened by the sight of corrupt capitalism. 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 Comunists had a wide variety of issues to use agianst the recent ineffectual coalition governments, but the allegations of widespread payoffs to various Italian officials—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 will be ultimately undermined.

The foreign policy implications for the United States are staggering, and in some cases, perhaps irreversible. The most important objectives of our foreign policy are seriously impaired by corruption of friendly foreign governments. The foreign government is weakened by corruption as popular support erodes thus jeopardizing common interests shared with our friends overseas.

As exemplified by Italy, Communist and other anti-U.S. forces are quick to take advantage of any evidence of immorality or corruption associated with pro-Western governments. Both fear and resentment are generated among foreign officials who become increasingly hostile as the United States continues to expose traditional corrupt practices abroad.

The countries of the developing world are especially susceptible to the tragic influence of bribes which often serve to propel an ever increasing desire for arms, thereby distorting their economy as well as their national priorities. As *New York Magazine* noted in March 1976, ". . . the Lockheed-Northrop documents provide some evidence that the companies, with their persistent bribing and lobbying, are themselves creating the new atmosphere of military ambition." The resulting economic and political instability is certainly detrimental to American foreign policy especially when it results in a backlash against American ideals and interests.

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 Untied States. It is clearly in our interest to put a stop to these pernicious practices. Leaving aside the question of 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 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.

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In January of last 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 5 years and half providing penalties of 6 to 10 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 last 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 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, which cannot be solved by the United States alone. Under the Ford administration, Deputy Secretary of State Robert S. Ingersoll proposed an international pact to combat corporate bribery, including a multilateral agreement within the Untied Nations system to help deter and punish corporate bribery 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, in corrupt business pracitces or not." I believe that this bill will be a significant first step in implementing that warning by making it clear that the U.S. Government will no longer tolerate corporate bribery.

The time is long overdue, Mr. Chairman, for affirmative and meaningful steps to be taken to cope with this situation. Failure to

take prompt and effective action can only encourage the continuation of these practices and, thereby, continue to create serious problems in our international economic and political relations throughout the world. The stability of numerous governments has been threatened and political parties in several countries have been seriously compromised. By enacting this measure, we would provide a real stimulus to American firms and others to conduct their business activities on an acceptable and ethical basis and to assiduously avoid any improprieties or questionable business arrangements. This legislation would remove any questions which American businesspersons, foreign governments and their officials and any others may have about the manner in which a U.S. firm operates overseas. Current statutes have failed to provide sufficient protection and more positive action is clearly needed.

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 foreign relations if this activity is permitted to go on. Revelations of illegal payments have served to the Congress should act to discourage bribery before it creates additional problems for American foreign policy.

Mr. ECKHARDT. We are honored this morning to have Secretary Blumenthal with us. Mr. Secretary, will you proceed in the manner that you see fit?

STATEMENT OF HON. W. MICHAEL BLUMENTHAL, SECRETARY OF THE TREASURY

Secretary BLUMENTHAL. Thank you, Mr. Chairman. I am pleased to be here this morning to testify in favor of H.R. 3815.

I have a prepared statement which, with your permission, I would like to submit for the record. Then, in making some opening remarks, I would like to summarize it in the interest of time.

Mr. ECKHARDT. Without objection, it is so ordered.

Secretary BLUMENTHAL. Thank you. Let me say at the outset that the Carter Administration fully supports the aims of this bill. We agree that the United States should impose criminal penalties on American businesses and their officials who bribe foreign public officials. There are a number of reasons why we feel this way.

In the first instance, clearly bribery is wrong. It is ethically and morally wrong. More importantly, it is unnecessary. In my judgment, based on my experience in business and based on my observation of what is or is not required I can see no excuse or justification for bribery.

Anyone who claims that this is necessary in order to protect American jobs or to protect their company, in my judgment, is wrong. It is a policy that creates the gravest of difficulties and should be discouraged by any and all means.

Apart from the moral repugnance and the inefficiency of the system, bribery is contrary to the foreign policy interests of the United States. There is ample evidence to support the statement that overseas bribery creates strains in our relations with friendly foreign countries and causes the international investment climates to deteriorate.

From foreign policy point of view, we feel it is important that this practice be discouraged in every way possible.

In order to make this kind of legislation fully effective, since it invariably deals with acts that have an impact across national borders, that a maximum degree of international collaboration between our government and other governments is necessary. Merely passing a law such as this would not be sufficient. It would be very difficult to enforce.

It is for this reason that we have supported and are supporting in a variety of ways international efforts to come to grips with this problem, including the negotiation of a treaty on corrupt practices in the United Nations and various bilateral methods of collaboration with other governments.

I have listed in my statement in some detail the steps which we have been engaged in in order to back up whatever legislation emerges from the Congress.

There are a variety of simultaneous efforts, that are underway as a result of all the publicity on bribery that we have seen in the recent past that have the effect of highlighting the things that are wrong with this kind of practice and of discouraging it.

I have summarized the various initiatives taken by our government to discourage this practice and they will be a part of the record. They include the successes that the SEC has scored in this regard in imposing direct controls. They include the efforts of the Internal Revenue Service in seeking information through the 11 questions that they have posed.

I have noted in the record, Mr. Chairman, that there are 50 criminal investigations as a result of these questions that are now going on. There are a number of other related steps that are important, including the work of the International Chamber of Commerce which has prepared a draft code of conduct through a panel established particularly for this purpose.

Perhaps I should in passing say, Mr. Chairman, that it is my experience that the vast majority of American businesses in my judgement would not dream of engaging in such a practice. This is in fact a practice that has been resorted to by a minority of persons, some of them misguided, all of them clearly wrong.

In supporting such legislation and in focusing on this problem, I would not wish to be recorded as implying in any way that it is a practice which I believe to be widespread or which I believe by any means to be acceptable to all but a small minority of American businessmen.

Turning now briefly, Mr. Chairman, to the specific comments on H.R. 3815, as I have said, we do support it. I testified accordingly on the Senate Bill S. 305 on the same matter. We suggested a number of changes in the Senate bill. Some of these have been dealt with in H.R. 3815. In particular H.R. 3815 now contains a definition of the term "control" which is, in my judgment, much more adequate and delimiting and easier to enforce.

Also, in accordance with the Administration's suggestion, it excludes small facilitating payments and therefore, defines what is meant by bribery more adequately than was previously the case. It also excludes from coverage certain employees whose duties are

clerical in nature. It defines the term "foreign official" more adequately than was previously the case.

There are in H.R. 3815 a few provisions which we believe ought to be looked at again and which, in the view of the administration, should be amended in order to make the bill more effective.

The first of these, of course, deals with the question of who shall have responsibility for enforcement. In our view there is a good deal of merit to assigning that responsibility to the Department of Justice. We would prefer to see it lodged with the Department of Justice rather than requiring the SEC to have primary enforcement responsibility.

I would have to say, Mr. Chairman, that this is a matter of judgment. It is not a matter that we consider to be of critical importance.

Mr. ECKHARDT. Mr. Secretary, would you permit me to interject at this point? Do you understand the enforcement provisions under our bill not to be in the Department of Justice? Investigatory functions are with the SEC, but the ultimate criminal enforcement would be in the Department of Justice.

Secretary BLUMENTHAL. I am not a lawyer, Mr. Chairman. I presume that the prosecution in the courts would be in the hands of the Department of Justice, but that when we talk of enforcement it really, as I understand it, means the investigation, the getting of the facts together, the following up and the policing of the provisions of this bill, that those would be with the SEC, as I understand it.

Mr. ECKHARDT. That is correct.

Secretary BLUMENTHAL. Well, as I said, we would prefer to see all that under Title 18 of the U.S. Code. But as I said, that is not a matter which we feel is of central importance. It is a judgment that we have made that we would prefer to have it there.

The second point which I have listed is that we feel that foreign issuers of registered securities should not be covered. The third point is that the extraterritorial coverage should be reduced by defining domestic concern to include only those foreign corporations which are owned or controlled by U.S. individuals or corporations and which have their principal place of business in the United States. As I understand it, that is a change that was made in the Senate antibribery bill, S. 305.

Fourth, in those provisions dealing with payments to officials through third parties, a standard of "having reason to know" that the payment will be passed on to an official seems a little broad for a criminal statute. We think that probably ought to be looked at again. I am inclined to wonder what exactly is meant by having reason to know and how one would defend oneself against the allegation that one had reason to know or not to know and I think that is a little vague.

The fifth point is that the mere acquiescence in an illicit payment even when done knowing fully should not be grounds to prosecute.

Mr. ECKHARDT. Mr. Secretary, I think we have noted that possible defect. Acquiesce is a somewhat unusual term for a criminal statute. That is, a person doing nothing to prevent a criminal act is very seldom made to criminal sanctions. We have discussed the possibilties of using the term "aid and abet" rather than acquiesce.

Secretary BLUMENTHAL. I think that probably would be good because that is a specific action of aiding and abetting rather than acquiescing. That would probably take care of this.

We do have a series of amendments that we worked out among the interested departments which would strengthen the enforceability of H.R. 3815 and indeed in some instances broaden its scope. We will make these available to you, Mr. Chairman, so that you might consider them in the initial consideration of this bill.

These, generally speaking, are my opening remarks, Mr. Chairman.

I should add that I have always felt and continue to feel that the real key to preventing this kind of action from being taken by American businesses has to lie with American businessmen themselves.

I have always felt that the possibilty of a professional code promulgated and enforced by businessmen themselves in the same way in which lawyers and other professionals, engineers and doctors, have their professional codes in which their peers participate jointly in setting the standards and in enforcing them, that that would be a very effective way.

I have always felt that a criminal statute such as this one will not be easy to enforce, particularly because it does involve acts that take place in other countries, the question of extra territoriality, the availability of witnesses, and gets you into the question of acts taken in other jurisdictions in which the laws are different.

I would, therefore, wish to end by stressing that we must not underestimate the difficulties of enforcement that in any case will result from this kind of legislation. It is for this reason that I feel so strongly that if we are to be successful in enforcement, the counterpart to this kind of legislation which is an agreement with other countries, multilaterally and/or bilaterally is probably essential in order to, have this kind of legislation mean something.

Nevertheless, we fully favor it and we want to work with you to make sure that the most effective legislation emerges from your deliberations.

[Testimony resumes on p.186.]

[Mr. Blumenthal's prepared statement and summary follow:]

STATEMENT OF THE HONORABLE W. MICHAEL BLUMENTHAL
SECRETARY OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
OF THE
COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

Mr. Chairman, Members of the Subcommittee:

The Carter Administration supports the aims of H.R. 3815. We agree that the United States should impose criminal penalties on American businesses and their officials who bribe foreign public officials.

Paying bribes -- apart from being ethically wrong, as well as illegal in most countries -- is simply not necessary to the successful conduct of business in the United States or overseas. My own experience as Chairman of the Bendix Corporation was that it is not necessary to pay bribes to have a successful export sales program. We made it clear to our employees that there was no business we wanted badly enough to pay a bribe for. This policy did not hurt us.

The United States Government has an interest in seeing that international business does not reward inefficient producers who have to bribe to gain contracts. The United States also has an interest in assuring that our relations with friendly foreign countries are not adversely affected by overseas bribery. Revelations of bribery create strains in our relations with these countries and cause the international investment climate to deteriorate.

International Efforts

Actions by the United States Government will not be entirely effective in dealing with the bribery problem unless they are matched by comparable actions of other developed and developing countries. We have made a continuing effort to deal with this problem and are working to develop an international consensus against corrupt practices.

An essential component of this effort is the negotiation of a treaty on corrupt practices in the United Nations. The United States has formally proposed that the treaty be based on three concepts:

(1) criminal laws in home and host countries prohibiting bribery in international transactions;

(2) international cooperation on exchange of information and judicial assistance in enforcement of these laws; and

(3) uniform provisions for disclosure of payments to foreign officials and agents made to influence official acts.

In response to this initiative, the U.N. has set up an intergovernmental working group and directed it to report by this summer on a possible treaty for consideration by the Economic and Social Council and the General Assembly. The working group has met three times and has scheduled an additional meeting in June to complete its report, which I will make available to you as soon as it is ready. It has held very useful discussions on the possible contents of a treaty. Although significant differences still exist and much work remains to be done, we are hopeful that it will be possible to build a consensus in favor of an international agreement.

The Administration continues to believe that such international actions will be an important complement to new domestic legislation. President Carter is giving the effort his fullest support.

In addition to this initiative, the United States is continuing to cooperate through bilateral agreements in the law enforcement effort of other governments with respect to alleged payments by U.S. companies. Thirteen agreements have been signed and discussions are underway with other governments which have expressed interest in concluding similar agreements.

Domestic and Private Sector Efforts

Recent action by the Executive Branch and the independent regulatory agencies has, I believe, increased the deterrent effect of existing law in this area. With your permission, Mr. Chairman, I would like a short summary of this action to be inserted in the record.

While these initiatives have produced significant results and involve many agencies of the U.S. Government, the Administration believes that they should be complemented by new legislation along the general lines of H.R. 3815.

In supporting legislation to criminalize overseas bribery, the Administration does not wish to give the impression that it regards American businessmen as generally corrupt or that it does not appreciate the efforts that have been made by businessmen to set their own houses in order. I believe that the vast majority of American businessmen are ethical and honest. I understand that most American multinational corporations have taken positive steps, such as issuing policy statements and strengthening audit committees composed of outside directors, to deal with the overseas bribery problem.

I am particularly interested in the initiative of the International Chamber of Commerce in organizing a commission to formulate a code of ethics for businessmen. The commission has circulated a draft code to the national chambers of commerce for comment. This code covers both domestic and foreign bribery of public and business officials. It also provides for the establishment of an International Council on Ethical Practices to apply the code on an international level. I am encouraged by the ICC's progress to date, and hope that a code broadly acceptable to all member units of the ICC will be agreed upon and implemented in the near future.

Comments on H.R. 3815

To turn now to H.R. 3815, which would criminalize corrupt payments made to foreign officials -- as I have stated, we support it.

As I am sure you realize, drafting anti-bribery legislation that is fair and enforceable is a difficult task. As I said in my testimony before the Senate Committee on Banking, Housing and Urban Development, on their anti-bribery legislation, the Administration believes that great care must be taken with an approach which makes certain kinds of extraterritorial conduct subject to our country's criminal laws. Moreover, a law which provides criminal penalties must describe the persons and acts covered with a high degree of specificity in order to be enforceable and to provide fair warning to American businessmen.

There is ample evidence in H.R. 3815 that you have recognized a number of these problems. For example, the bill contains a definition of the term "control," which is an important

element in making clear the intended scope of the law. Also, it excludes small, facilitating payments from its coverage by excluding employees whose duties are ministerial or clerical from the definition of the term "foreign official."

However, Mr. Chairman, I do believe that H.R. 3815 as it is presently drafted could give rise to serious enforcement problems. It is the Administration's firm view that the bill should be improved in a number of respects if it is to be fairly and effectively enforced and if its implementation is not to unduly offend foreign countries whose officials would be implicated in cases brought under U.S. criminal law.

Aspects of H.R. 3815 which the Administration believes should be changed include the following:

1. Requiring the SEC to have primary enforcement responsibility for a criminal law would be a serious diversion from its primary mission of securing disclosure to protect investors in registered securities.

2. Foreign issuers of registered securities should not be covered.

3. The extraterritorial coverage should be reduced by defining "domestic concern" to include only those foreign corporations which are owned or controlled by U.S. individuals or corporations and which have their principal place of business in the United States. (A corresponding change was made in the Senate anti-bribery bill, S. 305, during markup by the Senate Banking Committee.)

4. In those provisions dealing with payments to officials through third parties, the standard of "having reason to know" that the payment will be passed on to an official is too broad for a criminal statute.

5. Mere acquiescence in an illicit payment, even when done knowingly and willfully, should not be grounds for prosecution.

The Administration has prepared a set of proposed amendments to H.R. 3815 which it wishes to offer for the subcommittee's consideration. These amendments, which have been worked out carefully among the interested Departments, are

designed to strengthen the enforceability of the H.R. 3815 bill, and, where appropriate, broaden its scope. They would not weaken the legislation, but rather, I believe, help ensure that it is workable and fair.

I do not think it is necessary for me to describe the proposed amendments in detail here, but I should note that the Administration has proposed that the new law become part of Title 18 of the United States Code. This would place the responsibility for investigation and prosecution of foreign bribery in the Justice Department. This approach would reduce the risk of disparate and duplicative enforcement activities that can occur when responsibility for the same statute is split between two agencies. The SEC would, in any event, retain its present powers to seek injunctive relief against registered issuers who have violated various provisions of the act, and to obtain broad ancillary relief as we have seen in the past few years.

Other amendments focus primarily on the areas of concern I have mentioned above.

I would be very happy to make members of my staff available to discuss the proposed amendments with the subcommittee's staff.

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SUMMARY FOR THE RECORD

INITIATIVES TAKEN BY THE U.S. GOVERNMENT
TO DISCOURAGE FOREIGN BRIBERY

1. The Securities and Exchange Commission has been impressively successful in obtaining disclosure from issuers of registered securities who have engaged in these improper practices. It is already clear that these disclosures have compelled many firms to impose strict internal controls against these practices.

2. In June 1976 the Internal Revenue Service issued eleven questions to which corporate officers and outside auditors are required to respond in affidavit form. These questions are designed to discover whether corporations have been illegally deducting bribes. As of December 31, 1976, the eleven questions had been asked in approximately 800 large case examinations. Indications of slush funds or illegal activity have been found in over 270 such cases. Most of these cases are still under active consideration, and over 50 criminal investigations have been started.

Also in the tax area, the Tax Reform Act of 1976 eliminated the tax benefits (deferrals and deductions) associated with illegal payments made by majority owned subsidiaries and domestic international sales corporations. This new prohibition parallels long-standing prohibitions against deductions of illegal payments made in the United States.

3. The Arms Export Control Act of 1976 now requires reports of payments (including political contributions and agents' fees) that are made or offered to secure the sale of defense items abroad. The data reported by U.S. firms is made available to Congress and to federal agencies responsible for enforcing laws on this subject. The Department of State has issued detailed regulations to implement this requirement.

Furthermore, 1976 amendments to the Foreign Military Sales Act require disclosure to purchasing governments and to the Department of Defense of any agents' fees included in contracts covered by the act. Fees determined to be questionable by the Defense Department or unacceptable by foreign governments will not be allowed costs under such contracts.

4. Last year, the International Chamber of Commerce organized an international panel to formulate a code of ethics for businessmen. The panel is scheduled to present a code of ethics to the ICC Executive Board soon. Subject to approval by the

national chambers of commerce, the code could be adopted by the ICC council at its June 1977 meeting.

5. The United States is actively pursuing in the United Nations a treaty on corrupt payments in international transactions. The U.S. has formally proposed that the treaty be based on three concepts: (1) enforcement of host country criminal laws; (2) international cooperation on exchange of information and judicial assistance in enforcement; and (3) uniform provisions for disclosure of payments to foreign officials and agents made to influence official acts.

The U.N. working group for this initiative has met three times and will likely meet again to begin drafting. It has been directed to report by this summer on a possible treaty on illicit payments for consideration by the United Nations Economic and Social Council and possible action by the General Assembly.

A number of other governments have expressed interest in international action, but there is much work still to be done. This treaty may be an essential complement to effective enforcement of domestic legislation. President Carter is giving this effort his fullest support.

6. The Department of Justice, in cooperation with the Securities and Exchange Commission and the Bureau of Customs, has reviewed the foreign activities of approximately fifty domestic corporations. This review has resulted in the opening of active criminal investigations on a number of multinational corporations. Several of these investigations are now in the grand jury stage.

The U.S. is also continuing to cooperate through bilateral agreements in the law enforcement efforts of other governments. Thirteen agreements on specific corporate groups have been signed, and discussions are underway with other countries.

Mr. ECKHARDT. Thank you, Mr. Secretary.

Mr. Metcalfe?

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

Mr. Secretary, we are delighted to have you with us this morning. Let me pick up on the last statement that you made about an agreement with other countries that will be multilateral as well as otherwise.

Isn't that going to be a huge undertaking or would you be selective in the countries that you have this agreement with?

Secretary BLUMENTHAL. Well, there are two ways of doing it. One of them is through this United Nations intergovernmental working group under the auspices of the Economic and Social Council.

There have been a series of meetings in New York. There is another working group meeting scheduled in June. We are pressing hard for something to emerge from this effort.

In addition to that, we may wish to conclude bilateral agreements which provide for the exchange of information and close collaboration in the prosecution of offenders where the two countries are involved.

