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TRANSNATIONAL CONDUCT OF AMERICAN MULTINATIONAL CORPORATIONS: QUESTIONABLE PAYMENTS ABROAD

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INTRODUCTION

American corporations engage in a wide spectrum of activities in foreign countries to insure the success of their international business endeavors. One prevalent activity is the payment of money to persons or officials in the foreign countries who are in a position to further the interests of the corporation.¹ These payments may take the form of payments to foreign consultants and agents, campaign contributions to political parties and bribery of government officials. Millions of dollars have been channeled through these payments which often extend over a period of years.²

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¹ Sansweet & Blundell, *On the Give, For U.S. Firms Abroad, Bribery Can Often Be Routine Business Cost*, Wall St. J., May 9, 1975, at 1, col. 1.

² A Library of Congress analysis indicates that 20 large United States corporations have been accused of, or have admitted to making, foreign payments totalling \$306 million for "questionable business practices." Most of the corporations concerned are defense contractors or oil companies. See N.Y. Times, Nov. 18, 1975, at 61, col. 2.

Representative Les Aspin (D-Wis.) released the following list of payments compiled by the Library of Congress report:

	Amount	Purpose
American Home Products Corp.	\$ 750,000	Agents fees
Ashland Oil	1,200,000	Foreign payments & illegal domestic political contributions

Corporate political contributions in the host countries comprise a sizable portion of overseas payments.³ Acknowledging such payments, several corporations maintain that they are customary and in accordance with the laws of the respective host countries.⁴ According to an

Citgo	645,000	Overseas payments
Del Monte	500,000	Consultant fees
Exxon	50,000,000	Overseas payments for legitimate and illegitimate purposes
FMS Corp.	200,000	Agents fees
General Motors	475,000	Canadian & S. Korean political groups
Gulf Oil	5,000,000	Illegal political contributions abroad
ITT	39,000	Bribes
IBM	180,000	Canadian politicians
Lockheed	202,000,000	Consultant fees, political contributions, foreign agents
Merck & Co.	140,000	Assistance in Foreign Sales
McDonnell Douglas	190,600	Agents fees
Mobil Oil	2,100,000	Italian & Canadian political contributions
Northrop	30,000,000	Bribes & consultants fees
Occidental Petroleum	3,000,000	Venezuelan officials
Phillips Petroleum	1,400,000	Slush fund
Raytheon	1,681,000	Agents fees
United Brands	2,000,000	Bribes & contribution to Italian political groups
Vinnell	4,500,000	Agents fees
	<u>\$306,000,600</u>	

Press Release from Congressman Les Aspin, *Aspin: U.S. Companies Pay \$306 Million for "Questionable" Business Practices*, Nov. 17, 1975, at 2.

³ Wall St. J., July 18, 1975, at 12, col. 2.

⁴ IBM announced in Aug., 1975, that its Canadian subsidiary, IBM Canada, Ltd., contributed an average of \$36,000 a year to national and provincial campaigns in the past five years. Wall St. J., Aug. 4, 1975, at 2, col. 4. In a letter to IBM stockholders, Chairman Frank T. Cary said that the Board of the subsidiary believed "political contributions by Canadian companies, and in accordance with Canadian laws, are appropriate." However, such payments have been halted due to the parent company's world-wide policy against political contributions. Letter from Frank T. Cary to the Stockholders of International Business Machines Corp., Aug. 1, 1975, on file at the offices of the *Boston College Industrial and Commercial Law Review*. Exxon authorized its Italian affiliate, Esso Italiana, to pay \$27 million to Italian political parties from 1963-71. Another \$19 million in unauthorized political contributions may have been paid. EXXON CORP., PRELIMINARY PROSPECTUS, EXXON PIPELINE CO. 29-30 (Sept. 30, 1975); N.Y. Times, July 13, 1975, at 1, col. 5. Exxon Corp. also made political contributions in Canada, Australia, and Japan. Wall St. J., Nov. 17, 1975, at 17, col. 2. DuPont Co. has admitted making political contributions in Canada of \$38,000 (Canadian) since 1971. Wall St. J., July 22, 1975, at 5, col. 2. A Mobil Oil executive told a Senate subcommittee that Mobil Oil Italiana contributed an average of \$534,000 per year for four years (1970-73) to three major Italian political parties. *Hearings on Political Contributions to Foreign Governments Before the Subcomm. on Multinational Corps. of the Senate Foreign Relations Comm.*, 94th Cong., 1st Sess., pt. 12, at 316 (1975) [hereinafter cited as *Senate Hearings on Political Contributions*] (Statement of Everett S. Checkett, Exec. V.P., Int'l Div., Mobil Oil Corp.).