You are quite right that theoretically, if you wish to do this with all countries so that you can go into all jurisdictions and have the best possible collaborations, you do have a very large task. I think there is no substitute for attempting to do as much as possible and probably you would not have to do that with every country. There are some countries that are more important in this regard than others.

One would begin by working with the more significant countries in which the business relations between U.S. businessmen and that country are of great importance. You could begin with Japan and a few countries like that and then spread out and get a pattern.

Mr. METCALFE. If you select countries, then you no doubt will select those countries where our big corporations have major interest in those countries. Would that be casting an aspersion as a possibility or are you fearful of that?

Secretary BLUMENTHAL. I would not as a corporate executive have felt that an aspersion was cast on our integrity or our standards simply because my government made clear in a concrete way to the government of the country in which we happened to have an investment that it was opposed and that indeed it was illegal in our country to engage in acts of bribery.

Mr. METCALFE. Mr. Secretary, on page 4 of your statement you mention the exclusion of "small facilitating payments." I add "grease payments" as they are sometimes called.

Do you think that these should be excluded?

Secretary BLUMENTHAL. Yes, I have found generally in debates over this issue some people, who wish to make consideration of this issue difficult, will go to either extreme. Either they will say, "Do you really mean if you pay a headwaiter $2 to get a good table in a crowded restaurant, that that is a criminal practice that must be made illegal because it is a bribe?"

In other words, they go to the ridiculous example in order to make the point.

Or on the other hand they take the other case which is the hydrogen bomb case and say, "Can you really blame an executive who has 20,000 potentially unemployed who is confronted with competition from others, foreign companies maybe who engage in this practice, where the fate of 20,000 American workers and their families and wives and children hangs in the balance, would you say that a payment which is the same as everyone else is making, therefore, should be criminal."

The answer to that is that it almost never happens that way.

That is an extreme example. But I think one has to be reasonable about it. In many countries around the world what you refer to as grease payments are a way of life. They are clearly not what we are after. They don't cause any international embarrassment. I think the morality of that is of a totally different order of magnitude. I have paid a headwaiter something to get a table with a customer, but I have not engaged in bribery.

Mr. METCALFE. Where do you draw the line between facilitating payments and bribes?

Secretary BLUMENTHAL. I think that is a matter of judgment. I have no particular dollar figure. I really don't know.

I think it should be whatever the committee feels right.

Mr. METCALFE. Is it your answer as far as a definition as to facilitating payments, that that is ultimately going to wind up as an exchange of money or some material services where in the case of grease payments it may be that a person may contact another person and say, "Would you introduce me to the proper persons here along those particular lines?"

That is casting some influence, is it not? It is not as serious. There is no actual exchange of money other than you may compensate or be very kind to the person that you are asking a favor from.

Secretary BLUMENTHAL. Well, I think it is here, Mr. Metcalfe, where you get into the whole question of definition of what is a bribe. It is not, I think, so much the question of how much money passes or what you call it. It is possible to cover up what is in fact a bribe by calling it a compensation for certain services.

One of the difficulties of enforcement is the question of proof as to whether or not the particular compensation given is in fact normal or abnormal or whether you know that a part of it will, through some third party in a particular country, be turned over to an official. It becomes very difficult.

The whole question of compensation of agents, for example, comes into play in that regard.

Mr. METCALFE. I have just one additional question, Mr. Secretary.

How would you respond to those who contend that if this legislation is enacted, U.S. businessmen will be operating by different rules and they will be placed in a competitive disadvantage?

Secretary BLUEMENTHAL. I think that that may be true in individual instances. On the other hand, it does not worry me unduly. In my judgment, 99.9 percent of American business abroad is obtained because products are good products, competitive products of a kind, quality and a price that are wanted by the customer and not because these kinds of payments are made.

To the very, very small extent a particular company may lose a particular contract because it refuses to engage in this practice, I

would be willing to say, all right, we will be at a slight competitive disadvantage and we will all sleep the better for it.

That is the practice I followed in my company. It did not hurt us at all. We grew and prospered anyway. It may be that this or that contract might have been lost, but we could never prove it. It enhanced our reputation and it would enhance the American business reputation.

Look at the damage to the whole reputation of the American business community that has been caused in those instances in which that practice was not followed. It is not worth it.

Mr. METCALFE. Thank you very much, Mr. Secretary.

Thank you, Mr. Chairman.

Mr. ECKHARDT. Thank you. Mr. Secretary, I think your last comment is very apt. Actually, we are to a certain extent always at a business disadvantage in that we have, for instance, strict antitrust laws. But, in the long run, the fact that we have them puts us at, we believe, an advantage because our economy is more competitive and more vigorous because of it. However, in some specific instance it might well be a disadvantage in trading abroad with the many competing companies.

Secretary BLUMENTHAL. That is right. There are clear differences. There are differences in the tax system under which we have to operate. There are differences in the wage rate, differences in styles of living, differences in the antitrust laws.

There are also some great advantages that we have. So I would not worry about it.

Mr. ECKHARDT. I would like to get into a little the question which you say does not trouble you greatly, but with which we perhaps have some difference concerning who actually investigates and administers the process as opposed to prosecutes the ultimate case. I want to give you some of our thinking and just discuss it quite frankly and openly more or less in the sense of thinking out loud as to what policy would be most desirable in that area. Of course, the SEC presently has considerable investigatory authority. Any violation of the Securities Exchange Act of 1934 which, of course, is the act that this bill would amend is already subject to criminal sanctions.

At this moment, I understand the SEC has referred some 300 cases which it has investigated to the Justice Department. The reason we approached this in this manner is that the SEC has been more deeply into this subject than any other governmental agency. It also has a certain informational reach through the corporate reporting requirements that goes beyond most other agencies. Furthermore, there has never really been a whisper of doubt about the SEC's intention to investigate questions of this nature and expose them. Of course, its reach is generally related to the interest of stockholders not to have their funds wasted. This does to a certain extent extend its area of protection and concern. But as a very practical matter, it seemed to us that the SEC was the appropriate agency, to conduct the investigations because of its concern about the corporation's stockholders' interest.

Now we do not, of course, change what is a customary role of the SEC with respect to criminal prosecutions. It presently has very

wide authority with respect to civil action and may act there as its own attorney as you, of course, know. But with respect to criminal prosecutions, it acts through the Justice Department and it does so here. So we had not felt that we had veered far away from existing practices. In a sense we felt that we were following the pragmatic course in assigning the responsibility at this point.

Secretary BLUMENTHAL. I think that in any case, whichever way you come out, Mr. Chairman, what will be required is the close collaboration between the SEC and the Department of Justice in the investigation and ultimate prosecution and disposition of these matters.

The approach of placing a criminal law on bribery in title 18 of the U.S. Code and in assigning the responsibility for investigation and prosecution to the Justice Department is primarily to avoid the risk of duplication and disparity of enforcement activities when a statute is split between two agencies. That is the main argument of going the other way.

In a criminal investigation involving a foreign bribery case, if you were to follow the title 18 route, the Justice Department would have to work very closely with the Enforcement Division of the SEC and utilize the expertise that the SEC has developed in this area, but you would avoid deviating from the longstanding tradition of having the Justice Department primarily responsible for the investigation of criminal activities.

Mr. ECKHARDT. But, under this process since there would ultimately be the necessity of traveling the route of Justice Department prosecution, it would appear that there would be little practical possibility of dual investigation because the Justice Department doesn't have to race SEC to get into the act. It knows that the case will ultimately come to it.

Secretary BLUMENTHAL. What happens when there is domestic bribery? Isn't that a matter that lies with the Justice Department?

Mr. ECKHARDT. Yes, that would be true. Of course, it would also probably be subject to state law.

Secretary BLUMENTHAL. So I suppose the other implicit question is: What makes foreign bribery sufficiently different from domestic bribery to follow one procedure in one case and another procedure in another.

Mr. ECKHARDT. Well, let me suggest one other pragramatic reason and perhaps it might answer that question. When I state this, I do not mean in any way to anticipate any improper activity on the part of the Justice Department or the Attorney General. However, it is true that foreign bribery does have implications that go into a political realm and sometimes into an international realm. That is a big thing. It is a thing of grave importance. Now as remote as the possibility would be, if I were President of the United States, I do not believe that I would want authority to control the investigation directly. It has certainly been true historically that the President of the United States is very close to the Attorney General. In three successive Presidencies, the Attorney General was the President's brother, the Attorney General was the son of the President's dear and old friend, the Attorney General was the President's old law partner. An independent regulatory commission, on the other hand,

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is not a part of that official family of the Executive Department. Recognizing, of course, that there should be some consideration of international implications, we do ultimately channel the matter through the Justice Department. I would feel that the President would be more secure if he could say to other nations, 'This is a matter of domestic law. This is a matter which I can't touch. This is a matter in which a quasi-judicial agency enforces the right of investors not to have their money wasted away in illegal usage. I think there is some deep policy considerations in keeping this matter as far away from individual, personal judgment as possible. It seems to me that the independent regulatory agency is the best area in which this can be done.

Secretary BLUMENTHAL. I see and hear very clearly the point that you are making, Mr. Chairman. I would think that a President, any President acting properly and lawfully as he must, would be well advised and indeed in my judgment would have no choice in any matter, foreign or domestic, but to uphold the law. I am sure his Attorney General would do so.

The same thing applies to certain activities of the Treasury. There are under my direct control and the control of an Assistant Secretary the responsibility for the enforcement of tariff laws, including investigations with regard to the possible imposition of counterveiling duties.

Mr. ECKHARDT. Suppose in a case of foreign bribery that has considerable international political ramificiations the President is approached by the head of state with the urgent solicitation that the President do something about quashing this matter. Or suppose he is approached by the Secretary of State as a result of such contact. It is not necessarily improper or immoral or dishonest or a deviation of the Presidential duty to weigh the facts involved in such a case. Perhaps it is a good thing to afford such a possible balance and restraint by ultimately providing that the prosecution must be through the Justice Department as we do.

Thus I feel that a President would feel more comfortable if he could answer some foreign diplomat or the head of state by saying, "The question of investigation of these facts is out of my hands. This matter is conducted by the SEC. This is not related to activities of the Secretary of the State Department. Ours is the nation of laws and not of men." There are some areas in which a President's restraint may be his strength in bargaining with other nations. Indeed, I think this seems to be pretty much in line with President Carter's general attitude that there must be a basic morality which is not deviated from and that in the long run the cost of not deviating from that basic morality is a strengthening force to the United States rather than a weakening force.

Practically speaking, there are pressures that could be placed to quash investigations. I would like to see those stopped. I don't mean to in any way reflect on the integrity of any department of government or of the executive family. I am simply talking in terms of what manner of structure under any President and under any circumstances would be the most immune from interference for reasons other than the ends of justice.

Secretary BLUMENTHAL. I understand your point. I think it is possible under certain circumstances. The example that I was choosing in my own area has to do with allegations of dumping. I think the President is in that case in the same position to say to a head of state, and that may well happen at times that he has to say ours is a nation of laws and under the laws the Secretary of the Treasury is obligated to investigate the facts with regard to allegations of dumping and I cannot do anything about it.

If he is acting properly, that is what he must say. And the Secretary of the Treasury when put under pressure, if he is acting properly, must say that to the President.

Mr. ECKHARDT. That would work if we had a good President, which generally depends on the level of integrity and the determination of the person. But what would happen with, say, a Warren Harding and his Attorney General? Would we not be better protected nationally in that situation if the authority of investigation, not the authority of prosecution, were in the hands of an agency somewhat immune from Presidential control? I just pose these questions. I think they are deeply philosophical.

Secretary BLUMENTHAL. Only one more return question, Mr. Chairman.

I don't know how we protect ourselves against a bad President, a bad Attorney General, or with all due respect, a bad Chairman of the SEC. And there is no protection against having a bad Chairman of the SEC who may be more open to pressures, even though the law says that he must not be and he is in a certain sense independent of those.

Mr. ECKHARDT. But our experience has not indicated that this is very likely to happen. One reason, perhaps, is that a body like the SEC has staggered terms for its members and they are appointed by various Presidents. Also the SEC as an independent regulatory agency must respond to both sides of the aisle of, say, this committee. For instance, there was not a whisper of withholding the enforcement of security regulations in the Vesco case. There was a whisper of withholding enforcement proceedings of the EPA or at least of the Justice Department with respct to several cases that were developing during the Nixon administration. One was the ARMCO case on the Houston ship channel. There was a possibility of such occurring in the case of the Gulf Utilities case.

I am merely suggesting that history indicates a higher level of immunity from the swing of the pendulum from strict justice and integrity to lax justice and integrity in the Presidential office. I agree with you that there is always the possibility that corruption may extend into all levels of our government, but it seems to me that certain areas are less likely to be so infected. Now mind you, I am not suggesting that the Justice Department was corrupt at any time. I think that certainly at the working levels of the Justice Department there has been no question of its integrity. But I think that we would be less than honest if we said that was true all the way to the top in all instances.

Secretary BLUMENTHAL. I suppose, Mr. Chairman, you have slightly more confidence in independent regulatory agencies than perhaps I do.

Mr. ECKHARDT. Well, I have confidence in some of them.

Secretary BLUMENTHAL. That is the point.

Mr. ECKHARDT. One of them that I happen to have confidence in is the SEC.

Secretary BLUMENTHAL. I can think of some where I would feel it is really the other way around.

Mr. ECKHARDT. That is right. If we had drafted this law with respect to certain other agencies, I would probably be inclined to go for the Justice Department as the primary investigator. Well, there are a few other things that we have touched upon here that perhaps deserve a little more exploration. You suggest we eliminate from coverage of this act foreign corporations controlled by domestic concerns which do not have their main place of business in the United States. Would we thus be opening the door for the acquisition of a number of foreign corporations purchased by domestic concerns solely for the purpose of avoiding that portion of the bill?

Secretary BLUMENTHAL. I suppose the danger that ingenious minds are at work, is always there. I think it is probably a pretty small risk as against the other factors. The reason why we urge some caution and some delimiting in this area is that we want to be careful on this whole question of extraterritoriality, of not seeking to extend the reach of U.S. law beyond where it should properly be extended. The problem of enforcement then becomes very, very difficult. I doubt whether a company would specifically set up such an entity for the purpose of bribing. I think it is possible, but not very likely.

Mr. ECKHARDT. I note that both the administration's proposed bill and H.R. 3815 contains definitions of control. The administration adopts what I understand to be the IRS definition of 50 percent of the outstanding stock whereas H.R. 3815 is similar to the Investment Company Act of 1940 which creates a presumption of control at 25 percent. Do you have any comment as to which percentage may be more desirable?

Secretary BLUMENTHAL. I believe 50 percent is more desirable, particularly where it deals with foreign entities. My own experience is that in most countries while you have control with regard to certain acts at 25 percent, what you really require here is day-to-day management control. Generally, in foreign operations it is effective only when you have 50 percent.

In the experience I had in my company, in instances where we controlled less than 50 percent of the stock, unless we had a separate management contract or there was an unusual situation — in fact we had control over certain acts, increase of capital and some major activity, but basically we did not functionally control the management. In some instances it was slightly less.

I know of one major instance where it was less because the shares were publicly traded and therefore we had de facto controls because we had 40 percent and the rest was traded on the exchange.

But in the normal circumstances, the control is in the hands of the men who run the company and management will have places on the board and share in the profits. I think to hold American business responsible, the 50 percent definition which the IRS uses is probably the more reasonable one.

Mr. ECKHARDT. Thank you, Mr. Secretary.

Mr. Carney, did you have questions at this time?

Mr. CARNEY. You say in your second paragraph, "Paying bribes are ethically wrong as well as illegal." I think if something is illegal here and illegal overseas, that is one thing.

Where do you draw the line if something may be ethically wrong in a country but perfectly legal?

Secretary BLUMENTHAL. I cannot think of any countries in which the paying of a bribe is legal. It may be practiced, but is not legal.

Mr. CARNEY. Where do we draw the line on what is a bribe or what is business? If a way of business in some country is considered ethically right and businessmen do it, and if they do it they cannot be convicted under their country's laws, why should we make it illegal?

Secretary BLUMENTHAL. I believe that you would find, sir, that in virtually every country of the world what is defined as a bribe in this draft legislation is also illegal. Now the difference is that in most countries the law is not enforced. It is winked at.

But even in the most corrupt countries where the practice of bribery is widespread you will find a law on the books which says it is illegal to do that. We would have to go by the definition. The legal definition of bribery and the prohibition against do not differ very much from one country to another in my judgment. It is the practices and the enforcement of of the law that is different between countries.

Mr. CARNEY. Do you think we have a right to force either on American businessmen or on other countries our standard of what is moral or not? I see sheiks coming over here with 5 and 10 wives. That is illegal in our country but not over there. Should we stop them from bringing their other 9 wives in here?

Secretary BLUMENTHAL. No. I would have to discuss whether that is a perfect analogy to the question of bribery.

Mr. CARNEY. It is illegal here to have more than one wife at a time.

Secretary BLUMENTHAL. We are talking about our own citizens and the acts of our own citizens and our own companies. We are not imposing on foreigners. Under this proposed legislation we are only seeking to impose standards on subsidiaries and executives of those subsidiaries which are controlled, in this case more than 50 percent controlled, by Americans and American capital and shareholders and who therefore have to conform to our laws and practices.

Mr. CARNEY. If it is ethically wrong somewhere and not illegal and other businessmen do it from other countries, why shouldn't our businessmen be allowed to do it?

Secretary BLUMENTHAL. I believe we are entitled to have certain national ethical norms by which we all decide to live. If other countries wish to live differently, that is fine, but we are entitled to say to our business community, "Thou shalt not do such and such."

Mr. CARNEY. I am a great believer in "When in Rome, do as the Romans do."

Secretary BLUMENTHAL. That is the argument used for Americans bribing abroad. I don't believe in "When in Rome, do as the Romans do." I don't think that is right and I don't see any justification.

Mr. CARNEY. If you are going to foreign countries and doing something illegal, that is one thing, but if you are doing something that is unethical by our standards but in that country it is ethical and not a crime, I don't think they should hamper American businessmen; because, if it is not illegal, other countries are surely going to do it.

Secretary BLUMENTHAL. I know of no country in which bribery is legal.

Mr. CARNEY. You say ethically there. You go beyond bribery. You say ethically in your testimony.

Secretary BLUMENTHAL. What happens is that in a foreign country it is illegal, but it is considered to be ethically all right to violate the law. So it is the other way around. It is not that it is legal but considered ethically wrong. It is illegal but considered ethically right. It, therefore, provides an opportunity for us to say since it is illegal here and illegal there but winked at, we do not want to condone it.

Mr. CARNEY. Something that smacks of bribery and illegality done under the table, but if the American businessman goes somewhere which we may not consider ethical, makes a full disclosure and says he puts out the money for advertising purposes or goodwill, in this country we have a thing called finders' fees. I think that is pretty much the same thing. It is legal in this country, but it is just another type of bribery in my judgment. You get a cut for getting somebody some business and you do it your way.

Secretary BLUMENTHAL. It is here where you get into the question of definition and enforcement. You are right, that is a problem. It comes up most frequently in the question of agents' commissions. The only way to handle that within a company is in a pragmatic manner. I suppose those responsible for enforcing the law would have to do that.

What we did in my company was to say that we will not pay unusual and extraordinary agents' commissions in any country. Now what is unusual and extraordinary? That is a matter of pragmatism and judgment. If normally you pay 5 percent in a certain industry and somebody from a certain country comes and says I can get you that business but it will cost you 20 percent, that is abnormal and unusual. You don't need to do a lot of investigating and look under the table to know that the reason it costs 20 pecent is that he is splitting it with somebody in that particular customer's office who is going to get a cut of it.

We say we don't do that. Is 71/2 percent unusual and extraordinary? It becomes a question of judgment and what kind of services are rendered. I think it would be possible for the SEC or the Justice Department to make judgments in these matters. But I don't underestimate the difficulty of the task. That is why in my statement here and my statement before the Senate I stated that you are going to have some problems.

Mr. CARNEY. Thank you.

Mr. ECKHARDT. We also have noted the problem of one American business in competition with another American business overseas. If the standards of American business are not applied in Rome, not only may we be permitting our businesses to engage on the same

basis with other foreign businesses, but we may also be permitting a very low level of standards to prevail as against another American business. That I think has been one concern of the committee in drafting the bill. It may be a good thing to say, "When in Rome, do as the Romans do," but it may not be a good thing to say "When in Rome, do to other Americans as the Romans do."