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executive vice-president of Mobil Oil Corporation, "in many countries including Italy, corporate contributions to the political process are perfectly legal and considered ethically proper as well."⁵ Even where political contributions are illegal, corporate officials are often unaware of this fact and make the contribution on the basis of their erroneous understanding of the host nation's laws. At least one American corporate official, maintaining his belief that it was legal at the time, has admitted contributing four million dollars to the political parties of a country which in fact prohibited such payments.⁶

Payments are often justified on the grounds that they are essential to "protect democracy"⁷ or to continue doing business in the respective host countries. Indeed, company executives declare that foreign political parties and governmental officials exert intense pressure for contributions and that if the payments are not forthcoming, the corporation may be precluded from doing business in the country.⁸ Such payments have also been defended as consistent with the accepted way of doing business in foreign nations.⁹ Cessation of payments by American firms might mean the loss of substantial amounts of business to their foreign rivals, who acquiesce to demands for, or expectation of, such payments.¹⁰ If the payments are not

⁵ *Senate Hearings on Political Contributions*, *supra* note 4, at 321 (statement of Everett S. Checkett). Canada and Italy apparently are two major countries in which political contributions by foreign corporations are legal. *Wall St. J.*, May 19, 1975, at 1, col. 6.

⁶ Former Gulf Oil Corp. Chairman B.R. Dorsey claims he only recently became aware that payments to the controlling political party in Korea in fact violate a Korean statute. Dorsey asserts he was pressured into making contributions of \$1 million in 1966 and \$3 million in 1970 to the Democratic Republic Party of the Republic of Korea. According to Dorsey, such payments were necessary in order for Gulf to stay in business there. *Senate Hearings on Political Contributions*, *supra* note 4, at 9-10 (Statement of B.R. Dorsey, Chairman, Gulf Oil Corp.). See also *Wall St. J.*, May 2, 1975, at 1, col. 6. General Motors Corp., in correspondence with the Senate Foreign Relations Subcomm. on Multinational Corps., indicated that a partner in its Korean venture also made an unauthorized political contribution of \$250,000 in Korea in 1972 which General Motors has been attempting to recover. Because control of General Motors Korea is equally divided between G.M. representatives and its Korean partner, G.M. efforts to recover the money thus far have been unsuccessful. Carley, *When in Rome . . . Oil Company Gifts to Political Parties Stir Inquiries in Italy*, *N.Y. Times*, Aug. 5, 1975, at 39, col. 6.

⁷ This argument is particularly recurrent with regard to payments in Italy. *Wall St. J.*, May 19, 1975, at 1, col. 6. See *Senate Hearings on Political Contributions*, *supra* note 4, at 318 (statement of Everett S. Checkett); *Wall St. J.*, July 18, 1975, at 3, col. 2.

⁸ *Senate Hearings on Political Contributions*, *supra* note 4, at 8 (statement of B.R. Dorsey).

⁹ According to the *New York Times*, former Commerce Secretary Rogers C.B. Morton believes American companies have little choice but to engage in kickback schemes. Apparently referring to the Middle East, Morton is quoted as saying, "It's perfectly obvious that business is not done on the same ethical level across the world." While not condoning such practices, he noted that "this is the way business has been done since time began." *N.Y. Times*, Oct. 23, 1975, at 59, col. 8. See also Jensen, *Many U.S. Executives Reported in Favor of Overseas Bribes*, *N.Y. Times*, Feb. 13, 1976, at 45, col. 1 (Conference Board study).

¹⁰ Sansweet & Blundell, *On the Give, For U.S. Firms Abroad, Bribery Can Often Be Routine Business Cost*, *Wall St. J.*, May 9, 1975, at 1, col. 1. This argument is weakened

made, the executives argue, the foreign government may raise taxes, revoke licenses, or refuse to grant permission for proposed company actions. Nationalization or expropriation of the company's assets is, of course, the ultimate reprisal.¹¹

A large portion of overseas corporate payments also goes to "consultants" and foreign agents as commissions and fees.¹² The role of these consultants and sales agents, who are often former high ranking American and foreign military officials,¹³ is controversial. Corpo-

somewhat by the fact that not all companies yield to the local government's demand for payoffs. *Id.*

¹¹ See Wall St. J., April 9, 1975, at 1, col. 6.

¹² A Northrop Corporation report, for example, issued by its Executive Committee stated that of \$30 million related to disbursements made or committed overseas, "nearly all" was paid according to agreements with consultants and commission agents. REPORT TO THE BOARD OF DIRECTORS OF NORTHROP CORPORATION ON THE SPECIAL INVESTIGATION OF THE EXECUTIVE COMMITTEE 59 (July 16, 1975) [hereinafter cited as NORTHROP DIRECTORS REPORT]. For an extensive compilation of documents relating to foreign sales and operation of the Northrop Corp., see *Senate Hearings on Political Contributions*, *supra* note 4, at 393-932; See Wall St. J., July 18, 1975, at 19, col. 2. Company documents released by the Senate Foreign Relations Subcommittee on Multinational Corporations indicate Lockheed Aircraft Corp. made payments of at least \$106 million in agents' commissions in Saudi Arabia alone from 1970 to mid-1975. N.Y. Times, Sept. 13, 1975, at 31, col. 8. Documents relating to foreign sales and operations of Lockheed are collected in *Senate Hearings on Political Contributions*, *supra* note 4, at 933-1171. Lockheed disclosed that it has paid or appropriated over \$200 million for foreign consultants and other fees since 1970. Wall St. J., Oct. 8, 1975, at 8, col. 2. Such payments, however, later cost Lockheed a \$1.3 billion sale to Japan. N.Y. Times, Feb. 11, 1976, at 1, col. 6. Lockheed officials have acknowledged that the company knows or suspects that \$22 million flowed to officials or political parties overseas. Wall St. J., Feb. 4, 1976, at 4, col. 2. The Grumman Corp., a large defense contractor, recently admitted that it agreed to pay Iranian lobbyists more than \$20 million in commissions over a five-year period as part of a \$2 billion sale of 80 F-14 Tomcat fighter planes to Iran. N.Y. Times, Dec. 13, 1975, at 37, col. 3. Reactions of the Iranian government to the agents' fees paid by Grumman include seeking a \$28 million rebate from the company and reportedly deciding not to order more Grumman F-14 planes. N.Y. Times, Feb. 15, 1976, § 1, at 34, col. 3; N.Y. Times Feb. 18, 1976, at 45, col. 2. See N.Y. Times, Feb. 11, 1976, at 66, col. 1. McDonnell Douglas Corp. has disclosed foreign payments of \$2.5 million in the form of fees, commissions and consultant payments, apparently to government officials, from 1970 to 1975. The corporation asserts that none of the payments were illegal or made in connection with military aircraft. N.Y. Times, Nov. 29, 1975, at 35, col. 5. See also "Agent's Fees In The Middle East," *Hearings on the Activities of American Multinational Corps. Abroad Before the Subcomm. on Int'l Econ. Policy of the House Comm. on Int'l Relations*, 94th Cong., 1st Sess., at 100-03 (1975); Statement of Lt. Gen. Howard M. Fish, Director, Defense Security Assistance Agency, *Hearings*, *supra*, at 103; Statement of Brig. Gen. James W. Stansberry, Deputy Ass't Sec. of Defense (Procurement, Installations, and Logistics), *id.* at 129; Statement of Thomas P. Stern, Dep. Dir. of the Bureau of Politico-Military Affairs, U.S. Dept. of State. *id.* at 158-159; Statement of Adnan M. Khashoggi, on Triad Marketing for U.S. Defense Material Manufacturers, *id.*, Appendix 15, at 272-73. In Bolivia, for instance, foreign corporations are required by law to carry on their business through local agents or subsidiaries. In N.Y. Times, May 27, 1975, at 39, col. 1. Representative Les Aspin has released Pentagon documents indicating that five foreign agents have received \$18.7 million in fees for \$500 million in military sales in Jordan, Israel, Kuwait, and Saudi Arabia since mid-1973. The largest fee, \$8,886,000, was paid to the Triad Financial Establishment, operated by Saudi businessman Adnan M. Khashoggi, in connection with aircraft sales to Saudi Arabia.

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rate officials assert that the services of foreign agents are necessary because it is financially impractical for a firm to establish offices in every country which might be a potential customer.¹⁴ Officials further allege that consultants in foreign countries perform valuable services by providing technical, legal, financial, and marketing advice in a manner similar to consultants in the United States.¹⁵ In describing the duties of one such consultant—a former French general—the president of Northrop Corporation said the general assumed primary responsibility for “the analysis of all political, economic and military situations in Europe, with changing relationships between principal countries and emphasis on defense-related programs.”¹⁶ The general’s secondary responsibility, according to the president of Northrop, was to alert the corporation to business opportunities in defense-related areas as they arose.¹⁷

Despite these apparently legitimate services performed by some consultants of multinational corporations, consultants may serve as conduits to transmit bribes to influential officials in foreign governments.¹⁸ Foreign consultants are characterized as “influence peddlers” who know “who to talk to and whose pockets to line in a particular country to get the job done.”¹⁹ According to a former cor-

Release by Representative Les Aspin, *Aspin: \$18.7 Million In Agents Fees in Middle East*, Sept. 29, 1975. A report reviewing Northrop’s consultant costs prepared by the Defense Contract Audit Agency, has recommended that the Defense Department reconsider Triad’s status as a sales agent under the Armed Service Procurement Regulation (see notes 156-159 *infra*) for the period 1971-74 due to the possibility Triad may have used “improper influence” in arranging Foreign Military Sales contracts. Report on Special Review of Consultant Costs and Other Matters, Northrop Corporation, to Dept. of the Air Force, Air Force Contract Mgmt. Div. (AFSC) from Defense Contract Audit Agency, Aug. 6, 1975, at 10 [hereinafter cited as Air Force Report]; *id.* Exhibit B, Note 1, at 19-23.

¹⁴ Northrop Corp. has disclosed that it employed several former high ranking American and foreign military officers as consultants. N.Y. Times, June 26, 1975, at 55, col. 5. In the Middle East, prominent businessmen with close ties to foreign governments are often engaged as agents. For an account of one of the more successful Middle East agents, see *Servant of the Sheik*, FORBES, June 15, 1975 at 45.