Secretary BLUMENTHAL. That is right. You would at least eliminate that kind of argument as between two American competitors in a foreign country.

Of course, what some people would say is that that is only a part of the problem. What you may be doing is cutting both of these American companies out and you will be channeling that business to a foreign competitor which will be bad for the balance of payments and all those other things.

You can try to deal with that problem either through the International Chamber of Commerce, the United Nations or bilateral agreements by getting foreign nations to agree to declare these acts illegal and to prosecute and exchange information with regard to any, not just Americans, but their own nationals and third country nationals.

Mr. ECKHARDT. I think our counsel, Mr. Opper, had a question.

Mr. OPPER. Mr. Secretary, you indicated that giving Justice the entire investigatory authority under the bill would eliminate the disparate enforcement activities between the two agencies since under this bill the SEC is not given investigative authority for companies which do not file with the Commission.

Would it be fair to say, however, that virtually all cases would probably involve public companies which file with the SEC and therefore this would effectively eliminate this apparent disparity?

Secretary BLUMENTHAL. Well, I don't know whether all cases would involve public companies. They might not. This doesn't make that distinction. It doesn't just deal with public companies. It deals with any business.

Mr. OPPER. Public companies refers to those companies which file with the SEC. Under the first provision of the bill those companies would be subject to SEC investigation. For all other companies under the second section section of the bill the Justice Department which would have the principal investigative authority.

As I understand your prepared statement, there is the feeling that giving each agency investigative authority, depending upon whether or not the company involved files with the SEC, would effect disparate and perhaps duplicative enforcement.

What I am suggesting is that virtually all companies that would be engaged in this kind of business or would be of such magnitude to bribe officials of foreign governments would probably be public companies—companies that would file with the SEC. So there would be very few cases which the Justice Department would investigate unilaterally.

Secretary BLUMENTHAL. That is right. That is correct if you give that responsibility to the SEC.

As I said, you would in any case have to have a collaboration between the SEC and the Justice Department.

First of all, the Justice Department later on has to prosecute. When it comes to domestic bribery, it has to do the investigating

and you have the distinction between foreign and domestic to get back to the point the chairman and I discussed. I think it is over that issue that the concern over duplication arose.

But you can do it either way. As I said earlier, it is not in my view a vital point we would press very strongly for.

Mr. OPPER. I think it is contemplated that the SEC in their investigations work very closely with the Justice Department. I understand the report on S. 305 will reflect that.

Mr. ECKHARDT. Are there further questions? If not, Mr. Secretary, we certainly very much appreciate your testimony here which will be most helpful to us. We understand you have some recommendations with respect to amendments which will be given very careful attention.

Thank you very much

Mr. ECKHARDT. We now have the Honorable Harold M. Williams, Chairman Designate of the Securities and Exchange Commission. Perhaps by tomorrow we would not have to qualify that statement. We are very glad to have you here today.

STATEMENT OF HON. HAROLD M. WILLIAMS, CHAIRMAN, SECURITIES AND EXCHANGE COMMISSION, ACCOMPANIED BY HARVEY L. PITT, GENERAL COUNSEL

Mr. WILLIAMS. Thank you, sir. It is my pleasure to be here.

Mr. ECKHARDT. It is one of those cases where you don't know whether to say "Mr. Chairman." In the case of Mr. Schlesinger I could call him once and future chairman.

Mr. WILLIAMS. Thank you, sir. I have been sworn and have been functioning as Chairman since Monday. The ceremonial event occurs this afternoon.

Mr. ECKHARDT. Good. Then I think the term "Chairman" applies. You may proceed.

Mr. WILLIAMS. I appreciate this opportunity to appear before you this morning to testify on the subject of H.R. 3815 and to suggest other legislative approaches to the problem of questionable or unlawful corporate payments and transactions. If I may, I would like to submit my testimony for the record.

Mr. ECKHARDT. Without objection, it will be made a part of the record.

Mr. WILLIAMS. I have spent most of my life in industry. I might note that the objectives of H.R. 3815 are objectives I strongly support. My feeling is that they are a part of the basic morality of our society and the conduct that H.R. 3815 is designed to proscribe is conduct which is not supported in our society and tends to erode not only ethical standards but the free, competitive and effective marketplace and is conduct which is not needed nor justifiable.

Section 1 of H.R. 3815 would prohibit any issuer of securities subject to the Commission's jurisdiction from using the means of interstate commerce to make any payment designed to influence corruptly a foreign official, political party, or candidate. Violations of this new prohibition—like any other provision of the Federal securities laws—would be investigated by the Commission's staff and could be made the subject of civil proceedings to enjoin further

misconduct. Similarly, where appropriate, the Commission would refer its files to the Justice Department for criminal prosecution.

Section 2 of the bill would enact a similar prohibition, as an independent provision of the Criminal Code, applicable to any domestic business not subject to section 1. Section 2 would be enforced exclusively by the Justice Department.

In looking at H.R. 3815, I would like also to address a second legislative proposal in this area. The Senate Committee on Banking, Housing and Urban Affairs has voted to report favorably to S. 305, a bill which takes a somewhat broader approach to the problem of questionable corporate payments. S. 305 includes the same prohibitions—in slightly different form—as does H.R. 3815. But, it also contains provisions which the Commission recommended to the Congress last year to strengthen the system of corporate accounting and auditing. S. 305 would require issuers of securities to keep accurate books and maintain an adequate system of internal accounting controls. The bill would also make it unlawful to falsify corporate accounting records or to deceive an accountant in connection with an audit.

I should note, Mr. Chairman, that very similar provisions are also embodied in H.R. 1602, which was introduced by Congressman Murphy and is pending before the subcommittee.

The Commission believes that, from the standpoint of investor protection, this broader legislation represents a more effective and meaningful approach to the problem of improper or illegal corporate payments. We do not, of course, oppose the enactment of the direct prohibitions incorporate both H.R. 3815 and S. 305. The Commission stands ready to accept the expanded mandate which enforcement of those prohibitions would entail. The Commission does not believe, however, that prohibitions against bribery are the full answer. In our view, the long-term solution requires a fundamental strengthening of the recordkeeping, auditing, and internal control systems which are the foundation of any modern, multinational corporation.

For these reasons, I urge the subcommittee to broaden its approach beyond direct prohibitions against foreign bribery.

Mr. Chairman, since the Commission began investigating such practices in 1973, injunctive actions have been brought against 31 corporations on account of questionable or illegal payments. In addition, more than 300 corporations have made disclosure of such payments voluntarily. All told, these registrants include some of the largest and most widely held public companies in America. The abuses which these companies have disclosed have run the gamut from bribery of high foreign officials to so-called facilitating payments allegedly necessary in order to insure that low-level functionaries would discharge their ministerial duties.

In addition, we have learned of instances of commercial bribery, entailing excessive sales commissions, kick-backs, political contributions and a variety of other transactions involving off-book or disguised expenditures of corporate assets.

On May 12, 1976, the Commission prepared its Report on Questionable and Illegal Corporate Payments and Practices, which discusses in detail the disclosures which had been obtained to that

date. While the number of companies which have reported abuses has tripled since last May, the type of conduct disclosed has not significantly changed. Accordingly, I believe that that report, which has previously been transmitted to this subcommittee, constitutes the best existing empirical foundation for legislative action in this area.

The key point I would draw from the Commission's experience is that these illicit payments almost necessarily involve the frustration or circumvention of the system of internal corporate control. Internal control systems are designed, in part, to insure that shareholder assets are utilized for legitimate business purposes and that the resulting transactions are recorded on the corporate records. Those records must also allow independent auditors to ascertain whether financial statements drawn from them fairly represent the financial position of the business. But, in virtually every case of questionable payments, this system of corporate accountability has been frustrated.

Clearly, individual abuses uncovered in our enforcement and voluntary programs are serious. But, the more fundamental problem is the defiance or circumvention of the system of corporate accountability on which the securities laws—and indeed our system of capital formation—rest. It is on this problem that we believe a legislative solution must focus.

In the May 12 report, the Commission proposed remedial legislation based on its experience with questionable corporate payments. That legislative recommendation embodied four goals:

(1) Require issuers to make and keep accurate books and records.

(2) Require issuers to devise and maintain a system of internal accounting controls meeting the objectives already articulated by the American Institute of Certified Public Accountants.

(3) Prohibit the falsification of corporate accounting records.

(4) Prohibit the making of false, misleading, or incomplete statements to an accountant in connection with an examination or audit.

These proposals constitute Section 102 of S. 305, and Section 1 of H.R. 1602. Both bills are, in those respects, very similar to legislation the Senate unanimously passed during the 94th Congress. The Commission continues to believe that these proposals represent the most effective solution to the problem of questionable or illegal corporate payments.

Enactment of legislation of this nature would create a climate which would significantly discourge a repetition of improper payments. Furthermore, it would demonstrate a strong and affirmative congressional endorsement of the need for accurate corporate records, effective internal control measures and management candor in connection with the work of independent auditors. Such an endorsement would end any debate concerning the Commission's proper role in the solution to the problem of questionable payments. Finally, this legislation would furnish the Commission and private plaintiffs in implicit actions, with potent new tools to employ against those who persist in concealing from the investing public the manner in which corporate funds have been utilized.

As the Committee may be aware, on January 19, 1977, the Commission issued a notice of proposed rulemaking in this area. In

that release the Commission announced that it was considering the promulgation, with certain changes, of the essentials of our legislative proposals as Commission rules. I should like to submit, for your record, a copy of that notice which sets forth the rationale for the proposals in some detail. The Commission has the authority, under existing law, to adopt rules of this nature, but we firmly believe that the enactment of the legislation we have suggested is most desirable. Accordingly, although the Commission will proceed expeditiously with its rulemaking, we urge the Congress to take early and favorable legislative action which would eliminate the need for administrative regulations.

[Testimony resumes on p.210.]

[The following material was received for the record:]

PROPOSED RULE CHANGE

Notice of the proposed rule change together with the terms of substance of the proposed rule change was given by publication of a Commission Release (Securities Exchange Act Release No. 12914 (October 21, 1976)) and by publication in the *Federal Register* (41 FR 47300 (October 28, 1976)). Interested persons were invited to submit written data, views and arguments concerning the proposal by November 27, 1976. The Commission has not received any comments concerning the proposed rule change.

The Commission finds that the proposed rule change is consistent with the requirements of the Act, and the rules and regulations thereunder applicable to national securities associations, and in particular the requirements of Section 15A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change referenced above be, and it hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

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[1] The original deadline for submission of written comments on the proposals was June 30, 1975; the time for such comment was extended until July 18, 1975, in Securities Exchange Act Release No. 11508 (June 30, 1975), and until October 1, 1975, in Securities Exchange Act Release No. 11653 (September 15, 1975), 40 FR 43284 (1975). *See also* Securities Exchange Act Release Nos. 11546 (July 10, 1975), 40 FR 53085 (1975), and 11951 (December 24, 1975), 41 FR 836 (1976).

[2] Securities Exchange Act Release No. 12432 (May 12, 1976). *See* Securities Exchange Act Release No. 11951 (December 24, 1975), 41 FR 836.

[3] Securities Exchange Act Release No. 12432 (May 12, 1976), at 2, n. 3.

[4] *Id. See also* File No. SR-1 for previous comments received with respect to the NASD transaction fees.

SECURITIES EXCHANGE ACT OF 1934
Release No. 13185/January 19, 1977

PROMOTION OF THE RELIABILITY OF FINANCIAL INFORMATION, PREVENTION OF THE CONCEALMENT OF QUESTIONABLE OR ILLEGAL CORPORATE PAYMENTS AND PRACTICES, AND DISCLOSURE OF THE INVOLVEMENT OF MANAGEMENT IN SPECIFIED TYPES OF TRANSACTIONS

Proposed Amendments to Rules and Schedules

The Securities and Exchange Commission today announced a series of rulemaking proposals designed further to promote the reliability and completeness of the financial information which issuers are required to file with the Commission pursuant to the Securities Exchange Act of 1934. These proposals would require each issuer registered pursuant to Section 12 of the Securities Exchange Act, or required to file periodic reports pursuant to Section 15(d), to

(1) maintain books and records accurately reflecting the transactions and dispositions of assets of the issuer; and

(2) maintain an adequate system of internal accounting controls designed to provide reasonable assurance that specified objectives are satisfied.

In addition, the Commission, in order to protect the reliability of financial information required to be filed pursuant to the federal securities laws and to protect the integrity of the independent audit of issuer financial statements required under existing Commission rules, is proposing rules which would explicitly

(1) prohibit the falsification of an issuer's accounting records; and

(2) prohibit the officers, directors, or stockholders of an issuer from making false, misleading or incomplete statements to an accountant engaged in an examination of the issuer.

Although, as discussed herein, the Commission's authority to promulgate rules of this nature does not rest solely on Section 13 of the Securities Exchange Act, these rules, if adopted, would be codified in a new Regulation 13B, entitled "Accuracy of Books, Records, and Reports."

The Commission believes that these proposals, while not directed solely to the problem of questionable or illegal corporate payments and practices, would serve to create a climate which would significantly discourage repetition of the serious abuses which the Commission has uncovered in this area. The Commission's experience has indicated that improper corporate payments are rarely reflected correctly in the corporate books and records and, indeed, are often symptomatic of a failure in the system of corporate internal accounting controls. In addition, the need to suppress information concerning such payments frequently entails the falsification of records and the deception of auditors.

Because of the unique significance of such payments in the evaluation of the competence and integrity of corporate management, the Commission is also proposing to require

disclosure, in connection with any proxy solicitation or information statement pursuant to Regulation 14A under the Securities Exchange Act, of the facts pertaining to the involvement of any officer or director in such corporate payments, and of any corporate policy concerning such matters. [1]

Background

Beginning in 1973, as a result of the work of the Office of the Watergate Special Prosecutor, the Commission became aware of a pattern of conduct involving the use of corporate funds for illegal domestic political contributions. Because these activities involved matters of significance to public investors, the nondisclosure of which entail violations of the federal securities laws, on March 8, 1974, the Commission published a statement expressing the views of its Division of Corporation Finance concerning disclosure of these matters in public filings. See Securities Act Release No. 5466 (Mar. 8, 1974).

Subsequent Commission investigations revealed that instances of undisclosed questionable or illegal corporate payments—both domestic and foreign—were indeed widespread and represented a serious breach in both the operation of the Commission's system of corporate disclosure and, correspondingly, in public confidence in the integrity of the system of capital formation. On May 12, 1976, the Commission submitted to the Senate Banking, Housing and Urban Affairs Committee a detailed "Report on Questionable and Illegal Corporate Payments and Practices" ("May 12 Report"). That report describes and analyzes the history of the Commission's activities concerning improper corporate payments and outlines the legislative and other responses which the Commission, based on its experience, recommended to remedy these problems. One of the key conclusions drawn in the May 12 Report was that:

> The almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system of corporate accountability which has been designed to assure that there is proper accounting of the use of corporate funds and that documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts. Millions of dollars of funds have been inaccurately recorded in corporate books to facilitate the making of questionable payments. Such falsification of records has been known to corporate employees and often to top management, but often has been concealed from outside auditors and counsel and outside directors.
>
> Accordingly, the primary thrust of our actions has been to restore the efficacy of the system of corporate accountability and to encourage the boards of directors to exercise their authority to deal with the issue. May 12 Report at a.

On the basis of the conclusions in the May 12 Report, the Commission, in addition to pursuing its enforcement and disclosure programs actively, proposed a 2-pronged approach to prevent further such abuses. First, the Commission recommended that Congress enact legislation aimed expressly at enhancing the accuracy of the corporate books and records and the reliability of the audit process which constitute the foundations of the system of corporate disclosure. Specifically, the Commission proposed legislation which would

> (1) require issuers to make and keep accurate books and records;
>
> (2) require issuers to devise and maintain a system of internal accounting controls meeting the objectives articulated by the American Institute of Certified Public Accountants in Statement on Auditing Standards No. 1, Section 320.28 (1973);
>
> (3) prohibit the falsification of corporate accounting records; and
>
> (4) prohibit the making of false, misleading, or incomplete statements to an accountant in connection with any examination or audit.

The second prong of the Commission's suggested attack on the problem of questionable and illegal corporate payments involved strengthening the independence and vitality of corporate boards of directors by requiring that companies maintain audit committees comprised of independent directors and by encouraging the separation of the functions of independent corporate counsel and director. In the May 12 Report, the Commission proposed that, at least initially, these principles could best be implemented by amendment to the listing requirements of the New York Stock Exchange and the rules of the other self-regulatory organizations, rather than by direct Commission action. [2]

Senator Proxmire, Chairman of the Senate Committee on Banking, Housing and Urban Affairs, introduced, as S. 3418, the Commission's legislative proposal, and held hearings on that and other bills related to the problem of illicit corporate foreign payments. [3] Ultimately, the Committee referred a bill to the Senate floor—S. 3664—which embodied all of the Commission's legislative recommendations (as well as certain other proposals). [4] On September 15, 1976, the Senate, by a vote of 88-0 unanimously passed S. 3664. The House of Representatives, however, was unable to complete work on this legislation before adjournment sine die on October 2, 1976.

The Commission continues to believe that Congressional action on the legislation which it proposed in the May 12 Report would be the most desirable means of demonstrating a national commitment to ending the types of corporate misconduct, and defiance of the recordkeeping systems on which disclosure under the securities laws is premised, which

the Commission's investigations have uncovered.[5] The Commission also believes that the serious abuses which its May 12 Report and subsequent activities have disclosed require prompt remedial action and has never taken the position that legislation is the sole means by which the substantive goals of its proposals could be effected. Indeed, the Commission believes that the close relationship between the objectives which Congress, in 1934, sought to accomplish by enactment of the Securities Exchange Act and the substance of its legislative proposals places those proposals within the reach of the Commission's general rulemaking authority under Section 23(a) of the Securities Exchange Act. Accordingly, the Commission is today publishing for comment rulemaking proposals which would accomplish the objectives of its earlier legislative recommendation.

Maintenance of Accurate Corporate Books and Records and an Attendant System of Internal Accounting Control

The Commission has found that improper and undisclosed expenditures of corporate assets are frequently accompanied by inaccurate maintenance, or outright falsification, of corporate accounting records and, similarly, failure in the internal controls system designed to insure the accuracy of corporate records and the utilization of assets solely for proper purposes. In this regard, the May 12 Report states:

> [M]ost of the instances of reported abuse also involved some falsification of corporate records or the maintenance of records that appear to be inadequate. In many of the reports submitted voluntarily by corporations, the description of the payments and their documentation appears to have been inadequate to permit ready identification or verification of the purpose of the payments. Similarly, the reports the Commission obtained as a result of enforcement actions disclose flagrant instances of abuse of the system of corporate accountability, including the establishment and maintenance of substantial off-book funds that were used for various purposes, some questionable and some clearly illegal.
>
> 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 regard this to be a significant point, and one that is central to [remedial measures]. May 12 Report at 41-42.

a. *Maintenance of accurate records*

In light of these findings, the Commission is proposing for comment new Securities Exchange Act Rule 13b-1 which would require every issuer registered with the Commission pursuant to Sections 12 or 15(d) of the Securities Exchange Act to make and keep books, records, and accounts which accurately and fairly[6] reflect the transactions of the issuer and the dispositions of its assets.[7] The Commission believes that such a rule will discourage the types of misconduct which thrive in the absence of adequate recordkeeping.

The Commission's authority to promulgate such a rule under existing law, and the obligation to maintain accurate books and records, stems from the reporting requirements of the federal securities laws.[8] Section 12(b)(1) of the Securities Exchange Act, for example, permits registration of issuers only upon the filing with the Commission of such information as the Commission may require, as necessary or appropriate in the public interest or for the protection of investors, in respect of, among other things:

> (A) the organization, financial structure and nature of the business;
>
> . . . . .
>
> (J) balance sheets for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission by independent public accountants;
>
> (K) profit and loss statements for not more than the three preceding fiscal years, certified if required by the rules and regulations of the Commission, by independent public accountants; and
>
> (L) any further financial statements which the Commission may deem necessary or appropriate for the protection of investors.