¹⁵ NORTHROP DIRECTORS REPORT, *supra* note 12, at 47. Wall St. J., June 10, 1975, at 8, col. 2.

¹⁶ *E.g.*, NORTHROP DIRECTORS REPORT, *supra* note 12, at 47; N.Y. Times, June 6, 1975, at 41, col. 5.

¹⁷ N.Y. Times, June 7, 1975, at 1, col. 7.

¹⁸ *Id.* Duties of other Northrop consultants are discussed in N.Y. Times, June 26, 1975, at 55, col. 5. For a review of Northrop consultant services and certain payments determined by the Defense Contract Audit Agency to be “questionable” as allowable costs under Foreign Military Sales contracts, see Air Force Report, *supra* note 12 at 33-62. Services provided by Northrop consultants and the compensation paid therefore are also discussed in NORTHROP DIRECTORS REPORT, *supra* note 12, at 6-46.

¹⁹ See Air Force Report, *supra* note 12, at 10, 21-22; N.Y. Times, Aug. 11, 1976, at 1, col. 6.

²⁰ Former Northrop executive, John R. Hunt, as quoted in a document in the possession of a Senate subcommittee. Wall St. J., June 10, 1975, at 8, col. 2. In some countries, it is allegedly necessary to have a local agent in order to bribe local officials as the officials will only accept payment from someone they have known and trusted for years. Wall St. J., May 9, 1975, at 2, col. 1

porate executive, corporations often pay their consultants on a no-questions-asked basis, preferring not to know how the agents operate.²⁰ Senator Frank Church ably summed up the dispute over the services provided by agents and consultants when he concluded that some agents and consultants clearly provide legitimate technical or political advice to the company while others apparently are guilty of illegal payoffs, but "[i]n between these two extremes is a gray area of questionable legitimacy"²¹

Companies manifest a closed attitude in discussing whether consultants use a portion of their fees for various forms of illegal payoffs. Several companies have acknowledged making payments to foreign governmental officials either directly or through agents.²² As in the case of political contributions, however, these firms often contend that the foreign agents and governmental officials extorted such payments²³ and that the companies had no choice but to make the

²⁰ Illustrative of this practice is the Economic and Development Corporation (EDC), a Swiss-based company organized in 1971 to promote the interest of Northrop by working "behind the scenes through the use of the right people in the right places." Reportedly EDC efforts resulted in commissions of over \$3 million for the sale of Northrop aircraft; however, former Northrop chairman, Thomas E. Jones, was quoted as saying he had never met the people behind EDC. The organizer of EDC, Frank J. DeFrancis, is said to have commented that Northrop did not care to know precisely how EDC operated. Wall St. J., June 9, 1975, at 4, col. 2. For Northrop's description of EDC, see NORTHROP DIRECTORS REPORT, *supra* note 12, at 9-13; *Senate Hearings on Political Contributions*, *supra* note 4, at 409-21. Often the costs of these fees are recouped by product mark-ups. Wall St. J., May 9, 1975, at 1, col. 1.

²¹ N.Y. Times, June 7, 1975, at 1, col. 7.

²² The Northrop Corp. has disclosed that it gave a Middle East businessman \$450,000 for the purpose of bribing two Saudi Arabian generals in 1972 and 1973. NORTHROP DIRECTORS REPORT, *supra* note 12, at 21-25; N.Y. Times, June 10, 1975, at 55, col. 5. United Brands has admitted that it deposited \$1.25 million in a Swiss bank account designated by a Honduran official "in connection with discussions regarding a tax on the export of bananas imposed by that country." Answer, SEC v. United Brands Co., Civil Action No. 75-0509 at 2 (D.D.C., filed July 25, 1975). See also Wall St. J., April 9, 1975, at 1, col. 6; N.Y. Times, May 17, 1975, at 33, col. 1. United Brands has denied charges by the SEC that it made cash payments of approximately \$750,000 to European governmental officials between 1970 and 1975 "in connection with the securing of favorable business opportunities." Answer, SEC v. United Brands Co., *supra* at 1; see Complaint, SEC v. United Brands Co., Civil Action No. 75-0509 at 4 (D.D.C., filed Apr. 9, 1975). However, according to press reports, United Brands has publicly admitted these payments. Maidenberg, *New Rules, Harsh Life in Bananas*, N.Y. Times, May 11, 1975, § 3, at 1, col. 7; Wall St. J., Aug. 19, 1975, at 7, col. 1; N.Y. Times, Aug. 19, 1975, at 45, col. 2. Apparently the company did not reveal the purpose of these payments. Ashland Oil, Inc., in a report filed with the SEC divulged payments of \$150,000 and \$40,000 to two government officials in Gabon, East Africa. I REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL, INC., June 26, 1975, at 123. For details of Ashland's other overseas payments, see *id.* at 116-129. See also N.Y. Times, June 28, 1975, at 35, col. 6. Minnesota Mining & Manufacturing Co. said that one of its smaller foreign subsidiaries paid a \$52,000 bribe in mid-1975 to a customs agent to avoid penalties for evading customs payments. Wall St. J., Nov. 18, 1975, at 6, col. 1.

²³ United Brands claims that pressure was placed on Eli Black, company president, by Honduran officials. N.Y. Times, May 17, 1975, at 33, col. 1. Wall St. J., Apr. 9, 1975, at 1, col. 6. If in fact the companies were coerced into making such payments,

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payments if they wished to continue doing business.²⁴ To a certain extent this contention is buttressed by evidence suggesting that, at least in some instances, what began as bribery may have evolved into extortion as government officials, realizing their power over the firms' interests in their respective countries, have forced the corporations to continue the payments.²⁵

Corporations also expend funds abroad in efforts to overthrow or "destabilize" a host government.²⁶ The desire to gain relief from unfavorable policies of the government in power or the desire to prevent the election of officials who might jeopardize company interests leads firms to undertake such a course of conduct. The most infamous example of this conduct is the activities of International Telephone and Telegraph Company in Chile in 1970. A report of the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee concluded that "the highest officials of the ITT sought to engage the CIA in a plan covertly to manipulate the outcome of the Chilean presidential election. In so doing the company overstepped the line of acceptable corporate behavior."²⁷ More recently, a Costa Rican official accused three American companies of conspiring against Central American banana-producing states to prevent such countries from raising export taxes. The official specifically charged, on the basis of unconfirmed reports, that the companies had established a \$5 million secret fund to promote the destabilization of governments supporting the taxes.²⁸

they would not appear to meet the definition of bribery because the payments were not made voluntarily. Bribery is "the *voluntary* giving or receiving of anything of value in corrupt payment for an official act done or to be done or with the corrupt intent to influence the action of a public official or of any other person professionally concerned with the administration of public affairs. . . ." BAILENTINE'S LAW DICTIONARY 155 (3d ed. 1969) (emphasis added).

²⁴ *Hearings on Lockheed Bribery Before the Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. 27 (1975) (Statement of D.J. Haughton, Chairman of the Board, Lockheed Aircraft Corp.).

²⁵ *Wall St. J.*, May 19, 1975, at 1, col. 6. Italian investigators recently conducted inquiries into the large contributions paid by some American oil companies to Italian political parties. The size of the contributions led to speculation that these payments may have actually been "veiled bribes" aimed at securing specific benefits from the Italian parliament. Apparently some investigators believe that what began as contributions later became bribery, and finally extortion by Italian politicians. *But see* Carley, *Fiasco in Italy Political Slush Fund Hid Other Spending, Cost Exxon Millions*, *Wall St. J.*, Nov. 14, 1975, at 1, col. 6. The failure of corporations to seek the assistance of and support by United States governmental authorities weakens the argument that the payments were extorted.

²⁶ DEPARTMENT OF ECONOMIC AND SOCIAL AFFAIRS, THE IMPACT OF MULTINATIONAL CORPORATIONS ON DEVELOPMENT AND ON INTERNATIONAL RELATIONS, U.N. DOC. E/5500/Rev. 1 ST/ESA/6 at 45-46 (1974).

²⁷ REPORT TO THE SENATE COMMITTEE ON FOREIGN RELATIONS BY THE SUBCOMMITTEE ON MULTINATIONAL CORPORATIONS, THE INTERNATIONAL TELEPHONE AND TELEGRAPH COMPANY AND CHILE, 1970-71, 93d Cong., 2d Sess. 18. *See also* A. SAMPSON, THE SOVEREIGN STATE OF ITT 259-88 (1973).

²⁸ *Wall St. J.*, May 21, 1975, at 4, col. 2.

As important as the purposes for which the corporate funds are expended is the manner in which corporations allocate the money for use in making overseas payments and the way such payments are recorded on the corporate books. Different companies use various methods of allocating and recording foreign political payments to disguise or "launder" the funds earmarked for overseas payments. Thus, firms may create secret "slush funds" from which payments can be made with little or no accountability.²⁹ For example, Gulf accumulated a slush fund by recording the transfer of funds to a dummy Bahamian subsidiary as capital contributions to the subsidiary. These funds were then recorded as deferred charges and expenses on the subsidiary's books.³⁰ According to a Gulf vice-president, the firm

²⁹ *What Ashland Oil Said About Itself*, BUS. WEEK, July 21, 1975, at 17. The mechanics of Ashland Oil's overseas funds transfers are detailed in 1 REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL, INC., June 26, 1975, at 116-20. Lockheed allegedly resisted Indonesian Air Force officials' demands that "commissions" be deposited directly into a Singapore bank account by Lockheed. Lockheed preferred the use of an intermediary dummy corporation or Lockheed subsidiary, fearing that direct payments would not be allowed as deductions by the Internal Revenue Service and that subsequent public disclosure of such payments might damage Lockheed's name and reputation. Carley, *Grease or Grit? Lockheed's Payoffs To Indonesians Were Difficult To Arrange*, Wall St. J., Nov. 17, 1975, at 1, col. 6. For Lockheed documents relating to its sales in Indonesia, see *Senate Hearings on Political Contributions*, *supra* note 4, at 935-1000.