Likewise, Section 13(a) authorizes the Commission to compel the filing of annual reports, certified by independent public accountants if the Commission so requires, and other information necessary to up-date Section 12 registration statements.[9] The Commission's activities concerning questionable or illegal corporate payments and practices have demonstrated a connection between the failure to disclose such misconduct in reports filed pursuant to Section 12, and 13, 15(d) and the failure to maintain reliable and auditable corporate records. Accordingly, rules such as proposed Rule 13b-1 constitute "such rules and regulations as may be necessary or appropriate to implement the provisions of [the Exchange Act]" Section 23(a)(1). Absent reliable underlying corporate records, the preparation of financial statements in accordance with generally accepted accounting principles would be extremely difficult.

b. *Maintenance of a system of internal accounting controls*

Proposed Rule 13b-2, which requires management to devise and maintain a system of internal accounting controls, is closely related to proposed Rule 13b-1 in both purpose and statutory foundation. The reliability of corporate records is dependent on the effectiveness of the procedures adopted to

insure that corporate transactions are, in fact, reflected in those records and, conversely, to insure that assets are not exposed to unauthorized access and use. Accordingly, proposed Rule 13b-2 would require that issuers filing reports pursuant to Sections 12 or 15(d) of the Securities Exchange Act maintain an adequate system of internal accounting controls sufficient to provide reasonable assurance that:

> (a) transactions are executed in accordance with management's general or specific authorization;
>
> (b) 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;
>
> (c) access to assets is permitted only in accordance with management's authorization; and
>
> (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

These proposed objectives for a system of internal accounting controls have been drawn from the objectives of such a system defined by the American Institute of Certified Public Accountants in Statement on Auditing Standards No. 1, Section 320.28 (1973). The Commission believes that these goals provide a reasonable basis for the implementation of the required system of controls, and that such objectives are already familiar to the business community.

The establishment and maintenance of a system of internal controls is an important management obligation. A fundamental aspect of management's stewardship responsibility is to provide shareholders with reasonable assurance that the business is adequately controlled. Additionally, management has a responsibility to furnish shareholders and potential investors with reliable financial information on a timely basis. An adequate system of internal accounting controls is necessary to management's discharge of these obligations.[10]

Systems of controls will, of course, vary from company to company. The size of the business, diversity of operations, degree of centralization of financial and operating management, amount of contact by top management with day-to-day operations, and numerous other circumstances are factors which management must consider in establishing and maintaining an internal accounting controls system. The design of any such system necessarily involves exercise of management's judgment, and entails the balancing of the cost of implementing any given internal accounting control against the benefit to be derived. By requiring that a system provide reasonable assurance that the specified objectives are met, the Commission's proposed rule recognizes that the issuer must, in good faith, balance the costs and benefits as they relate to the circumstances of that company. The definition of the term "reasonable assurance" in proposed Rule 13b-2 is, like the objectives for a system of internal accounting controls, taken from existing accounting literature. See Statement on Auditing Standards No. 1, supra, Section 320.32.

Although the Commission understands that there may be practical limitations to the implementation of internal accounting controls,[11] the Commission believes that, despite the inherent limitations on a system of internal accounting controls, all companies should establish and maintain such systems. A properly functioning system should provide reasonable assurance to investors that the data generated by that system and embodied in interim financial data or annual financial statements fairly reflect the issuer's financial position. Moreover, a properly functioning system of internal accounting controls, including articulated policies relating to improper payments, should significantly discourage questionable or illegal payments and practices.[12]

Falsification of Accounting Records and Deception of Auditors

The Commission is also soliciting comment on a rule—proposed Rule 13b-3—which would prohibit the falsification of corporate accounting records maintained pursuant to proposed Rule 13b-1, and on a rule—proposed Rule 13b-4—which would prohibit issuer officers, directors, or shareholders from deceiving or obstructing accountants in the discharge of their responsibilities in connection with the examination of the financial statements of issuers subject to Rule 13b-1. The Commission believes that express prohibitions of this nature, while already implicit in existing law, are necessary to insure the effectiveness of the proposed corporate recordkeeping requirement and that such prohibitions uniquely respond to problems which the Commission's investigations have disclosed:

> The most devastating disclosure that we have uncovered in our recent experience with illegal or questionable payments has been the fact that, and the extent to which, some companies have falsified entries in their own books and records. A fundamental tenet of the recordkeeping system of American companies is the notion of corporate accountability. It seems clear that investors are entitled to rely on the implicit representations that corporations will account for their funds properly and will not "launder" or otherwise channel funds out of or omit to include such funds in the accounting system so that there are no checks possible on how much of the corporation's funds are being expended or whether in fact those funds are expended in the manner management later claims.
>
> Concomitantly, we believe that any legislation in this area should also contain a prohibition against the making of false and misleading statements by corporate officials or agents to those persons conducting audits of the company's books and records and financial operations. May 12 Report at 58.

a. Prohibition against falsification of accounting records

Proposed Rule 13b-3 would prohibit any person from falsifying corporate accounting records required to be maintained pursuant to proposed Rule 13b-1. The Commission believes that such a prohibition is a necessary compliment to the requirement that the issuer maintain accurate books and records. In many cases, instances of concealed corporate payments and off-book cash funds have resulted from the activities of particular individuals, acting with or without the knowledge or authorization of top management, to cause such transactions to be improperly reflected on the corporate records. Proposed Rule 13b-3 would permit the Commission to take action to preclude such individuals from further frustrating either the system of corporate recordkeeping or the broader system of accountability by which management monitors the activities of the entire array of individuals entrusted with corporate assets.

The Commission has given consideration to certain facets of the issue, discussed below, and has tentatively concluded that proposed Rule 13b-3 would fall within its authority to promulgate rules "necessary or appropriate to implement the provisions of [the Exchange Act]" Section 23(a)(1). At the outset, it must be recognized that, while the Commission proposes to codify the prohibition in question under Section 13 of the Act, the Commission does not rely on that provision, in itself, to furnish a complete foundation for the proposed rule. In addition to the periodic reporting requirements, the rule also is predicated upon Sections 10(b), 14(a), 20(b) and 20(c) of the Act. The Commission, from experience with the problems treated in its May 12 Report, has concluded that the falsification of accounting records has a strong propensity to lead to a variety of evils against which Congress has authorized it to take rulemaking action including:

> (1) the utilization of deceptive devices, such as materially false statements or material omissions, in connection with the purchase or sale of securities by the means of interstate commerce;
>
> (2) the filing of inaccurate and incomplete periodic and annual reports with the Commission;
>
> (3) the solicitation of proxies in contravention of Rule 14a-9, 17 CFR 240.14a-9; and
>
> (4) the hindrance, delay, and obstruction of the making and filing of required documents, reports, and information.

Accordingly, the Commission believes that a remedial provision such as proposed Rule 13b-3 would, if adopted, be within the scope of Sections 10(b), 13(a), 14(a), and 20(c) of the Act.

The Commission believes it appropriate to outline briefly its present views concerning two issues related to the scope of Rule 13b-3. First, although Section 13(a) authorizes the Commission to impose certain *requirements* upon *issuers*, the proposed rule would create a *prohibition* applicable to *any person*. The effects of a falsification in making reports required under Section 13 misleading or incomplete are not, of course, contingent on the identity of the wrongdoer or on whether he acts with the knowledge or acquiescence of management. The falsification of accounting records constitutes an obvious hindrance to the preparation of required reports, the evil which Section 20(c) was designed to prohibit, and, therefore, Section 20(c) of the Act would permit the Commission to promulgate a rule of this nature applicable to "any director or officer of, or any owner of any securities issued by, any issuer required to file any document, report or other information." While a prohibition applicable to directors, officers, or securities holders might well serve to encompass many of the problems the Commission has encountered, the Commission thinks it desirable that the rule by broadened to reach any person who engages in the falsification of accounting records. This is especially appropriate in light of Section 32(a) of the Securities Exchange Act, which provides criminal penalties for "*any person* who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed under this title or any rule or regulation thereunder" (emphasis added).

Likewise, Section 10(b) of the Act authorizes the Commission to prohibit deceptive devices—regardless of by whom employed—in connection with the purchase or sale of securities. Because the falsification of accounting records, especially in order to conceal questionable corporate payments, has an unavoidable tendency to lead to the concealment of material information from purchasers and sellers of the issuer's securities, and to the omission of such information from proxy solicitations, the Commission believes that the extension of proposed Rule 13b-3 to any person is warranted.

Second, the Commission recognizes that not every falsification of an accounting record will necessarily have the effect of causing a violation of Rule 10b-5 and Section 20(c). The Commission believes, however, as stated above, that the nexus between altered books and these violation is so close as to justify a rule of the type proposed. An attempt to define a class of "harmless" falsifications would appear to be futile and would serve only to provide a loophole for the unscrupulous.

b. Prohibition against deceptive or misleading statements to auditors

Proposed Rule 13b-4 would prohibit any officer, director or shareholder of the issuer from making a materially false or misleading statement, or omitting to state any material fact necessary to make statements made not misleading, to an accountant in connection with an audit of the financial statements the issuer or the filing of required reports.[13] The purpose and authority for this proposal are, in large measure, similar to those discussed in connection with proposed Rule 13b-3. The accountant's examination of the issuer's financial statements is one of the key safeguards to the reliability of

the system of financial disclosure; to the extent that individuals hamper or frustrate the accountant's work, the reliability of that system is diluted.

Although the Commission's legislative proposal would prohibit "any person" from engaging in the types of interference with the accountant's work which proposed Rule 13b-4 proscribes, the proposed rule itself extends only to the individuals to which Section 20(c) of the Securities Exchange Act applies: "any director or officer of, or any owner of any securities issued by, any issuer." The Commission adheres to its position that a prohibition extending to "any person" would be desirable and not concluded that it would lack the authority to promulgate a rule of that scope. The Commission has, however, determined that, for the present, a rule identical in coverage to Section 20(c) would be adequate to meet the abuses which it has uncovered in this area, and that rulemaking action of greater coverage is inappropriate.[14] It must be stressed, however, that the exclusion from the express language of proposed Rule 13b-4 of low-level corporate employees and persons unaffiliated with the issuer does not indicate that those individuals may mislead the issuer's accountants with impunity. In appropriate circumstances, the existing antifraud provisions of the federal securities laws, and the concept of aiding and abetting, can be invoked against those who deceive the auditors of a publicly held corporation. In this area, as in other areas where duties and liabilities are created under the federal securities laws, case-by-case balancing of the needs of the investing public against the interests of those who have engaged in conduct injurious to investors is essential.[15]

It has been suggested that any prohibition such as proposed Rule 13b-4 be limited to proscribing misleading *written* communications with auditors. The Commission believes, however, that such a limitation would be ill-advised. One engaged in an audit of corporate books and records can be misled by an oral misstatement just as by a written one, and the resulting injury to investors can be serious. Moreover, section 12(2) of the Securities Act, and also the several antifraud provisions of the Securities Exchange Act, have long been applied in Commission and private actions to oral misstatements without unusual or unintended consequences.

Disclosure Concerning Questionable Payments in Proxy Solicitation

The Commission is also proposing amendments to schedule 14A under the Securities Exchange Act of 1934 to require information in proxy statements concerning the involvement of top management in specified types of questionable or illegal corporate payments or transactions and concerning formal corporate policies as to such matters. Specifically, these amendments would add two new Subitems, 6(d)(1) and 6(d)(2) to Schedule 14A which would deal, respectively, with disclosure of questionable transactions and disclosure of corporate policies regarding such matters. As discussed below, the Commission believes that this type of information is particularly relevant to shareholder proxy and voting decisions.

Proposed Item 6(d)(1) would require disclosure of

> the material facts pertaining to the involvement of any director of the issuer, any person nominated for election as director, or any executive officer of the issuer in any material political contributions by the issuer or from its assets, whether legal or illegal; [16] the disbursement or receipt of corporate funds outside the normal system of accountability; payments, whether direct or indirect, to or from foreign or domestic governments, officials, employees or agents for purposes other than the satisfaction of lawful obligations, or any transaction which has as its intended effect the transfer of issuer assets in the manner described; the improper or inaccurate recording of payments and receipts on the books of the issuer or its subsidiaries; or any other matters of a similar nature involving disbursement of issuer assets.[17]

Discussion could, however, be omitted of any facts which have previously been both reported in a filing with the Commission and described in an issuer document distributed to shareholders.

The Commission believes that information concerning disclosure of the facts regarding the involvement of directors or top officers in reported instances of questionable payments is highly significant to shareholders in determining whether to give a proxy. A previous Commission public inquiry suggested that many investors use different criteria in determining whether to give a proxy than in making investment decisions.[18] The proxy solicitation process is, of course, the most direct opportunity which shareholders have to endorse or reject the stewardship of those entrusted with the discharge of corporate affairs. Nevertheless, in many of the disclosures concerning questionable or illegal corporate transactions appearing in current and annual reports filed on Forms 10-K and 8-K—which are designed to supply updated and current information concerning the registrant—the role of particular members of management has not been fully set forth. Where individuals who are standing for election to a corporate board or who are a part of top management which is soliciting proxies have been involved in, or personally aware of, questionable or illegal corporate transactions, the Commission believes that shareholders are entitled to more detailed information concerning their role in such matters than might otherwise be necessary.

Concerning the existence and substance of any corporate policies dealing with questionable transactions, the Commission believes that, in at least some circumstances, such policies are of sufficient importance to investors to merit inclusion in proxy statements. The Commission also recognizes, however, that, in a different context, it declined to require the disclosure of policy statements alone in light of the fact that such statements are subject to public relations posturing or to the recitation of boiler-plate assertions of good faith, and do not permit of any type of verification.[19]

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In the case of the specified types of questionable practices, however, the Commission believes that the opportunity for investors to compare any stated policy to the actual conduct of those seeking shareholder proxies or votes is especially meaningful. And, given the fact that over 200 registrants have made disclosure concerning specific instances of misconduct of this nature, any policy statement which may have been adopted will be readily subject to comparison with specific fact situations. Because, however, of these special considerations regarding general corporate policy pronouncements, the Commission is considering two alternative formulations of proposed Subitem (d)(2) concerning corporate policies as to questionable payments and transactions. Alternative A would require all issuers subject to Regulation 14A to include in every proxy solicitation disclosure of whether or not the issuer has adopted any formal policy regarding the types of questionable payments and transactions specified in proposed Item 6(d)(1). Alternative B, on the other hand, would require such disclosure only where the issuer was also required, by virtue of proposed Item 6(d)(1), described above, to disclose facts concerning some particular questionable or illegal payment or transaction. The Commission invites comment on the advantages and disadvantages of each approach in order to assist it in determining which, if either, should be adopted.

Conclusion and Request for Comment

The Commission believes that the proposed rules herein, in conjunction with its suggestion that the self-regulatory organizations consider requiring certain steps to enhance the independence of corporate boards, have the potential significantly to enhance the reliability and accuracy of issuer financial reporting.[20] Likewise, the Commission believes that a specific disclosure requirement concerning the involvement of top management in improper corporate payments may be appropriate in connection with the solicitation of proxies. The Commission recognizes, however, that the area is difficult and complex, and intends to afford careful consideration to the views of all interested persons before taking final action on all, or any part of, these proposals.

All interested persons are invited to submit their views and comments, in triplicate, on the foregoing proposals to George A. Fitzsimmons, Secretary, Securities and Exchange Commission, Washington, D.C. 20549 on or before the close of business March 11, 1977. The Commission specifically invites comment on (1) the effect, operation, and desirability of the proposals herein; (2) the impact which these proposals, if adopted, would be likely to have on the abuses outlined in the May 12 Report; (3) the extent of the Commission's authority in the areas involved; (4) whether it would be appropriate to exempt issuers registered under the Investment Company Act of 1940 from the operation of any of these proposals; and (5) pursuant to Section 23(a)(2) of the Securities Exchange Act, the likely impact, if any, which these proposals would have on competition.

All such communications should refer to File S7-671 and will be available for public inspection and copying at the Commission's Public Reference Room, 1100 L Street, N.W., Washington, D.C. The text of the proposed amendments discussed herein is set forth below.

TEXT OF PROPOSED AMENDMENTS

[new] REGULATION 13B: ACCURACY OF BOOKS, RECORDS, AND REPORTS

[existing Rule 13b-1 shall be renumbered as Rule 13b-18]

§ 240.13b-1 Accounting records.

Every issuer which is required to file any report pursuant to Section 13 or 15(d) of the Act (and the Commission's rules and regulations thereunder) shall make and keep books, records, and accounts which accurately and fairly reflect the transactions of the issuer and the dispositions of its assets.

§240.14b-2 Internal controls system for accounting records.

(a) Incident to the making and keeping of such books, records, and accounts as are required pursuant to Rule 13b-1 of this regulation, every issuer shall devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurance that

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

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

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

(4) 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) As used in (a) of this rule, the term "reasonable assurance" shall mean that the cost of internal accounting control need not exceed the benefits expected to be derived. The benefits consist of reductions in the risk of failing to achieve the objectives implicit in the definition of accounting control.

§240.13b-3 Falsification of accounting records.

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 kept pursuant to Rule 13b-1 of this regulation.

§240.13b-4 Obstruction of accountants.

It shall be unlawful for any director or officer of, or any owner of any securities issued by, any issuer

(a) directly or indirectly, to make, or cause to be made, a materially false or misleading statement; or

(b) directly or indirectly, to omit to state, to 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 such statements were made, not misleading, to an accountant in connection with (1) any audit or examination of the financial statements of the issuer required to be made pursuant to this subpart, or (2) the preparation or filing of any document or report required to be filed with the Commission pursuant to this subpart or otherwise.

[amended] § 240.14a-101 Scheduled 14A. Information required in proxy statement.

* * * * *

Item 6. Nominees and directors.[2]

* * * * *

(d)(1) State the material facts pertaining to the involvement of any director of the issuer, any person nominated for election as director, or any executive officer of the issuer in any material political contributions by the issuer or from the issuer's assets, whether legal or illegal; the disbursement or receipt of corporate funds outside the normal system of accountability; payments, whether direct or indirect, to or from foreign or domestic governments, officials, employees or agents for purposes other than the satisfaction of lawful obligations, or any transaction which has as its intended effect the transfer of issuer assets for the purpose of effecting such a payment; the improper or inaccurate recording of payments and receipts on the books of the issuer or its subsidiaries; or any other matters of a similar nature involving disbursements of issuer assets. Disclosure need not be made of any matter which has been previously reported in a filing with the Commission and described in an issuer document distributed to shareholders.

(d)(2) [Alternative A] Indicate whether or not the issuer has any policy regarding payments or transactions of the type described in (1). If the issuer has such a policy, briefly describe it. If the policy is set forth in a written document, three copies thereof are to be filed with the Commission at the time preliminary materials are filed pursuant to Rules 14a-6 or 14c-5.

(d)(2) [Alternative B] If the issuer is required to disclose any payment or transaction pursuant to (1), then, in addition to such disclosure, indicate whether or not the issuer has any policy regarding payments or transactions of the type described in (1). If the issuer has such a policy, briefly describe it. If the policy is set forth in a written document, three copies thereof are to be filed with the Commission at the time preliminary materials are filed pursuant to Rules 14a-6 or 14c-5.

By the Commission.

George A. Fitzsimmons
Secretary

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[1] It should be noted that, in large measure, the proposals herein codify existing law rather than create new obligations. One who, for example, falsified corporate records or deceives corporate auditors would, depending on the facts and circumstances involved, have engaged under present law in a violation of the antifraud provisions of the federal securities laws. Likewise, disclosure of the items proposed to be included expressly in Schedule 14A would, if material, be required under existing law.

[2] Exhibit D to the May 12 Report is a letter, dated May 11, 1976, from Chairman Hills to Exchange Chairman Batten suggesting that the New York Stock Exchange ("NYSE") consider action of this nature. Subsequently, on September 7, 1976, the NYSE circulated a proposal requiring listed domestic (but not foreign) issuers to establish independent audit committees and, on January 6, 1977, took final action thereon. The Commission, pursuant to Section 19(b) of the Securities Exchange Act, will formally consider the terms and conditions of the Exchange's proposal, after opportunity for public comment.

To date, neither the NYSE nor the other self-regulatory organizations have taken action with respect to the Commission's suggestion that consideration be given to "whether members of law firms which have the responsibility of advising the corporation, including the board, should also serve as members of that board of directors." May 12 Report at 67 and at Exhibit D, p. 2.

[3] Hearings Before the Committee on Banking, Housing and Urban Affairs U.S. Senate, on S. 3133, S. 3379, and S. 3418, 94th Cong. 2d Sess. (May 18, 1976).

[4] See S. Rep. No. 94-1031, 94th Cong. 2d Sess. (1976).

[5] Cf. May 12 Report at 57:

> [T]he question of illegal or questionable payments is obviously a matter of national and international concern, and legislation in this area is desirable in order to demonstrate clear Congressional policy with respect to a thorny and controversial problem.