Exxon reportedly established a "Special Budget" to make secret political payments in Italy. According to the *Wall St. Journal*, the company accounted for funds disbursed from the Special Budget by paying fake or dummy invoices from political party newspapers for advertising or surveys (such payments thus becoming tax deductible as "business expense") and by establishing a secret bank account (not recorded on company books) funded from various rebates and kickbacks. Company officials received cash from the bank account, then transmitted it to party newspapers. While \$27 million was authorized for payments under the Special Budget, the President of Esso Italiana apparently utilized 40 secret bank accounts and tapped Exxon's operating budget to make another \$29 to \$32 million in unauthorized payments. Carley, *Fiasco in Italy: Political Slush Fund Hid Other Spending, Cost Exxon Millions*, Wall St. J., Nov. 14, 1975, at 1, col. 6. EXXON CORP. PRELIMINARY PROSPECTUS, EXXON PIPELINE CO. 29-30 (Sept. 30, 1975). Exxon's operations in Italy are discussed in detail in testimony before a Senate subcommittee by Exxon controller Archie Moore, *Senate Hearings on Political Contributions*, *supra* note 4, at 241-67. A report submitted to the SEC by Phillips Petroleum Co. stated that two Swiss corporations were organized by Swiss nationals as a means of accumulating funds. Of \$2,856,000 received by the Swiss corporations, "\$1,350,000 was withdrawn from the accounts of the Swiss corporations in cash, transferred to the company headquarters, and deposited in the cash fund." Form 8, Amendment to Application or Report of Phillips Petroleum Co., at 3-4, *as quoted in* Address by Stanley Sporkin, Director, SEC Enforcement Div., National Ass'n of Accountants, Oct. 15, 1975 at 4-5, on file at the offices of the *Boston College Industrial and Commercial Law Review*.

³⁰ *Senate Hearings on Political contributions*, *supra* note 4, at 12 (statement of B.R. Dorsey). Gulf allegedly diverted \$10.3 million to its slush fund between 1960 and 1973. Approximately half went for foreign payments; the remainder was utilized for illegal domestic political contributions. Wall St. J., Nov. 17, 1975, at 30, col. 1; Wall St. J., Nov. 12, 1975, at 3, col. 2; Wall St. J., Dec. 4, 1975, at 40, col. 2. For a more detailed description of the workings of the Gulf slush fund payments, see N.Y. Times, Nov. 26, 1975, at 1, col. 1; Wall St. J., Nov. 17, 1975, at 30, col. 1; Wall St. J., Dec. 12, 1975, at 5, col. 1.

Castle & Cooke also maintained a separate account from which its overseas pay-

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placed the funds in a Swiss account for later use.³¹ Ashland Oil also created a slush fund by recording non-existent expenses on a foreign subsidiary's books while, in fact, routing the money to an overseas bank.³² Even where corporate funds are not "laundered" by channeling payments through a foreign subsidiary or foreign bank account, but are transferred directly from the corporation to the recipient, the company's books often list the payments as "advertising and research" expenses or other such expenditures.³³

The foreign payments, the irregular manner in which corporations establish slush funds, and more significantly, the practice of falsifying corporate books have created a myriad of legal problems for the companies.³⁴ Among the headaches which the disclosure of such practices has brought are shareholder derivative suits alleging, under state law, the waste and misuse of corporate assets and the breach of fiduciary duties by corporate officers and directors.³⁵ Other share-

ments were paid. The company has said that money paid to expedite shipments and provide security services for company operations in Latin America was from a special account provided for that purpose. Payments were shown on the books as "first cost of fruit." Castle & Cooke acknowledged distributing approximately \$800,000 over the last ten years. The company indicates it considers such payments proper and is continuing them. "They weren't made to obtain preferential business treatment," a company spokesman declared. Wall St. J., Nov. 26, 1975, at 2, col. 2. Wall St. J., Nov. 25, 1975, at 7, col. 1.

³¹ Wall St. J., May 2, 1975, at 1, col. 6.

³² *What Ashland Oil Said About Itself*, BUS. WEEK, July 21, 1975, at 17; Wall St. J., July 15, 1975, at 5, col. 2.

³³ Explanations given for the cover-ups are that nondisclosure of recipients was customary in the host country. Wall St. J., July 15, 1975, at 4, col. 2. Mobil Oil's Executive Vice-President of its International Division, Everett S. Checkett, told a Senate Subcommittee that all contributions to Italian political parties "were made from Mobil's normal business accounts, by company check or bank remittance. These contributions were not paid from any secret fund, and did not involve any out-of-country financial transactions." *Senate Hearings on Politician Contributions*, *supra* note 4, at 316 (statement of Everett S. Checkett). However, questioning by Senators revealed that the payments were shown on Mobil Italiana's books as advertising and research expenses at the request of the political parties. *Id.* at 317. Wall St. J., July 18, 1975, at 12, col. 2. Exxon recorded \$20 million in political contributions in Italy as payments to various newspapers, publicity agencies, and other organizations. EXXON CORP., PRELIMINARY PROSPECTUS, EXXON PIPELINE CO. 29-30 (Sept. 30, 1975). Merck & Co. recorded a political contribution as a promotional expense "in keeping with the custom . . . not to acknowledge corporate political contributions." Merck & Co., Form 8-K Current Report to SEC 2 (Dec. 17, 1975).

³⁴ For example, Community Broadcasting of Boston, Inc. has filed a petition with the FCC alleging that General Tire & Rubber Co. channeled pay-offs to public officials or political parties in Chile, Morocco and Rumania. Wall St. J., Dec. 11, 1975, at 7, col. 1. General Tire owns 36% of Chile's largest tire-making company whose manager supposedly established a secret Liechtenstein bank account from which some payments were made. Wall St. J., July 3, 1975, at 24, col. 2.

³⁵ Among the companies beset by shareholder derivative suits are Exxon Corp., United Brands Co., Gulf Oil Corp., Ashland Oil, Inc., and International Telephone and Telegraph Corp. Derivative suits against Exxon and certain past and present directors allege that Exxon's assets were wasted and impaired by the expenditure of more than \$50 million as improper political contributions in Italy and as bribes for political favors or other unlawful purposes without an accounting or disclosure, and by the falsification

holder suits allege violations of certain provisions of the Securities Exchange Act of 1934 and the rules promulgated thereunder.³⁶ At the administrative level, the Securities and Exchange Commission has assumed primary responsibility for forcing disclosure of the foreign activities of American multinational corporations.

This article will explore solutions to the problem of adequate standards and procedures for the national and transnational regulation of the conduct of American multinational corporations. Initially, the focus will be upon a national solution: regulation by the SEC—under the traditional disclosure doctrine and the emerging standard of integrity disclosure—and by the executive and legislative branches of the federal government. A transnational solution will then be discussed, culminating in the formulation of a transnational code of conduct to regulate corporate activity in foreign nations. It is the

of corporate books to hide the diversion of corporate assets. *EXXON CORP., PRELIMINARY PROSPECTUS, EXXON PIPELINE CO.* 28-29 (Sept. 30, 1975). *Wall St. J.*, Sept. 23, 1975, at 3, col. 2. After an investigation, however, the Exxon corporation found no basis for taking action against its officers regarding the Italian payoffs. *Wall St. J.*, Feb. 2, 1976, at 7, col. 2; *N.Y. Times*, Jan. 31, 1976, at 33, col. 1.

The United Brands suits, also brought against the company and certain past and present executives, involve the alleged payment of bribes to foreign officials from 1970 to 1975, falsification of corporate books, filing of false and fraudulent income tax returns, and the filing of false and fraudulent reports and financial statements concealing such bribes. The plaintiffs contend that the defendant directors and officers breached their fiduciary duties by approving such activities and that United Brands has or may be damaged by litigation instituted as a result of these activities, by punitive action by the government of Honduras and other Central American countries, by fines and penalties that will result from the filing of false income tax returns, and by the loss of goodwill and reputation. *Garfield v. Doriot*, Index No. 13517/1975 at 7-12 (S. Ct. N.Y.). See *Lewis v. Brangwynne*, Index No. 6364/1975 at 4-7 (S. Ct. N.Y.). Shareholder suits against Gulf Oil Corp. are noted in Calame, *Stonewalling It at Gulf Oil*, *Wall St. J.*, Apr. 18, 1975, at 12, col. 4; *Wall St. J.*, Dec. 4, 1975, at 40, col. 2; *Wall St. J.*, Dec. 5, 1975, at 15, col. 3; against Lockheed, in *Wall St. J.*, Feb. 18, 1976, at 4, col. 2; *N.Y. Times*, Feb. 25, 1976, at 49, col. 4; *Wall St. J.*, Feb. 25, 1976, at 30, col. 2.

The action against Ashland Oil asserts that the defendant directors and officers "fraudulently, wrongfully and negligently suffered and caused the moneys, property and effects of ASHLAND to be wasted, squandered and impaired . . ." *Levin v. Atkins*, Civ. Action No. C-75-0095L(B) at 5 (W.D. Ky. 1975). For a copy of the first amended complaint in *Levin*, see II REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL INC., Exhibit 28 (June 26, 1975). A shareholder suit brought against ITT by New Jersey State Senator Anne Martindell alleged that ITT engaged in illegal political activities in Chile in 1970. The parties reached a settlement that cleared the company of the allegation, but required ITT senior executives to certify yearly that they have not interfered in the political process of any country. See *Wall St. J.*, Aug. 20, 1975, at 11, col. 1. For an analysis of the duty of care and the liability for wasting corporate assets, see H. HENN, *HANDBOOK OF THE LAW OF CORPORATIONS* 453-57 (2d ed. 1970).