[6] In connection with Congressional consideration of S. 3418 and its progeny, some concern was expressed over whether the phrase "accurately and fairly" in the legislation connoted an unattainable measure of exactitude. As the Senate Banking, Housing and Urban Affairs Committee observed:

> The term "accurately" in [S. 3664] 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. Thus, for example, recording depreciation in a manner permitted by the Internal Revenue Code may not be a precise measurement, but it is nevertheless clearly a permissible one within the intent of [this requirement]. S. Rep. No. 94-1031, supra, at 11.

The Commission agrees with this observation. Moreover, the Commission believes that to require a lesser standard in defining the obligation to keep books and records could lead to the argument that falsifications or omissions below a certain dollar amount may be tolerated.

[7] In proposing this language in the May 12 Report, the Commission did not, of course, intend the phrase "dispositions of its assets" as in any sense a limitation on the scope of the requirement that accurate books and records be maintained. The issuer's responsibility to keep records correctly reflecting the status of its liabilities and equities is no less than its obligation to maintain such records concerning its assets.

The word "transactions" in the proposal encompasses accuracy in accounts of every character, and the phrase "disposition of its assets" was added simply to reflect the fact that the abuses outlined in the May 12 Report involved almost exclusively improper accounting for assets. In any event, proposed Rule 13b-1 is intended to require accuracy throughout an issuer's accounting records.

[8] See S. Rep. No. 94-1031, supra, at 11.

[9] In this regard Section 13(b) authorizes the Commission to prescribe

> the form or forms in which the required information shall be set forth, the items or details to be shown in the balance sheet and the earnings statement, and the methods to be followed in the preparation of reports, in the appraisal or valuation of assets and liabilities, in the determination of depreciation and depletion, in the differentiation of recurring and nonrecurring income, in the differentiation of investment and operating income, and in the preparation, where the Commission deems it necessary or desirable, of separate and/or consolidated balance sheets or income accounts of any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer. . .

[10] The term "internal accounting controls" does not ordinarily encompass all corporate policies and procedures. Matters of efficiency, employee relations, and production quality control, for example, should not be confused with the accounting controls established to insure the reliability of financial information.

[11] Statement on Auditing Standards No. 1 sets forth some of these limitations:

> There are inherent limitations that should be recognized in considering the potential effectiveness of any system of accounting control. In the performance of most control procedures, there are possibilities for errors arising from such causes as misunderstanding of instructions, mistakes of judgment, personal carelessness, distraction, or fatigue. Furthermore, procedures whose effectiveness depends on segregation of duties obviously can be circumvented by collusion.
>
> Similarly, procedures designed to assure the execution and recording of transactions in accordance with management's authorizations may be ineffective against either errors or irregularities perpetrated by management with respect to transactions or to the estimates and judgments required in the preparation of financial statements. In addition to the limitations discussed above, any projection of a current evaluation of internal accounting control to future periods is subject to the risk that the procedures may become inadequate because of changes in conditions and that the degree of compliance with the procedures may deteriorate. Statement on Auditing Standards No. 1, supra, Section 320.34.

[12] The Commission recognizes that no system of internal controls can, in itself, prevent every kind of misconduct which the Commission has encountered in this area. It does not follow, however, that a requirement that such a system be maintained is idle or superflous, and the Commission believes that effective systems of internal accounting controls can discourage such misconduct.

[13] The Commission intends that this rule would encompass the audit of issuer financial statements by independent accountants; the preparation of any required reports, whether by independent or internal accountants; the preparation of special reports required to be filed with the Commission, as, for example, pursuant to judicial orders incident to Commission enforcement proceedings; and any other examination conducted by an accountant and culminating in the filing of a document with the Commission.

[14] The fact that proposed Rule 13b-4 is narrower in scope than its legislative counterpart does not indicate that the Commission has determined to accept the position of certain commentators who, in response to the Commission's legislative proposal, argued that a prohibition applicable to third parties would discourage such persons from responding to requests for confirmation of account balances or otherwise cooperating with accountants. In this regard, the Senate report on S. 3664 states:

> By specifically prohibiting material false or misleading statements or omissions to state material facts to auditors, the bill is designed to encourage careful communications between the auditors and persons

from whom the auditors seek information in the audit process. The Committee does not believe that this provision will inhibit such communications and intends that this prohibition is to be directed only at those who fail to exercise due care in furnishing information to auditors engaged in an audit, a standard that we believe represents what is customarily expected in normal commerce. S. Rep. No. 94-1031, 94th Cong. 2d Sess. at 12 (1976).

[15] Cf. Sections 11 and 12 of the Securities Act of 1933, 15 U.S.C. 77k and 77l; see H. Rep. No. 85, 73rd Cong. 1st Sess. at 9 (1933).

[16] The Commission specifically invites comment on whether *lawful* corporate political contributions should be included in this instruction.

[17] The Commission intends that the phrase "disbursement or receipt of corporate funds outside the normal system of accountability" would encompass the full range of schemes by which off-book pools of assets are accumulated, including, for example, overbilling, unrecorded transactions in violation of foreign exchange controls, and embezzlement incident to the diversion of corporate assets to improper purposes. Likewise, abuses such as the maintenance of a factitious set of books would fall within "improper or inaccurate recording of payments or receipts."

[18] See Securities Act Release No. 5627 at 36 (Oct. 14, 1975) [40 FR 51656].

[19] See id. at 33.

[20] The Commission is also considering soliciting comment on the question of whether to require some form of reporting to shareholders concerning the issuer's system of internal accounting control.

[21] The Commission has previously announced a proposal to amend Schedule 14A, including the alteration of the caption of Item 6 to read "Information Regarding Management." See Securities Act Release No. 5753 (Nov. 2, 1976) [41 FR 49493].

SECURITIES EXCHANGE ACT OF 1934
Release No. 13186/January 19, 1977

In the Matter of

NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC.
1735 K Street, N.W.
Washington, D.C. 20006

(SR-NASD-76-14)

ORDER APPROVING PROPOSED RULE CHANGE

The National Association of Securities Dealers, Inc. (the "NASD") submitted on December 3, 1976, a proposed rule change under Rule 19b-4 to amend Schedule D under Article XVI of the NASD By-Laws by adding a new Part III to Schedule D, redesignating existing Part III of Schedule D as Part V thereof, redesignating existing Parts V through X of Schedule D as Parts VI through XI respectively, amending Part IV of Schedule D to add a new Section D thereof, and redesignating existing Sections D and E of Schedule D as Sections E and F respectively. Part III of Schedule D, as proposed to be added by the proposed rule change, describes the NASD's proposed Consolidated Quotations Service ("CQS") which will provide subscribers with quotations from all registered CQS Third Market Makers, as well as the Boston, Midwest, New York, Pacific, and Philadelphia Stock Exchanges, in approximately 2,000 common stocks, preferred stocks, warrants and rights registered or admitted to unlisted trading privileges on the New York Stock Exchange.

Part III of Schedule D, as proposed to be added, also establishes rules and regulations governing the activities of registered CQS Third Market Makers, including provisions governing (i) registration, (ii) character of quotations, (iii) business hours, (iv) withdrawal, (v) voluntary termination, and (vi) suspension and termination of quotations by action of the NASD. Section D of Part IV of Schedule D, as proposed to be added, contains the fees and charges associated with CQS.

Notice of the proposed rule change together with the terms of substance of the proposed rule change was given by publication of a Commission release (Securities Exchange Act Release No. 13047 (December 8, 1976)) and by publication in the *Federal Register* (41 FR 55404 (December 20, 1976)). Interested persons were invited to submit written data, views and arguments concerning the proposal by January 17, 1977. The Commission has not received any comments concerning the proposed rule change.

The Commission finds that the proposed rule change is consistent with the requirements of the Securities Exchange Act of 1934 (the "Act") and the rules and regulations thereunder applicable to national securities associations, and in particular the requirements of Section 15A of the Act and the rules and regulations thereunder.

IT IS THEREFORE ORDERED, pursuant to Section 19(b)(2) of the Act, that the proposed rule change referenced above be, and it hereby is, approved.

For the Commission by the Division of Market Regulation, pursuant to delegated authority.

George A. Fitzsimmons
Secretary

Mr. WILLIAMS. As I have indicated, while the Commission does not oppose outright prohibitions such as those in H.R. 3815, we do believe that those prohibitions alone are not the complete response to the problem of questionable payments. Correspondingly, in the past, the Commission has expressed some concerns over whether it should be responsible for the enforcement of those prohibitions—even as to its own registrants—since those prohibitions seem to arise from congressional objectives not strictly related to investor protection. In this vein, the Justice Department has suggested that such prohibitions would best be codified separately from the securities laws and committed exclusively to the Department's investigatory and prosecutorial responsibility.

The solution to the question of whether the Commission should be primarily responsible for the enforcement of the prohibitions in proposed new section 30A of the Securities Exchange Act requires a weighing of several factors. If the prohibitions in section 1 become part of the securities laws, investigatory and civil enforcement responsibilities would generally rest with the Commission, while criminal prosecutions would be brought by the Department of Justice. Theoretically, there might be drawbacks to this type of shared responsibility which would be avoided by wholly excluding the Commission from the process of enforcing the prohibitions. However, I think it important to recognize that, in this respect, section 30A would stand on no different footing from any other provision of the Federal securities laws. Willful violations of any of those statutes or of the Commission's rules are criminal offenses. As such, they are prosecuted by the Department of Justice, usually after the Commission has referred to it the results of its investigation. I believe that the Commission and the Department have worked together effectively in the past, and undoubtedly that cooperation will continue in the future.

There are other factors which must be considered and which may militate in favor of including the prohibitions in proposed section 30A in the Federal securities law. First, the investigation and litigation of cases arising under proposed section 30A would require the type of expertise and experience which the Commission has developed over the past 40 years. The development of cases involving fraud or similar misconduct on the part of the management of large corporations requires investigative and accounting abilities which the Commission already possesses. To duplicate that expertise in another segment of the government would be costly and inefficient. Moreover, the distinction between enforcing the requirement that there be disclosure of material questionable corporate payments, and enforcing prohibitions against those payments, may be more theoretical than real. In practice, the kind of foreign bribe prohibited by H.R. 3815 would usually be a material fact to investors. The Commission's enforcement staff will, therefore, have a continuing responsibility in this area, whether or not bribes are made illegal per se under the Securities Exchange Act of 1934. Thus, any "expansion" of the Commission's mandate which would appear to result from the enactment of section 30A as part of the Securities Exchange Act may, in fact, be insubstantial. Also, you might note that, if the prohibitions of proposed section 30A were

placed in title 18 of the Criminal Code alone, that would eliminate, from the alternative remedies that the government may choose, civil injunctive actions which have been a strong and valued enforcement tool of the Commission. Also, acknowledging that there may be some difficulty in criminal prosecutions in some instances, it would seem particularly desirable to invest civil injunctive power in the Commission. Certainly in domestic bribery cases, dual jurisdiction between the Commission to proceed civilly, and the Department of Justice, to proceed criminally, would provide complete coverage of those practices.

In the final analysis, the weighing of these factors and the balance to be struck is a matter committed to Congress' judgment. Let me stress that the Commission will, of course, vigorously discharge whatever responsibilities Congress chooses to confer upon it in this or any other area.

In closing, Mr. Chairman, I must note that the problem of corrupt and concealed payments made by American business to obtain favorable treatment in foreign commerce is both complex and disturbing. The Commission believes that the legislation which it proposed last May represents an effective and reasonable approach to that problem. Moreover, the Commission is prepared to play a vigorous role in the enforcement of legislation directly outlawing questionable payments, although that role would, at least in part, transcend our traditional mandate to protect investors through the mechanism of disclosure. I welcome this subcommittee's consideration of these matters and appreciate the opportunity to assist in that process here this morning.

I will be pleased to answer any questions the subcommittee may have.

[Testimony resumes on p. 225.]

[Mr. Williams' prepared statement follows:]

TESTIMONY OF THE HONORABLE HAROLD M. WILLIAMS, CHAIRMAN,
ON BEHALF OF THE
SECURITIES AND EXCHANGE COMMISSION
BEFORE THE
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
OF THE HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE

April 21, 1977

Mr. Chairman, members of the Subcommittee:

I appreciate the opportunity to appear before you this morning to testify on the subject of H.R. 3815, the proposed Unlawful Corporate Payments Act of 1977, and other legislative approaches to the problem of questionable or unlawful corporate payments and transactions. Section 1 of H.R. 3815 would amend the Securities Exchange Act of 1934 by adding a new Section 30A prohibiting any issuer of securities subject to the Commission's jurisdiction from using the means of interstate commerce to make any payment designed to influence corruptly a foreign official, political party, or candidate. Violations of this new prohibition — like any other provision of the federal securities laws — would be investigated by the Commission's staff and could be made the subject of civil proceedings to enjoin further misconduct. Similarly, where appropriate, the Commission would refer its files to the Justice Department for criminal prosecution. Section 2 of the bill would enact a similar prohibition, as an independent provision of the criminal code, applicable to any domestic business not subject to Section 1. Section 2 would be enforced exclusively by the Justice Department.

I would also like to address a second legislative proposal in this area. The Senate Committee on Banking, Housing and Urban Affairs has voted to report favorably to the Senate S. 305, a bill

which takes a somewhat broader approach to the problem of questionable corporate payments. S. 305 includes the same prohibitions — in slightly amended form — as does H.R. 3815, but also contains provisions which the Commission recommended to Congress last year to strengthen the system of corporate accounting and auditing. S. 305 would require issuers of securities to keep accurate books and maintain an adequate system of internal accounting controls. The bill would also make it unlawful to falsify corporate accounting records or to deceive an accountant in connection with an audit.

I should note, Mr. Chairman, that provisions very similar to those in S. 305 which I have mentioned are also embodied in H.R. 1602 which was introduced by Congressman Murphy and is pending before the Subcommittee.

The Commission believes that, from the standpoint of investor-protection, this broader legislation represents a more effective and meaningful approach to the types of corporate abuses which the Commission has uncovered during the past several years than does H.R. 3815. We do not, of course, oppose the enactment of direct prohibitions such as both H.R. 3815 and S. 305 incorporate and are ready to accept the expanded mandate which enforcement of those prohibitions would entail. The Commission does not believe, however, that prohibitions against bribery are the full answer. In our view, the long-term solution requires a fundamental strengthening of the record-keeping, auditing, and internal control systems which are at the foundation of the management of modern multinational business

enterprises. For these reasons, I urge this Subcommittee to broaden its approach to the problem of questionable corporate payments and consider legislation comparable to S. 305 rather than only direct prohibitions against foreign bribery.

Need for Remedial Legislation

The Commission, beginning in 1973, as a result of information uncovered by the Watergate Special Prosecutor, became aware of a pattern of corporate conduct involving illegal domestic and political contributions. Subsequent investigations revealed that instances of undisclosed questionable or illegal corporate payments — both domestic and foreign — were widespread and threatened to have a corrosive effect on the integrity of our system of capital formation and on public confidence in American business. From the perspective of the Commission's Congressional mandate to protect the investing public, it quickly became clear that the dependence of certain businesses upon concealed payments of this nature, and the attendant diversion of assets to purposes nowhere reflected on the corporate records, were facts of significance to investors. Nondisclosure of these transactions can, therefore, entail violations of the existing antifraud provisions of the federal securities laws.

The Commission's response to these revelations was two-fold. First, the Commission commenced a vigorous enforcement program under the federal securities laws aimed at preventing the future concealment of transactions of this nature. In this litigation, the Commission, has obtained injunctive relief prohibiting further such concealment and ancillary relief requiring a full-scale investigation, by disinterested outside counsel, of the facts and circumstances concerning

questionable transactions at the companies involved, appropriate disclosure of the results to shareholders, and the implementation of preventive measures designed to safe-guard against repitition of this conduct.

In addition, the Commission instituted its so-called voluntary disclosure program. This program is an outgrowth of procedures traditionally open to any registrant facing a novel disclosure question. Companies which believe that some type of a payment problem has not been properly disclosed to investors may come to the Commission's staff, discuss the situation, conduct an internal investigation, and make appropriate disclosure in Commission filings. While participation in this program does not immunize a company against Commission enforcement action, it does generally obviate the need for such proceedings.

The combined results of these two programs have been large in magnitude and disturbing. To date, the Commission has brought injunctive actions against 31 corporations on account of questionable or illegal payments. In addition, more than 300 corporations have made disclosure of such payments voluntarily. All told, these registrants include some of the largest and most widely held public companies in America. The abuses which these companies have disclosed have run the gamut from bribery of high foreign officials in order to secure some type of favorable, discretionary action by a foreign government to so-called facilitating payments allegedly necessary in order to insure that low-level functionaries will discharge ministerial duties — such as delivering the mail — which they are already obligated to perform.

In addition, we have learned of instances of commercial bribery entailing excessive sales commissions, kick backs, political contributions and a variety of other transactions involving off-book or disguised expenditures of corporate assets.

On May 12, 1976, the Commission prepared its Report on Questionable and Illegal Corporate Payments and Practices which discusses in detail the disclosures which the Commission had obtained to that date. While the number of companies which have reported abuses has tripled since last May, the type of conduct disclosed has not significantly changed. Accordingly, I believe that that report, which has previously been transmitted to this Subcommittee, constitutes the best existing empirical foundation for legislative action in this area.

The key point, I believe, to be drawn from the Commission's experience in this area is that illicit payments of the type which H.R. 3815 would prohibit almost necessarily involve frustration or circumvention of the system of internal corporate control. Internal control systems are designed, in part, to insure that shareholder assets are utilized for legitimate business purposes pursuant to management's instructions, and that the resulting transactions are recorded on the corporate records. Those records must also be maintained in such a way that independent auditors can ascertain whether financial statements drawn from them fairly represent the results of operations and the financial position of the business. In this connection, the Commission, in its May 12 Report, observed that

> "the almost universal characteristic of the cases reviewed to date by the Commission has been the apparent frustration of our system

of corporate accountability which has been designed to assure that there is a proper accounting of the use of corporate funds ~~is~~ AND "the documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts."

For this reason, although the individual abuses uncovered in our enforcement and voluntary programs are serious, the more fundamental problem, and the one on which we believe a legislative solution must focus, is the defiance or circumvention of the system of corporate accountability on which the securities laws — and indeed our system of capital formation — rest. Some argue that, since past misconduct has entailed defiance of the existing system, legislation designed to strengthen that system would be useless. It is, of course, true that accounting measures designed to prevent concealed or disguised payments may sometimes be successfully circumvented by determined wrong-doers, just as prohibitions will, in some instances, be ignored. I believe, however, that measures which create an environment making possible the continuation of these abuses only if the improper payments are accompanied by related violations of record-keeping and auditing statutes are likely to prove effective in dramatically reducing the incidence of such activities.

Legislative Approaches

A. Commission recommendations

In the May 12 Report, the Commission proposed remedial legislation based on its experience with questionable corporate payments. That legislative recommendation embodied four goals:

(1) Require issuers to make and keep accurate books and records.

(2) Require issuers to devise and maintain a system of internal accounting controls meeting the objectives already articulated by the American Institute of Certified Public Accountants.

(3) Prohibit the falsification of corporate accounting records.

(4) Prohibit the making of false, misleading, or incomplete statements to an accountant in connection with an examination or audit.

These proposals constitute Section 102 of S. 305, which in those respects is very similar to legislation the Senate unanimously passed during the 94th Congress. The Commission continues to believe that these four proposals represent the most effective solution to the problem of questionable or illegal corporate payments, and that these proposals would alleviate the underlying conditions which have permitted the abuses we have seen in the past.

Enactment of legislation of this nature would create a climate which would significantly discourage repetition of these improper payments and would demonstrate a strong and affirmative congressional endorsement of the need for accurate corporate records, effective

internal control measures, and management candor in connection with the work of independent auditors. Such an endorsement would end any debate concerning the Commission's proper role in the solution to the problem of questionable payments. Finally, this legislation would furnish the Commission and private plaintiffs with potent new tools to employ against those who persist in concealing from the investing public the manner in which corporate funds have been utilized.

As the Committee may be aware, on January 19, 1977, the Commission issued a notice of proposed rulemaking in this area. In that release the Commission announced that it was considering the promulgation, with certain changes, of the essentials of Section 102 of S. 305 as Commission rules. I should like to submit, for your record, a copy of that notice which sets forth the rationale for the proposals in some detail. While the Commission has the authority, under existing law, to adopt rules of this nature, the Commission, as it stated in its release proposing these rules,

> "continues to believe that congressional action on the legislation which it proposed in the May 12 Report would be the most desirable means of demonstrating a national committment to ending the types of corporate misconduct, in defiance of the recordkeeping systems on which disclosure under the securities laws is premised, which the Commission's investigations have uncovered."

Accordingly, although the Commission will proceed expeditously with its rulemaking, we urge the Congress to take early and favorable legislative action which would eliminate the need for administrative regulations.

Before turning specifically to H.R. 3815, I would like to address briefly some criticisms which have been leveled at the proposals in Section 102 of S. 305. First, it has been suggested that requiring companies to maintain accurate books and records is unrealistic, since accuracy is an unattainable standard in the context of accounting records. I find this objection somewhat perplexing in light of the fact that the IRS presumably expects that the same information be "accurately" reflected in corporate tax returns. In any event, we understand that the Senate report on this legislation will make clear, as does the text of the Commission's release announcing its rulemaking proposals, that the term "accurately" does not mean exact precision as measured by some abstract principle. Rather it means that issuer records must reflect transactions in conformity with accepted methods of recording economic events. Thus, for example, inventories are typically valued on either the assumption that costs are [illegible] on a first-in, first-out or a last-in, first-out basis. Both theories, if correctly and honestly applied, produce "accurate" records, even though each may yield considerably different results in terms of the dollar value of inventories.

Second, similar objections have been voiced concerning the proposed requirement that the corporate system of internal accounting controls be "adequate" to provide reasonable assurance that certain

objectives are accomplished. Again, this standard is hardly novel since the accounting profession has long required that auditors judge the adequacy of a client's internal control procedures in the context of determining the scope and nature of their auditing procedures. Moreover, the accounting literature from which this proposal is drawn makes clear that the concept of "reasonable assurance" entails the balancing of the costs against the benefits for any particular internal control measure.

Finally, it has been suggested that the Commission, or a private plaintiff in an implied action, ought to be required to show that any deception of auditors or falsification of accounting records was knowingly committed. The inclusion of a particular mental state as an element of these offenses is, in the Commission's judgment, unwise, since investors can as easily be injured by the incompetent and careless as by the devious. Nevertheless, the version of S. 305 which has been ordered reported to the Senate does include a requirement that the falsification of records or the deception of auditors be done "knowingly." I understand the Senate Banking Committee's report will make clear, however, that the knowledge required is merely that the defendant was aware he was committing the act alleged to constitute a violation — not that he necessarily have known or intended that the act was unlawful.

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B. H.R. 3815

As I have indicated, while the Commission does not oppose prohibitions such as those in H.R. 3815, we do believe that those prohibitions alone are an inadequate response to the problem of questionable payments. Correspondingly, in the past, the Commission has expressed some concerns over whether it should be responsible for the enforcement of those prohibitions — even as to its own registrants — since those prohibitions seem to arise from Congressional objectives not strictly related to investor protection. In this vein, the Justice Department has suggested that prohibitions such as those in Section 1 of H.R. 3815 might best be codified separately from the securities laws and committed exclusively to the Department's investigatory and prosecutorial responsibility.

Since Section 1 of H.R. 3815, as it is presently drafted, would enact these new prohibitions as Section 30A of the Securities Exchange Act of 1934, the Commission would be empowered to enforce the antibribery provisions of the bill in the case of Commission registrants, just as the Commission enforces other provisions of that Act. The Commission's responsibilities would extend to conducting investigations, bringing civil injunctive actions, commencing administrative proceedings if appropriate, defending lawsuits against the Commission and its staff arising out of the Commission's obligations under this Act, and referring cases to the Justice Department for criminal prosecution where warranted. The Justice Department, on the other hand, would have responsibility for enforcing Section 2 of the bill, which applies to domestic firms not registered with the Commission, and for prosecuting all criminal actions arising from either Section 1 or Section 2.

The solution to the question of whether the Commission should be primarily responsible for the enforcement of the prohibitions in proposed Section 30A requires a weighing of several factors. If the prohibitions in Section 1 become part of the securities laws, to the extent criminal prosecutions against Commission registrants would be premised on those prohibitions, the investigatory responsibility would generally rest with the Commission while the prosecutorial function would be discharged by the Department of Justice which is responsible for conducting all criminal actions arising under any federal statute. There may, at least in theory, be draw-backs to this type of shared responsibility, which would be avoided by wholly excluding the Commission from the process of enforcing the bill. I think it important, however, to recognize that, in this respect, Section 30A would stand on no different footing than any other provision of the securities laws. Willful violatons of any of those statutes or the Commission's rules are criminal offenses, and, as such, are prosecuted by the Department — usually after the Commission has referred to it the results of its investigation. I believe that the Commission and the Department have worked together extremely effectively in the past, and undoubtedly that cooperation will continue in the future.

There are other factors which must be considered and which may militate in favor of including the prohibitions in proposed Section 30A in the federal securities law. First, the investigation and litigation of cases arising under proposed Section 30A would require the type of expertise and experience which the Commission has developed over the past 40 years in enforcing the existing federal securities laws. The

development of cases involving fraud and or similar misconduct on the part of the management of large corporations requires the investigatory and accounting abilities which the Commission already possesses, and to duplicate that expertise in another segment of the government would be costly and inefficient. Moreover, the distinction between enforcing the requirement that there be disclosure of material questionable corporate payments and enforcing prohibitions against those payments may be more theoretical than practical since the kind of foreign bribe prohibited by H.R. 3815 would usually be a material fact to investors. The Commission's enforcement staff will, therefore, have a continuing responsibility in this area whether or not bribes are made illegal per se under the Securities Exchange Act of 1934. Thus, any "expansion" of the Commission's mandate which would result from the enactment of Section 30A as part of the Securities Exchange Act may, in fact, be insubstantial.

In addition, I believe that a further reason for vesting enforcement jurisdiction in the Commission arises from the fact that, under our existing enforcement program, in many cases the threat of criminal prosecution (for failure to make material disclosures) has induced management to cooperate with the Commission's so-called voluntary disclosure program. I expect that a direct prohibition would give our enforcment staff an additional effective tool for deterring further improper conduct, since an offender would risk prosecution — not just for failure to report a payment where the payment could be shown to be material — but also for utilizing the jurisdictional means in making the proscribed payment.

In the final analysis, the weighing of these factors and the balance to be struck is a matter committed to Congress's judgment. Let me stress that the Commission will, of course, vigorously discharge whatever responsibilities Congress chooses to confer upon it in this or any other area.

* * * *

The problem of corrupt and concealed payments made by American business to obtain favorable treatment in foreign commerce is complex and disturbing. The Commission believes that the legislation which it proposed last May represents an effective and reasonable approach to that problem. Moreover, the Commission is prepared to play a vigorous role in the enforcement of legislation directly out-lawing questionable payments, although that role would, at least in part, transcend our traditional mandate to protect investors through the mechanism of disclosure. I welcome this Subcommittee's consideration of these matters and appreciate the opportunity to assist in that process here this morning.

I will be pleased to answer any quesitons the Subcommittee may have.

Mr. ECKHARDT. Thank you, Mr. Chairman.

Mr. Metcalfe?

Mr. METCALFE. Thank you, Mr. Chairman.

I appreciate very much the Chairman coming here even before he has had a chance to be received informally or whatever the protocol is to your being confirmed.

I have just one question. Would it be a fair statement to make that the Securities and Exchange Commission favors Section 2 of H.R. 3815 as it is presently drafted, that is, Section 30A of the Securities Exchange Act of 1934, rather than a codification separate from the securities law and committed to the Justice Department?

Mr. WILLIAMS. Well, sir, I tried to summarize it. There is a dilemma here. We are prepared to go either way. The dilemma is that Section 30A would extend the traditional responsibilities of the

Commission. It leads us into the enforcement of corporate conduct, even in situations where investor protection is not the critical dimension. There are other direct beneficiaries of its terms, such as competitors, citizens, et cetera.

We have traditionally, under the Securities Exchange Act, been charged with investor protection, and that has been the principal focus of the Commission's responsibility. I am not here to opt for a broadening of the underlying mandate of the Commission. We do believe that we are capable of enforcing proposed section 30A and, in any event, that we will probably be the investigatory body that brings forth most of the matters that arise under proposed section 30A and will be initiating enforcement action in those situations which do impact investor protection under existing law.

We have the competence to implement the program at the least increased cost, and the division of authority or responsibility implicit in proposed section 30A—between the Commission and the Justice Department—is one we have lived with for years and worked with effectively.

So what I am saying, sir, is that we are comfortable with proposed section 30A, although we acknowledge that it does represent an expansion of the underlying mandate of the Commission; whether that mandate should be expanded is a matter we would prefer to leave to Congress.

Mr. METCALFE. Thank you very much.

Thank you, Mr. Chairman.

Mr. ECKHARDT. Mr. Chairman, I should like to try to clarify what the situation would be if we were to provide in this bill for certain accounting standards and make violations of such accounting standards unlawful. Now I understand that presently you are proceeding with promulgation of rules that would be of the nature of section 102 in S. 305. Am I correct?

Mr. WILLIAMS. Yes, sir.

Mr. ECKHARDT. What is the status of that proposed rule? When do you anticipate that it will be adopted?

Mr. WILLIAMS. I am advised that the comment period on the proposed rules, which had been extended for several weeks is over now, and the rules should be coming back to the Commission within probably the next 2 months.fb

Mr. ECKHARDT. I understand that you are saying that something akin to section 102 of S. 305 is necessary to demonstrate a national commitment to ending this type of corporate misconduct. Would we not indicate that national commitment by making the activity itself illegal?

Mr. WILLIAMS. Yes, sir, I believe clearly so. My sense of the importance of section 102 of S. 305 is that it provided a means of getting at the problem, a means of enforcement, since the conduct usually entails a subversion of the corporate accounting records. section 102 of S. 305 would also probably permit a simpler burden of proof than that which is entailed in the proof of bribery itself.

Mr. ECKHARDT. Now I understand that you presently have a penalty under the act for a violation of the rules so once you enact the rules you have that penalty as a means of enforcing it. Under S. 305, we would provide that certain things, for instance, to omit to

state or cause another person to omit to state a material factor, et cetera, would be an unlawful act. I suppose that would be subject to the same penalty as a violation of the rule. Am I correct?

Mr. WILLIAMS. The penalties imposed by S. 305, I believe, are somewhat more substantial, particularly in the case of corporations, than the present penalties under the 1934 act.

I would like to introduce Harvey Pitt, the General Counsel of the Commission, if I may.

Mr. PITT. In response to the Chairman's question, the penalties for violations of that section of S. 305 or our rules would be a criminal penalty, and there are also civil injunctive remedies and both would apply to the statutes since both make the conduct in question unlawful.

Mr. ECKHARDT. That is what I understood. Our feeling when we left out that section in the House bill was that since your rule could impose the same penalty and would be enforceable by just as stiff a provision, that it would be better to enact the proposal via rulemaking.

When we heard testimony with respect to the precise language involved here, it occurred to me that we were engaged in the kind of highly technical, specialized field that your agency is constantly dealing with and your agency has much more expertise than this committee in framing the precise standards involved. Besides that, if we did set out standards as suggested here, there might be some argument as to what extent we had pre-empted the field of establishing standards with respect to accounting. Then, if you should discover that we had somewhat missed the mark, you might find yourself rather rigidly bound within the congressional intent respecting such accounting standards.

So my feeling in drafting the bill that we introduced on the House side was that you would have just as much power to enforce your standard and that you were moving toward establishing a standard similar to the statutory provision that was considered. Also, but you would have the advantage of a greater flexibility and an opportunity to meet developing problems that might occur to the Commission and could be remedied immediately, whereas if you had to go back to Congress to get it changed, you would be subject to considerable delay.

Mr. PITT. I think your point, sir, is certainly well taken. But, the only area of concern that we would have, if our rules were codified in legislation, is whether the flexibility of our future rulemaking might, somehow, be foreclosed. Certainly this subcommittee could indicate, in the language of its report, that it was not intending to foreclose future rulemaking, or the same range of flexibility we presently possess.

The other side of the balance applies to both injunctive and criminal actions. In injunctive actions, we will meet, as we have been increasingly, with arguments as to the extent of our authority. While we believe our authority is clear, and I gather from Chairman Eckhardt's statement the subcommittee is not concerned about our authority, nevertheless, in litigation people will tend to delay our enforcement by raising challenges to the extent of our rulemaking auhority.

On the criminal side, while violations of rules are also criminal violations, there have been isolated court cases which tend to distinguish between violations of rules and violation of statutes. Criminal convictions for the latter are sometimes easier to obtain. While I think those cases that restrict criminal prosecutions for rule violations are not good law, the commitment of the subcommittee to the kinds of rules we have proposed, if our flexibility for future rulemaking is preserved, could avoid those problems.

Obviously, that requires a balancing by the subcommittee, and we do not think that is so significant a problem as to deter us from going ahead with our proposed rulemaking. But, those are the kinds of concerns that we had, concerns which a reaffirmation of our authority by the subcommittee could help to alleviate.

Mr. ECKHARDT. It seems to me you have one possible problem and that is whether or not your rules reach beyond the area in which you are directed to act presently. But if we should enact that statute, clearly we would intend to include the area of foreign bribery even though it might go somewhat beyond the protection of stockholders' interest. So it seems to me that it would be very difficult to argue that the rule was other than a rule to facilitate the existing mandate to the Commission. But if there be any doubt about that, it seems to me we could both preserve the flexibility that I felt was desirable and at the same time assure that your authority was protected by a statement something like what I have made here as to the reason for eliminating that section.

Mr. PITT. I think that that would alleviate the concern. I must say as a personal matter in litigating these issues in view of recent Supreme Court decisions, that we have some concern whether the judiciary will recognize the strength of such statements, and I believe it is safest to include such language, not simply in the colloquy during these hearings, but in the individual House and Senate reports and in the conference report. If that could be done, that would make it unmistakeable, even to the Supreme Court, that the Congress intended to preserve all of the flexibility that we agreed to be necessary.

Mr. ECKHARDT. Of course, we could go even further than that. We could put some findings in the bill if that were deemed necessary. I really don't like findings much because you get tied down to the purpose that you state there and don't give very great flexibility to the court. But it is an alternative.

Mr. WILLIAMS. I think there also could be some instances in which the argument might ensue as to whether a challenged act fits precisely within the purview of the term bribery. Probably a large part of the proof might, in any event, rest with the fact that the corporate records did not appropriately disclose the transaction.

But, it could still leave open the question of whether it was for the purpose of influencing an act or decision of a foreign official in his official capacity. With an additional provision equivalent to section 102, the finding of subversion of the accounting records themselves would be adequate.

Mr. ECKHARDT. I would like to take up a matter with you that you really didn't take up in your testimony. Frankly, in a bill as complex as this, I have no pride of authorship. As a matter of fact,

all these bills stem from many authors over a considerable period of time and the purpose of hearings like this is to throw the bill's content out for the constructive criticism of all persons who may be involved in it. Therefore, I take the liberty of criticizing the bill myself on one point and asking your opinion on it.

One thing that has come to concern me is the provision on page 4 providing that it is illegal for any agent of such issuer who knowingly and willfully carried out the practice to engage in it. I don't have any compunctions against making acts of foreign bribery illegal for the corporation. Of course, in order to prove the criminal activity, one would have to show not only that the act of bribery occurred overseas, which would be an act which would be almost totally subject to proof in a place far away from the court that made the determination, but another necessary link in the criminal chain would be the showing that some kind of official order was issued to engage in such bribery. In other words, the defendant would always be able to marshal what evidence there was to contradict any contention that the company had anything to do with the bribery. With respect to that necessary element of the case without which a conviction could not be had, the defendant would be peculiarly in control of the evidence, both overseas evidence and domestic evidence. But this is not so with respect to the individual who is an agent of such issuer and who is being accused of an act overseas where the totality of the proof would be from activities overseas. Indeed, the corporations interest might even be in conflict with that of the agent. The corporation might desire to have Joe Bloke found to have intentionally engaged in bribery and to have been the sole moving agent, that is, the company never agreed to it and the quicker they can convict Joe Bloke, the better off the company is. It is relieved of responsibility and it has a sacrificial lamb in Rome and everybody forgets about the activity. Also, there may be persons on the other side of the bribery picture. For instance, officials of Italy who might like to establish that Joe Bloke did in fact bribe a lower official and that this was not authorized and in that way remove the matter from political concern.

It does concern me a little that compulsory process is somewhat difficult when all of the facts that could be marshaled for the defense must be obtained from a place perhaps halfway around the world. I don't find any difficulty whatsoever with the corporation's position as a defendant because indeed it has a very inside road to testimony and information. For instance, with respect to what transpired within the corporation itself, it has the records in hand, and indeed as has been said by Secretary Blumenthal, the proof of these matters without cooperation from a foreign government might be difficult. At any rate, it seems to me that there is a vast difference between the position of the individual defendant accused of having violated the act and the corporate defendant. Besides, the individual defendant can be clapped in jail and the corporation can't be clapped in jail. Additionally, I think the SEC is used to dealing with corporate offenses. It is used to dealing with establishing responsibility within a corporate structure and it is not primarily engaged in proving individual criminal activity. Now I would like to have your comment as to whether or not it would be

destructive to the purposes of the act to eliminate provisions providing for criminal liability for the agent of such issuer who knowingly and willfully carried out such act or practice.

In the first place, he is pretty vulnerable to the law of the nation in which the act occurred. If he is accused there and tried there, he has witnesses available. He has compulsory process on those witneses. Presumably in that case the corporation would come to his defense and would aid him in defending his case. But if he is brought to a court in the United States and the witnesses are halfway across the world, it seems to me he is at a disadvantage and indeed this is a very peculiar exercise of extraterritorial criminal responsibility. We do it in cases involving such unusual situations as airplane hijacking, but we don't ordinarily try a man in a place other than where the offense occurred. In this case we might very well do so and we might very well put him at a great disadvantage. Perhaps, Mr. Chairman, you have some comment or perhaps your counsel has on this point.

Mr. WILLIAMS. I think it is a matter that deserves some additional consideration on our part. I would have several observations at the moment.

One is that my expectation would be that a common line of defense on the part of the corporation would, in any event, be that the agent acted without authority and was acting in a sense on his own and without knowledge on the part of the corporation.

The second is that, since the corporation is in essence a legal fiction, and since in the end corporate conduct is a composite of the conduct of the individuals in the corporation and responsible to the corporation, the enforcement of behavior should basically include within it the potential for sanctions against the individuals who make up that corporation.

Mr. ECKHARDT. I am not suggesting that it be left out. Actually, there are three levels of responsibility. First is the level on the corporation. The corporation could be fined up to $1 million in this case. Second, any officer, director, or employee of such issuer or any natural person in control of such issuer, who knowingly and willfully ordered, authorized, or acquiesced in the act or practice constituting such violation would be subject to the penalty. I would not eliminate that. The third is any agent of such issuer who knowingly and willfully engaged in the act. The agent is different from the other two. I guess he could say, " I was out of my mind when I did it and I did not direct myself to do it." But he is not in a position to bring evidence in to defend himself other than evidence which must be gotten in a foreign country. In the other two cases the evidence is either evidence that is available from the records or through the processes of the corporation in the United States or is readily available to them overseas because they are regularly doing business there. But the agent may have been back a year or so and then may be prosecuted. He would then be called upon to prove that the act did not occur.

It would be much more difficult for him, it seems to me, to defend than either the corporate individual or the responsible corporate authority or the corporation itself. They are saying, it happened, yes, it may have happened and it may have been admitted to

happen, but we had nothing to do with it. As a matter of fact, it was that irresponsible person that we improvidently sent to Rome that caused this difficulty.

Mr. PITT. I have just one observation: The structure of proposed section 30A, and it counterpart in section 3 of the bill, and particularly subsection (c) of the section, would require the government, and this would only apply to criminal prosecutions, to prove in the first instance that the issuer had violated the section, beause that is the condition precedent to the holding of any agent responsible.

It seems to me, therefore, that one possibility, and this perhaps could be strengthened if the subcommittee is sufficiently concerned with the problem, is to make it quite clear that, if there were some doubt as to the issuer's involvement in the violation of the law, and I think subsection (c) already reads this way, subsidiary personnel could not themselves be held liable. This would not cover an agent who had run amuck and was not acting pursuant to corporate order.

Mr. ECKHARDT. That is a very good point. That is one that I had really not taken into account in my question to you. Of course, this does relieve that conflict of interest between the issuer and the violator, but there could be the case where the issuer could really not deny that it had given some authority to act within this area. But the person overseas claims he did not exercise that authority. He didn't do what he is accused of doing or if he did do it, it was in the nature of a grease payment that was not such as to be intended to influence a foreign government. I think the question of whether one corruptly influences or gives money in order to corruptly influence a foreign government to take such an action, et cetera, even if it occurs with someone else than a foreign official who has purely clerical authority, might not necessarily be other than a legitimate facilitation of acts which that government official ordinarily does. So the question can be a very delicate one. It seems to me it puts the individual at a considerable disadvantage not to be able to defend the case at the place where the occurrence took place.

Mr. PITT. I see the problem. I think it is a real one. I am not advocating a position one way or the other, but one other point that should be made: because of the conditional predicate—that the issuer itself be proved to have violated the act and to have made an unlawful payment under it—that, insofar as foreign acts are involved, the issuer and the agent have a community of interest; that is, the agent would be protected by the issuer in at least those cases where the issuer chooses to contest the violation.

Mr. ECKHARDT. That is very important.

Mr. PITT. That is important because the issuer might, in some cases, choose not to contest, not necessarily because it believed it had violated the law, but because it was easier to plead to a violation than to subject itself to the rigors of a trial.

Assuming that there were allegations against an agent, and the issuer did contest the allegations against it, I think the agent would be placed in the position of disproving—not what acts the issuer authorized—but only disproving what charges might be raised against him as to what his understanding was. In all instances, the

burden would be on the government, it seems to me, to prove that conduct in violation of the act did occur, and the agent would not be compelled to bear the very difficult burden of proving that an act did not occur.

Mr. ECKHARDT. Of course, that is true. There is no question about that. But the thing about it is that the government would undoubtedly have both the resources and the ability to bring in witnesses from overseas whereas the individual would have a very difficult time bringing in witnesses to rebut such testimony. Of course, there is a reason why we left that in. You will note the sanction is a $10,000 fine and/or 5 years imprisonment which is relatively light for foreign bribery. I disliked it very much for that reason. I thought it was almost an invitation to use an individual as a scapegoat because it is so cheap to let him pay. So what we did was make a $1 million penalty applicable to the corporation itself and for individuals only a $10,000 penalty. We did that intentionally. We did it partially because we felt that it might be necessary to let the individual engage in plea bargaining and immunity in order to get testimony and in order to convict the corporation. Thus, it is rather important to keep the individual in as an enforcement technique. But I simply would not like to see a situation where we place such a heavy burden on an individual that we effectively deny him what is considered ordinary due process of law in this country. We might consider, for instance, removing the imprisonment provision. We might also consider some specific provisions with respect to process. In other words, if the government obtains process, the individual shall be afforded the same opportunity, even if it is at prosecutorial expense.

Mr. PITT. At a minimum, I think the language of subsection (c)(2), applying to any agent, might create some jurisdictional problems if the agent is wholly situated overseas and has not been in this country. While I think there are jurisdictional ties that could be asserted, the problems you express in this case might be even worse in terms of prosecution. But, I think you could so something along the lines you are suggesting either by amending this subsection or by report language that would clarify burdens of proof, obligations, and the involvement of agents, to provide a fair opportunity for an agent to present his defense. That does seem to be a very serious concern.

Mr. ECKHARDT. Well, I suppose you have to use the U.S. courts. Therefore, you always impose upon him the burden of defending himself far away from the point where the evidence can be obtained.

Mr. WILLIAMS. In many instances that claim would be made by the issuer as well, which incidentally I might note is another possible reason for language equivalent to section 102 of S.305.

Mr. ECKHARDT. But the issuer cannot very well make that claim because he has so many advantages above the prosecutor. In this case he has to have been engaged in the foreign country and that means he has probably got offices and operations over there. He has an opportunity to bring people over. It is a major corporation. It has the resources to bring in its witnesses, and above all, the witnesses lie within the control of the corporation itself.

Mr. PITT. Without intending to prolong this discussion, if I might I would like to make two additional points.

One possibility which occurs to me might be to strengthen the conditional predicate which would effectively prohibit a prosecution or at least incarceration of an agent if there was not a full trial and proof of the issuer's violation. The agent would be able to avail himself of the fact that the issuer had to prove that the payment itself did not fall within the act.

Presumably, if the issuer is compelled to litigate that issue in a criminal proceeding with its rigorous standards of proof, and if the issuer fails on that, I think there should be less sympathy for an agent in that context. The issue would turn, in the agent's case, to information which the agent had in his control, what his written or oral instructions were, what he did overseas, and how he facilitated the violation. There are elements he could draw upon and would have proof of in terms of his own conduct.

The second point is that, in your concern about agents, I think you should also consider the employees of issuers, because the term "employee" is a very inclusive term. At some juncture some of the concerns that you raised about agents, even though they would not apply to officers and directors, could apply to lower level employees who might also claim that they were asked to do something and did not quite understand what it was they were doing, but nevertheless are now charged with criminal conduct.

I think the strengthening of the conditional predicate would solve both problems without requiring you to change the enforcement benefits that the subcommittee originally perceived in applying this provision to agents. It is something we could take a crack at drafting, if the subcommittee wanted us to do that.

Mr. ECKHARDT. We would very much appreciate your cooperation in that. We also very much appreciate your valuable testimony here today, Mr. Chairman. Thank you very much.

The subcommittee will be adjourned to the call of the Chair.

[The following statements and letters were received for the record:]

Chamber of Commerce of the United States of America

Washington

STATEMENT
on
THE UNLAWFUL CORPORATE PAYMENTS ACT OF 1977 (H.R. 3815)
for submission to the
SUBCOMMITTEE ON CONSUMER PROTECTION AND FINANCE
of the
HOUSE COMMITTEE ON INTERSTATE AND FOREIGN COMMERCE
for the
CHAMBER OF COMMERCE OF THE UNITED STATES
by
J. Jefferson Staats*
April 27, 1977

The Chamber of Commerce of the United States appreciates this opportunity to give its views in opposition to H.R. 3815, as written, and to suggest alternative policy for the subcommittee to consider in dealing with questionable overseas business payments.

The Chamber's membership comprises a broad cross section of this country's commercial sector. We represent over 62,000 firms -- from large corporations to single proprietorships -- in addition to 2,500 local, regional and state chambers of commerce, 1,100 trade associations and 41 American chambers of commerce abroad. These National Chamber members, engaged in domestic and international business, are concerned about the issue of questionable overseas payments both as a basic ethical problem and because well-publicized reports of instances of such payments have tended to undermine public confidence in the entire corporate community and in the market economy as a whole.

The Chamber condemns the payment, solicitation or extortion of bribes, payoffs or kickbacks, and supports the disclosure of such acts and the prosecution of violations of national laws. The Chamber has long endorsed the highest standards of professional conduct of American business people operating in the United States or overseas. The overwhelming majority of U.S. firms operating abroad conduct their activities in accordance with the legal requirements of host countries and refrain from unlawful intervention in the domestic affairs of host countries. The recent

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*Staff Associate, Chamber of Commerce of the United States

controversy surrounding questionable payments has resulted in much confusion concerning the commercial propriety of commissions and fees related to business transactions. Commissions or fees are paid on sales, or for services rendered, as a part of conducting business worldwide. They are generally determined by the market place and, in and of themselves, are entirely legitimate.

The Chamber believes that disclosure has proved to be an effective deterrent against the offering or solicitation of various forms of questionable payments. U.S. securities law already requires public disclosure of material payments. This reporting requirement, embodied in the Securities and Exchange Commission's "Voluntary Disclosure Program," has prompted voluntary disclosures by many corporations over the last two years. This voluntary disclosure approach, taken with existing SEC rule-making authority and the SEC's recommended stock exchange listing requirements, should adequately respond to public, corporate and investor-related concerns. It is important to note, as well, that misrepresentations to the Internal Revenue Service of certain payments may constitute violations of the Internal Revenue Code.

The Chamber, therefore, is not convinced that new legislation is needed to confront the problems caused by questionable overseas business payments.

H.R. 3815

The Chamber opposes H.R. 3815. This legislation would make it a criminal offense for a United States business to give anything of value to any foreign official, political party, candidate or intermediary for the purpose of influencing governmental acts or decisions. The National Chamber is particularly troubled by these sections for the following reasons:

(1) The criminalization of questionable overseas business payments would contribute little to deterring such payments beyond that which is already accomplished by existing securities, tax and criminal law. Aspects of the payments problem which cannot be directly remedied by existing domestic law, such as the conduct of foreign government officials, also cannot be satisfactorily met by attempts to improperly

extend the reach of U.S. law. The inherent limitations of domestic law in dealing with all facets of the payments problem can only be overcome through the negotiation and implementation of bilateral, or preferably multilateral, agreements.

(2) Legislation which would impose criminal penalties for making questionable business payments would be very difficult to administer and enforce. H.R. 3815 attempts to compensate for poor or reluctant enforcement by some foreign governments of their own laws by, in effect, doing it for them. In order to prosecute successfully under these provisions, much evidence located outside of the United States would be required. U.S. prosecutors investigating the activities of foreign government officials will be totally dependent on the foreign government for sufficient information. Conversely, the accused could easily be prejudiced by an inability to obtain production of documentary evidence or attendance of witnesses located outside the jurisdiction of U.S. courts.

(3) H.R. 3815 could lead to conflicts between the United States and foreign governments. Decisions taken at any point in the development and prosecution of a case could involve the United States in sensitive diplomatic problems. The use by the Government or a defendant of certain evidence could cause embarrassment to a foreign government and create foreign policy problems for the United States stemming from our "meddling" in another country's internal affairs, even though such revelations should have come about through effective enforcement of domestic laws in the host country.

(4) With respect to the focus of the investigatory responsibility granted in Section 2 of H.R. 3815, the Chamber believes that the SEC does not seek nor should it be granted criminal enforcement responsibilities which do not relate to the regulation of securities and securities markets.

Multilateral Efforts

It has become apparent that a substantial number of questionable payments on the part of multinational firms are the result of demands from officials of, and others purporting to represent, governments in some countries. Such demands are frequently made in a context in which the company's refusal to comply may result in extreme economic penalties.

The Chamber is encouraged that the private sectors and governments of some countries have expressed interest in multilateral efforts to eliminate all such improper practices by businesses and by governments.

The conclusion of a multilateral agreement among the largest possible number of industrialized and developing countries could establish standards of ethical and equitable conduct of international business, provide that these same standards would apply to all businesses, create pressures or impose obligations on governments to vigorously enforce relevant domestic law, and establish a mechanism to resolve the diplomatic, commercial and legal problems associated with such practices. The Chamber endorses the efforts of the U.S. Government to bring about a treaty in this area under the auspices of the United Nations Economic and Social Council (ECOSOC).

Conclusion

In light of the general success of existing governmental programs and enforcement measures, the most constructive additional federal response to the troubling problem of questionable overseas business payments is not in the form of new legislation; rather, it is through the negotiation of international agreements. The many elements of the problem which are outside United States jurisdiction can be addressed effectively only in this manner. The discussion of governmental action in response to the questionable payments problem should not, however, overshadow the duty of American business people to obey the law and to maintain the highest standards of professional conduct.

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Statement of the
National Association of Manufacturers
to the
Subcommittee on Consumer Protection and Finance
of the
House Committee on Interstate and Foreign Commerce
on H.R. 3815
A Bill to Amend the Securities Exchange Act
April 28, 1977

The National Association of Manufacturers is a voluntary, non-profit organization of over 13,000 companies, large and small, located in every state of the Union. As the representative of firms which account for nearly 85% of American manufactured goods and the employment of approximately 15 million persons, the NAM is concerned that a number of corporations have made questionable or illegal foreign payments. NAM's Board of Directors called upon member companies to adopt individual codes of ethics and to adhere to the highest standards of business conduct. The Association has also favored strict enforcement of current laws and U.S. Government proposals for an international agreement to prevent improper payments in world commerce.

NAM believes that continued development of more effective internal corporate controls, improved enforcement of U.S. laws and the undertaking of successful international negotiations constitute positive and effective steps toward this problem's resolution. We are not convinced that further unilateral U.S. legislation is necessary. An information reporting system might be considered if elaborated within the context of a multilateral or bilateral approach to cooperative local law enforcement on this issue. We believe that a unilateral, criminalization approach such as proposed by H.R. 3815 would pose serious problems of extraterritorial enforcement, particularly regarding constitutional due process guarantees, and may prove counterproductive to the achievement of an effective multilateral accord. We therefore oppose enactment of H.R. 3815.

Background:

The issue of improper payments made overseas by some U.S. companies received widespread publicity in 1976, stimulating a policy debate on necessary corrective actions. A series of steps were undertaken at three different levels to meet the perceived problem and help assure both its immediate and longer-term resolution. The

first area of response has been in self-corrective and preventative actions by companies themselves. We continue to believe this approach to be both the most logical and effective means to deal directly with the problem. The NAM Board of Directors urged member companies to adopt individual codes of ethics and adhere to the highest standards of business conduct. In an open letter to the membership on April 19, 1976, former NAM Chairman Richard C. Kautz pointed to the NAM Code of Business Practices which states, in part, that "We will compete vigorously to serve our customers and expand our business, but we will avoid unfair or unethical practices." Individual company management is in the best position to take the leadership in making commitments, defining derelictions and applying censure and penalties to those who violate standards. Management is sensitized to the problem of improper foreign payments and the actions it has taken speaks well for private sector self-correction, including vigorous investigations of past payments, increased vigilance by directors, audit committees and outside accountants, and strong corporate leadership statements of policy coupled with tightened internal control procedures.

New governmental enforcement procedures under current law have also been undertaken by a number of agencies. The Securities and Exchange Commission (SEC) was at the forefront of initial disclosures of improper payments and is, of course, continuing to enforce regulations as applied relevant to publicly-held companies. The Treasury Department instituted procedures to investigate corporate payments abroad which might involve U.S. tax laws. A special Presidential cabinet-level task force conducted a study of the problem and last year recommended a new reporting and disclosure approach to supplement these other Executive Branch actions.

Two measures were passed during the 94th Congress which bear directly on this subject. One bill established reporting requirements on payments involving military sales and the other desginated tax penalties which would be applied in cases of foreign bribery. Proposed legislation to cancel Overseas Private Investment Corporation (OPIC) coverage on projects involving illegal payments passed the House but not the Senate,

while the reverse situation pertained with regard to a Senate bill similar to sections of the bill which is now before this Committee. Bills proposed by the previous Administration on the basis of the Presidental Task Force study which favored a reporting and disclosure system were not given full hearings in either House.

The third area of activity involved international efforts to deal with the payments problem. The United States concluded nearly a dozen bilateral information exchange agreements with foreign governmental agencies involving information to be used for investigations or judicial procedures in the foreign country. These agreements were negotiated so as to assure maintenance of proper Constitutional safeguards regarding judicial processes and information concerning individuals. The U.S. Government has also proposed to a special United Nation's Working Group the outlines of an international agreement to eliminate bribery from world commerce. The Senate has endorsed such a multilateral approach in Senate Resolution 265, passed unanimously at the end of 1975. Additionally, last year Senate Resolution 516 commended the OECD Guidelines for MNCs, including multilaterally-agreed voluntary standards on foreign payments which have been recommended by governments and widely accepted by multinational corporations.

Summary of H.R. 3815 ("Unlawful Corporate Payments Act of 1977")

The proposed "Unlawful Corporate Payments Act of 1977" makes it unlawful as a matter of Federal law for certain persons to make certain payments to foreign officials and other foreign persons.

Section 2 of H.R. 3815 amends the Securities Exchange Act of 1934 (15 U.S.C. §§ 78a, et seq.) to prohibit such payments by any corporation subject to regulation by the Securities and Exchange Commission because it "has a class of securities registered pursuant to section 12... or ... is required to file reports pursuant to section 15" of the 1934 Act. Section 3 of H.R. 3815 prohibits such payments by any "domestic concern,"

defined as any company not subject to regulation by the Securities and Exchange Commission which is owned or controlled by U.S. nationals, 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.

Both the operative provisions and the key definitions of Sections 2 and 3 of H.R. 3815 are identical. These operative provisions describe the unlawful payments and recipients, prescribe penalties, and determine personal liability for the unlawful payments. The two key definitions define "control" (with beneficial ownership of 25% or more of voting securities giving rise to a presumption of control) and "foreign official" (any officer, employee, or official representative of a foreign government whose duties are not "ministerial or clerical").

Unlawful payments consist of (1) an offer, payment, or promise to pay or (2) the giving of anything of value (3) corruptly (4) to any foreign official or foreign political party, party official or candidate (or to any person while knowing or having reason to know that a portion of the payment will reach the foreign official) by (5) use of the mails or any means or instrumentality of interstate commerce. A corrupt payment is one made to a foreign official for the purpose of "influencing any act or decision of such foreign official in his official capacity" or "inducing such foreign official to use his influence---to affect or influence any act or decision" of a foreign government.

Penalties are prescribed for companies convicted of making unlawful payments (a fine of up to $1 million) and for officers, directors, employees, or agents "who knowingly and willfully" participated or acquiesced in the company's unlawful payment (a fine of up to $10,000 or imprisonment up to five years or both).

Personal liability for fines imposed on individuals is required by the provision stating that "such fine shall not be paid, directly or indirectly, by" the company employing the individual.

NAM Position

The NAM continues to favor individual company codes of conduct and internal enforcement procedures as the most direct and effective method of dealing with this problem. Recognizing the global roots of improper commercial payments, we also favor the negotiation of an international agreement to eliminate to the greatest practicable extent such payments from world trade. It is our opinion that steps being taken voluntarily by individual U.S. companies and the increased enforcement of current U.S. laws by agencies such as the SEC and IRS, have largely resolved the problem of such payments by American companies. The negotiation of an international agreement to eliminate improper payments worldwide, probably utilizing an information reporting system to aid local law enforcement, would help assure that U.S. industry is not placed at a competitive disadvantage by unfair foreign practices as well as place world commerce on a better, market oriented trade and investment basis.

Evaluating H.R. 3815 in terms of this position, NAM must oppose the bill for three major reasons: (1) corrective actions already taken have made passage of the bill unnecessary; (2) inherent problems in the bill, particularly regarding its extraterritorial application and conflicts with constitutional due process guarantees, make it either unworkable, threaten serious undesirable side effects, or both; and (3) the criminalization approach runs counter to proposals for an international agreement based on reporting and disclosure principles and could impair the achievement of such an accord.

New U.S. Legislation Is Not Necessary

An effective solution to the problem of improper foreign payments does not require the passage of new laws. Substantial legal sanctions are already in existence which are applicable to foreign bribery: in the Internal Revenue Code, the Clayton Act, the Sherman Act, the Federal Trade Commission Act, and the Securities Exchange Act; in transactions involving AID or arms exports; and in shareholder derivative suits

based on state and federal law. The reported cases of improper foreign payments indicate not a lack of law, but of enforcement, both from within and outside the company.

Corrective actions undertaken by corporate management and boards of directors, by the accounting profession, and by law enforcement agencies have all brought a closer security and tightened control of corporate funds expenditures. These actions have also been beneficially supplemented by the role of the news media in spotlighting wrongdoing and calling attention to the need for corrective measures in this area. The investigatory work of the press has created an awareness that actions bordering on questionable conduct run the risk of widespread public disclosure. The power of this very real constraint should not be underestimated, given the attendant possible repercussions on a company's foreign business, its vulnerability to legal sanctions, and certainly just as important, the damage to the firm's public reputation.

Corrective actions already undertaken in the private sector and more effective enforcement of existing laws will, we believe, prove more than sufficient to resolve the payments problem without new legislation. What is needed now is not new laws dealing with U.S. companies, but rather an international agreement to assure that all businesses engaging in world commerce do so in a fair competitive manner.

Inherent Implementation Problems in H.R. 3815

The major inherent implementation problem in H.R. 3815 is its projected extraterritorial application which presents perhaps insurmountable practical enforcement difficulties and raises serious questions of constitutionality concerning due process guarantees. A case falling under the bill's prohibitions would involve a payment to a foreign government official, most likely on foreign soil, and perhaps by a foreign person. U.S. investigation of such incidents would inevitably raise national sensitivities and create diplomatic problems, making it unlikely that much official foreign

cooperation with U.S. investigatory efforts would be forthcoming. However, without such full cooperation and support, the practical implementation of H.R. 3815 would be nearly impossible since foreign witnesses and evidence would have to be obtained and transported to a U.S. court.

Official foreign assistance is even less likely to be available where the requestor is not the U.S. Government, but an accused defendant. Yet, under the U.S. constitutional system of justice, the defendant must have available to him adequate means to present his defense. Many U.S. persons accused of illegal acts under H.R. 3815 will be unable to produce exculpatory evidence and/or witnesses from abroad, because the extraterritorial reach of U.S. criminal law is long enough to charge the defendant, but not effective enough to compel production of evidence and testimony necessary to his defense. This type of difficulty in providing due process in criminal cases brought under the proposal in H.R. 3815 raises serious constitutional questions which should be resolved before the Committee takes further action on this bill.

The practical enforcement difficulties of the bill are also evident when considered in the context of the need for a clear and reasonable standard defining which corporate or individual actions might be considered violations of this proposed criminal statute. For instance, the bill attaches criminal liability to corporate employees who order, authorize or "acquiesce" in the making or a corrupt foreign payment. The concept of acquiescence is unclear and perhaps unprecedented in criminal legislation, leaving considerable doubt as to what actions or inactions might subject a person to criminal penalties. Further, the bill requires that a covered payment reach a foreign government official, but exempts foreign officials performing "clerical" or "ministerial" duties. This exemption is apparently an attempt to exclude so-called

"facilitating" payments from the law's coverage in recognition that legal prohibitions against such small payments are probably completely unenforceable. However, the definitional concepts are ambiguous when applied to foreign systems and cultures, where top ranking officials usually hold a ministerial designation.

Another area in which the practical difficulties of applying U.S. concepts and standards upon foreign cultures arises is the bill's treatment of foreign political contributions which are, in many cases, a perfectly proper payment under the established legal system of that foreign nation. Additionally, the legislation proposes the use of the "means or instrumentality of interstate commerce" as the act through which U.S. jurisdiction is asserted. While this mechanism may provide a constitutional basis for the statute, it is unclear whether its practical effect would necessarily reach the act of a payment made abroad. Surely foreign jurisdictions have a more direct and enforceable legal nexus upon which to prosecute persons engaging in corrupt practices.

An International Agreement is Needed

The desirability of an international agreement on bribery has been widely recognized and supported. Senate Resolution 265 called for the initiation of negotiations on such an agreement and subsequent initiatives were undertaken in both the GATT Multilateral Trade Negotiations and in the United Nations to seek an accord on preventing bribery. A special UN Working Group was established for this purpose and the U.S. has formally submitted a proposal to it outlining initial ideas on the substance of such an agreement. This Group is reportedly aiming at completing its report in time for the Economic and Social Council (ECOSOC) meeting in July and August of this year.

NAM favored Senate Resolution 265 and the negotiation in all appropriate international forums of a multilateral agreement to prevent bribery in international commercial transactions. The global scope of the problem argues for the participation of at least all major trading countries, if not virtually all countries worldwide, in

cooperatively seeking the elimination of improper payments.

We believe that the general approach originally outlined by the U.S. Government before the United Nations Commission on Transnational Corporations and reported to the Senate Banking Committee by former Undersecretary of State for Economic Affairs Charles Robinson on April 8 of last year constitutes a positive and operationally sound basis for negotiating an international accord. In particular, we believe the following elements could be included in a multilateral agreement: (1) All countries should clearly define the procedures to be followed by companies dealing with the government in procurement or regulatory matters, including what actions would constitute illegal payments. There should be a commitment to effectively enforce laws against both bribery and extortion. (2) Inter-governmental arrangements, probably bilateral in nature, should be considered to permit information exchange between governments, subject to necessary constitutional safeguards, to assist official foreign investigatory or judicial action involving illegal foreign payments. (3) An information reporting approach could be considered to assure that national governments have available to them the necessary information on payments to government officials in order to assist proper law enforcement and avoid possible foreign relations problems. However, such standardized reporting should be kept to the minimum necessary to meet these objectives.

The thrust of H.R. 3815, on the other hand, runs counter to the objective of seeking an international agreement and may in fact jeopardize the negotiation of such an accord. First, the unilateral and extraterritorial nature of the legislation will likely foster diplomatic conflict rather than multilateral agreement. There is certainly no reason for the U.S. to forego steps to correct obvious shortcomings within its own jurisdiction -- as has been done by the many corrective enforcement actions already taken. However, to take such unilateral corrective action in a manner which extends far beyond U.S. borders into the internal affairs of other sovereign nations, can only raise potentially serious diplomatic conflicts with other governments, as

has been amply demonstrated in the past in cases of U.S. antitrust and export control regulations. The extraterritorial enforcement of H.R. 3815 would indeed raise problems far beyond the magnitude of past experience, for the enforcement would by definition directly involve investigation and judicial actions concerning foreign officials involved in government procurement programs or regulatory matters which take place on foreign soil. This type of unilateral U.S. action is not conducive to fostering the levels of international cooperation necessary to develop a multilateral agreement on preventing improper payments.

Additionally, H.R. 3815 is at cross-purposes with the basic thrust of the most realistic and acceptable approach to an international agreement which rests upon the clarification and effective enforcement of each nation's domestic laws on bribery and extortion, a system of information reporting and an inter-governmental information exchange network. By contrast, H.R. 3815 seeks the extension of U.S. law into other countries, does nothing to reach situations of foreign extortion of U.S. companies, and does not advance the objective of enforcing laws against foreign as well as U.S. violators of bribery statutes. Any legislation passed by the Congress should be formulated in such a way as to encourage, not prevent, the achievement of an international accord dealing with the full scope of the payments problem and covering both U.S. and foreign companies.

Conclusion

The problem or improper corporate payments abroad has led to a number of self-corrective and preventative actions by the business community as well as improved governmental enforcement of U.S. laws. We believe that these steps have largely resolved the problem of such payments by U.S. firms, but that an international agreement is needed to reach the full global scope of such payments. NAM supports both the continued development of effective internal corporate controls and the successful negotiation of a multilateral accord to prevent improper payments in world commerce.

We do not feel that additional U.S. legislation is necessary at this time and specifically oppose the criminalization approach used in H.R. 3815. Primarily we feel that the bill would be impossible to effectively implement in a fair and consistent manner, it raises substantial constitutional due process questions, and it could lead to diplomatic conflicts counterproductive to the achievement of a desirable international accord on controlling improper payments.

Federal Regulation of Securities Committee

April 19, 1977

The Honorable Bob Eckhardt
Chairman, Subcommittee on
Consumer Protection and
Finance
Committee on Interstate
and Foreign Commerce
United States House of
Representatives
Washington, D.C. 20515

Re: H.R. 1602 and S. 305; and H.R. 3815

Dear Congressman Eckhardt:

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"). Although these comments do not represent the official position of the Committee, Section or ABA, or reflect the varying views of individual Committee members, the comments do reflect the views of the great majority of those responding to the draft of this letter which was circulated to the ABA's Ad Hoc Committee on Foreign Payments Legislation and to the chairmen of the 19 subcommittees of our Committee.

As is often the case, some of the lawyers participating in the drafting of these comments represent clients whose affairs are or may be affected by the proposed legislation which is the subject of our comments.

Nevertheless, it is the practice and tradition of the Committee and Section to prepare comments on proposed legislation and rules based on our experience and independent professional views of the matters involved in furtherance of the public interest. To assure that the expressed views also reflect a broad consensus, we have widely circulated a draft of this letter as indicated in the preceding paragraph.

I. H.R. 1602 and H.R. 3815

A. Introduction

H.R. 1602, introduced by Congressman Murphy, would prohibit foreign bribery and would require issuers of securities registered pursuant to Section 12, and issuers filing reports pursuant to Section 15(d), of the Securities Exchange Act ("Reporting Companies") to maintain accurate books and records and to maintain an adequate system of internal accounting controls.

H.R. 1602 is virtually identical to Title I of S. 305 introduced by Senators Proxmire and Williams. Neither H.R. 1602 nor H.R. 3815 includes provisions comparable to Title II of S. 305 which provisions would require increased reporting concerning the ownership of registered equity securities.

B. Comments on Sections 2 and 3 of H.R. 1602 and on H.R. 3815

We support, without reservation, the goal of eliminating foreign bribery. We agree that legislation designed to restore and maintain confidence in American business at home and abroad is desirable. However, legislation which assumes that a multinational corporation will be able to prevent all corrupt offers or promises by every employee, including foreign nationals whose concepts of business morality differ from our own, is unrealistic. Until the ethical precepts which we share with the sponsors of the legislation have been accepted not only by the American business community but also by the governments and businessmen with whom our business community must deal throughout the world, no effort to eliminate foreign bribery can be expected to be completely successful.

The lessons of history should not be ignored. As illustrated by Prohibition, making conduct criminal in an environment in which the legislation has neither the universal support nor the effective policing mechanism necessary for enforcement breeds disrespect for law, thus weakening the confidence in American business the legislation is intended to promote. Because we share the serious concern about the enforcement problems of S. 305 expressed by Secretary Blumenthal in his statement before the Senate Banking

Committee on March 16, 1977, we believe that criminal sanctions should not be imposed against the issuer unless the conduct is engaged in with the approval or actual, rather than constructive, knowledge of the corporation's directors and executive officers. If, on the other hand, such conduct reflects the inability of senior management to completely control the significant activities of lower level employees, a requirement of disclosure to the shareholders will promote the aims of the legislation without the problems of enforcement inherent in making the corporation criminally accountable for its inability to exercise complete control over the activities of all of its employees.

In addition to H.R. 1602 and H.R. 3815, we have reviewed proposed legislation of the Carter Administration which would amend Sections 103 and 104 of S. 305. Based on our review of these varying approaches, we urge that any law criminalizing foreign bribery:

1. not be included in the Exchange Act since it would detract from the concept of financial materiality to investors which has been inherent in the Federal securities law disclosure structure and has made possible the high levels of voluntary

compliance with those laws which has traditionally existed;

2. be included in the U.S. Criminal Code rather than introduced as an unrelated substantive criminal provision in the Exchange Act;

3. provide for uniform enforcement by the Department of Justice for all companies, whether or not they are publicly owned, rather than inviting the inconsistent enforcement and costly and inefficient duplication inherent in dividing responsibility between the Department of Justice and SEC; and

4. expressly exclude (i) low-level "facilitating" payments and (ii) legitimate payments to promote business and generate good will, rather than rely on subsequent interpretations of the term "corruptly."

We generally prefer the legislation proposed by the Carter Administration because it achieves all of the above objectives except the last one.

Although the exclusion in H.R. 3815 of ministerial and clerical employees from the definition of "foreign officials"

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is desirable, we believe it does not go far enough in dealing with the first portion of objective 4 listed above. The Administration's proposal and H.R. 1602 add the essential ingredient by providing that the purpose of such payments must be to assist in obtaining or retaining business with a foreign government, to direct foreign government business to any person, or to influence legislation or regulations of a foreign government. Similarly, the Administration's proposal and H.R. 1602 need the exclusion of ministerial and clerical employees found in H.R. 3815.

C. Comments on Section 1 of H.R. 1602

We favor the approach in H.R. 3815, which omits the accounting and related provisions contained in Section 1 of H.R. 1602 (and the identical Section 102 of S. 305), thereby recognizing the preferability of allowing the SEC to adopt rules to regulate the accounting and related matters in issue.

We hold this view even though the Committee has objections to the SEC's proposal. These objections are reflected in the Committee's comment letter to the SEC which questions whether the agency has authority to adopt such rules and suggests language changes. Accordingly, our favoring of the approach taken by your bill, that these accounting regulations are best left to administrative rulemaking which

has the necessary greater flexibility, is conditioned on whether the SEC adopts its proposed accounting rules.

In any event, if the subject accounting provisions are to be adopted by means of legislation, we urge consideration of the following suggestions concerning Section 1 of H.R. 1602.

1. None of the three subsections of Section 1 excludes immaterial acts or transactions. This is inconsistent with the basic approach of the securities laws that the courts and the SEC should concern themselves only with material items. Although materiality may not be measured solely in terms of dollars, a matter can be insignificant because of size alone and therefore without adequate basis to justify the time or attention of the courts or the SEC.

2. Subsection (2) would require a Reporting Company to maintain an adequate system of internal accounting controls. The provision assumes that questionable payments are made possible by inadequate accounting controls. To the contrary, a common characteristic of the cases to date has been the deliberate circumvention of internal accounting controls. Accordingly, we suggest that any 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 which violate existing accounting control systems. If additional statutory requirements are in fact necessary, the language suggested below at the end of this part 2 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 which focuses 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. Moreover, the suggested language would eliminate several drafting problems identified in our letter to this Subcommittee dated September 22, 1976.

We recognize that the language of Subsection (2) comes from existing auditing guidelines. However, language which may provide appropriate guidelines for accountants and define the objective of accounting controls is not necessarily appropriate for inclusion in a statute, the violation of which carries civil and criminal penalties.

Although we believe all issuers should maintain "an adequate system of internal accounting controls," we do not believe that as a matter of fundamental fairness the failure to do so should be made the subject of Federal civil and

criminal penalties in the absence of clearly articulated standards as to what would constitute an adequate system. The components of such a system are not contained in the accounting literature. Thus, adoption of this portion of the bill in its present form would provide inadequate guidelines to issuers as to when they are operating unlawfully. Given the difficulty inherent in establishing and defining an adequate system for all categories of issuers, we do not understand the pressing need to legislate this aspect of public accounting, particularly where the foreign payment situations disclosed to date have had almost the universal characteristic of circumvention of apparently adequate internal accounting systems. A far better approach -- one tailored to the actual problem -- would be to prohibit 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."

3. Subsection (3) would make it unlawful to falsify accounting books and documents. This provision does not require any intent to do an improper act, does not make any exception for immaterial inaccuracies and is not limited to persons having a management or employment relationship with the issuer. Items as trivial as a carelessly prepared expense voucher presumably would be included. Another effect of this Subsection would be to make willful falsifications of any accounting document a felony under Federal law wholly irrespective of the amount involved.

According to the Senate Report on S. 3664, the Proxmire bill in the 94th Congress, 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.

To address these negative consequences we suggest this Subsection read as follows:

> "(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."

We wish to suggest one additional point. As set forth in the next part of this letter, we believe the sort of prohibition contained in Subsection (3) is more appropriate for inclusion in the U.S. Criminal Code.

4. Subsection (4) 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. This provision would be counterproductive in our opinion because it would discourage communications with auditors in many cases. Because this Subsection does not require any intent to do an improper act, does not make any exception for immaterial inaccuracies, and applies to the most casual oral statements, 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 decline to furnish any information to the auditors rather than run the risk of an inadvertent violation of a civil and criminal statute.

For the above reasons, we believe Subsection (4) should apply only (i) to persons with specified relationships to the Reporting Company, and (ii) to a written communication

containing a material defect which is made with an intent to deceive.

In order to reflect the above comments 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 necessary 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 in the case of Subsection (3), we believe that in view of the nature of this statutory provision it should be included in the U.S. Criminal Code, if adopted at all, and not

be added to the Exchange Act. This would also readily permit these provisions to be made applicable to all issuers and not merely to Reporting Companies.

II. Title II of S. 305

A. Comments on Section 202

Section 202 of Title II would require disclosure of the residence and nationality of 5% beneficial owners of registered securities. We believe this added disclosure would be beneficial. However, such disclosure is already required by rules adopted by the SEC which become effective on August 31, 1977, and we are aware of no reason for substituting a new statutory requirement.

B. Comments on Section 203

Section 203 as originally drafted could establish a new reporting requirement for holders of record of as little as one-half of 1% of a registered equity security. As of this writing, however, this provision has undergone substantial amendment by the Senate Banking Committee to, among other things, maintain the reporting threshold at 5%. We favor Section 203, as amended, assuming the Congress determines that legislation in this area is needed at all.

If it is considered advisable, we would be pleased to meet with you or members of the staff of the Subcommittee 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

cc: Hon. Harley O. Staggers
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Hon. Robert Krueger
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Hon. James H. Scheuer
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ADMITTED IN THE DISTRICT OF COLUMBIA ONLY
GERALD GOLDMAN

ADMITTED IN CALIFORNIA ONLY
NORBERT A. SCHLEI

April 21, 1977

Hon. Bob Eckhardt
Chairman, Subcommittee on Consumer
Protection and Finance
Committee on Interstate and
Foreign Commerce
House of Representatives
1741 Longworth House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

I very much appreciated the opportunity, short as it was, to appear before you in connection with H.R. 3815. I would be less than frank, however, if I did not say I was disappointed that I was unable to complete my direct remarks and, therefore, looking back on the morning, I did not feel that I had presented my full case.

When I was finally reached after two hours and forty minutes of the first witness, the hour was late indeed. I felt, therefore, that to read even part of my statement, as the other witnesses had done, would be completely inappropriate and too time-consuming. Then, my abbreviated remarks were interrupted by the discussion on "partisanship". I did, however, feel that that was a valuable discussion and I trust that it cleared the air. My written statement was prepared after considerable work and with great effort by a group of senior accountants and lawyers, who care about seeing this problem really solved. We all have clients, but in this instance we are partisan only to the sense of our professional responsibilities. I would hope that you and the other members of the Committee and your counsel would grant us the

understanding that we came before you not as lobbyists for "sinister vested interests", but to share with you our experiences and be of help. I do hope you find the time to read my written statement.

Since I did not have the opportunity to finish my oral statement before you, may I here most briefly give you the few additional points I had wanted to make.

You asked during the hearing whether our group had a proposal for a disclosure system. We do, and it is set forth on page 13, paragraph (h) of my statement. It is part of the overall program which we recommend and which we have included in five points, commencing on page 10 and carrying through to page 15.

Our recommendation for disclosure is quite simple.

> All U.S. corporations, not just those subject to the jurisdiction of the SEC, should make periodic reports to an appropriate government agency of all payments made during the reporting period to government officials in foreign countries. We recommend no exclusions. Thus, facilitating payments as well as possible improper payments would be included.
>
> The report should include details as to the number of officials to whom payments have been made and could well specify the amounts of say, the three largest payments. Otherwise, no other details would be given, such as name of the country or name of the payee.
>
> These same corporations should report at the same time all payments made to foreign agents or other intermediaries. The report should be made separately for each agent or intermediary (without naming him), but naming the country where he is located, and importantly, describing the types of services he is to provide for the reporting corporation.
>
> There should be a criminal penalty for failure properly to report. Establishment of the crime would not require proof of the purpose or intent of the payment, only proof that the payment had been made.

We shall attempt to submit to you as quickly as possible statutory language to cover our proposal.

One point I believe I was able to make was that we oppose criminalization of the act of payment. We do so because we are convinced that it won't work. We do, however, believe that a disclosure system will work and our logic is essentially the following.

The disclosures, voluntary and involuntary, and the publicity, relating to foreign payments generated over the past three years opened the eyes of outside directors and audit committees of U.S. multinational corporations to the extent to which American business was making such payments. The reaction by outside directors was shock. In most instances they acted immediately to direct that their corporations should, under no circumstances, make such payments. They also ordered thorough investigations and where a record of payments was found, personnel were disciplined. Boards of directors, on the recommendation of audit committees or other investigating committees, adopted policies outlawing payments for the future and establishing internal controls to assure that such transactions would no longer be off book transactions and would be clearly identified.

A survey conducted by the accounting firms who are members of our group demonstrates that in all but a few hard-bitten cases these policies, many of which outlaw not only bribes but facilitating payments as well, continue to be strictly enforced. At the hearing I submitted to your counsel copies of the policy statements adopted by 26 large U.S. corporations.

It was the disclosure of payments to those outside directors (and in some cases to top management) and to the public, which prompted this action. In other words, once outside directors knew their corporations were making such payments, there was no question but that they would move to put an end to the practice.

We are convinced, therefore, on this record, that a Federal law requiring regular periodic gathering of this information and publicly reporting it to the government will assure that this already firmly held view of boards of directors (now I believe equally held by inside and outside directors) would be nourished and continued.

In all of this, we are talking about behavior. How do we change behavior of U.S. corporations? The behavior of outside board directors and audit committees has been abundantly demonstrated. A system which will assure the surfacing of the fact that payments are being made and subjecting this information to public scrutiny will certainly support and continue this behavior.

For those reasons, we are convinced that a disclosure system will work. What we all should be looking for is something that will work, not some "law and order declaration" which will act haphazardly, if at all, and will not deter the hardened corporate character.

You well know as a lawyer, that laws which cannot be enforced do not deter. There may be some most brief in terrorem effect until the true experience under the law is demonstrated. Thereafter, it disappears forever.

Again, Mr. Chairman, thank you for your courtesy in permitting me to appear before you and for introducing me to my erstwhile cousin, "Orville Ferguson". He indeed must be a slippery character.

Very sincerely,

Ralph Nader

cc: Franz Opper, Esq.

[Whereupon, at 11:30 a.m. the subcommittee was adjourned.]

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