³⁶ A consolidated action filed against United Brands in the Southern District of New York alleges violations of §§ 10(b), 13(a), and 14(a) of the Securities Exchange Act of 1934, 15 U.S.C. §§ 78j(b), 78m(a), 78n(a) (1970) and Rules 10b-5, 13a-1, 13a-11, 13a-13, and 14a-9, 17 C.F.R. §§ 240.10b-5, 240.13a-1, 240.13a-11, 240.13a-13, 240.14a-9 (1975). *Meer v. United Brands Co.*, 75 Civ. 1738, 1739, 1761 at 2-27 (S.D.N.Y., filed Sept. 1975). See *Levin v. Atkins*, Civ. Action No. C-75-0095L(B) at 2 (W.D. Ky. 1975) (alleging violations of §§ 10(b) and 14(a) of Securities Exchange Act).

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ultimate purpose of this article to demonstrate that a purely national solution is less desirable than transnational regulation, as such a national solution would adversely affect the position of American firms abroad by opening them up to possible reprisals from the host countries and to discrimination in favor of non-American, nonregulated companies. A need, therefore, exists for transnational regulation of multinational firms. Many obstacles, however, including the differing interests of developed and developing nations, presently impede the adoption of such a transnational code of conduct.

I. DISCLOSURE OF FOREIGN ACTIVITIES OF AMERICAN CORPORATIONS UNDER FEDERAL SECURITIES LAWS

The disclosure requirements of the securities laws have been the principle means through which the SEC has attempted to regulate the international activities of American corporations. The concept of disclosure underpins both the Securities Act of 1933³⁷ and the Securities Exchange Act of 1934.³⁸ Congress apparently concluded that disclosure would achieve the dual goal of informing investors and inhibiting illegal and unethical activities by issuers, corporate insiders, brokers-dealers and others engaged in various aspects of the securities industry.³⁹ This reliance on the concept of disclosure resulted in several specific provisions in the statutes. For example, detailed disclosures are required whenever a corporation publicly offers its securities for sale,⁴⁰ periodic reports must be filed with the SEC,⁴¹ and informative proxy materials must be furnished to shareholders.⁴² The Se-

³⁷ 15 U.S.C. §§ 77a *et seq.* (1970).

³⁸ 15 U.S.C. §§ 78a *et seq.* (1970).

³⁹ See *Feit v. Leasco Data Processing Equip. Corp.*, 332 F. Supp. 544, 564 (E.D.N.Y. 1971). Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 HASTINGS L.J. 311,319-20 (1974). The flexibility of disclosure as a regulatory mechanism was perceived as an additional advantage. See Knauss, *A Reappraisal of the Role of Disclosure*, 62 MICH. L. REV. 607 (1964).

⁴⁰ Securities Act of 1933 §§ 5, 7, Schedule A, 15 U.S.C. §§ 77e, g, aa (Schedule A) (1970). See generally H. BLOOMENTHAL, *SECURITIES AND FEDERAL CORPORATE LAW* § 1.03 (1975). Section 12(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78l(a) (1970) requires the registration of securities listed on national securities exchanges. Section 12(g) of the Securities Exchange Act of 1934, 15 U.S.C. § 78l(g) (1970) requires registration of securities traded in the over-the-counter market where an issuer of such a security has assets aggregating at least \$1 million and the security constitutes a class of equity securities held of record by at least 500 persons. See generally H. BLOOMENTHAL, *SECURITIES AND FEDERAL CORPORATE LAW* § 1.03 (1975).

⁴¹ Securities Exchange Act of 1934 §§ 12, 13, 15, 15 U.S.C. §§ 78l, m, o (1970). See Rules 13a-1, 13a-13, 17 C.F.R. §§ 240.13a-1, 240.13a-13 (1975). Reporting companies must file a general registration form, Form 10, 3 CCH FED. SEC. L. REP. ¶127,301(text of form), 27,302(instructions); update the registration statement annually by filing a Form 10-K, *id.* at ¶131,101(text of form), 31,102 (instructions); file a quarterly report, Form 10-Q, *id.* at ¶131,035 (text of form), 31,031 (instructions); and where necessary, file a monthly Form 8-K, *id.* at ¶131,001 (text of form), 31,002 (instructions).

⁴² Securities Exchange Act of 1934 § 14, 15 U.S.C. § 78n (1970). For a discussion of the proxy statements, see 2 L. LOSS, *SECURITIES REGULATION* 876-89 (2d ed. 1961); H. BLOOMENTHAL *SECURITIES AND FEDERAL CORPORATION LAW* § 13.08 (1975). An issuer

curities Exchange Act also contains a broad antifraud provision which resulted in the promulgation of Rule 10b-5 by the SEC.⁴³

Issuers with securities listed on national securities exchanges have additional disclosure obligations. The New York Stock Exchange Rules, for example, state that "a corporation whose stock is listed on the New York Stock Exchange is expected to release quickly to the public any news or information which might reasonably be expected to materially affect the market for securities."⁴⁴

The applicability of Rule 10b-5 to corporate activities in foreign countries does not focus upon trading by insiders but upon the timing of the disclosure of facts. It has been held that, absent insider trading, the timing of the disclosure of material facts is a matter of business judgment⁴⁵ and that "information about which the issues revolve must be 'available and ripe for publication' before there commences a duty to disclose."⁴⁶ Thus, if an issuer withholds disclosure in the honest and reasonable belief that a valid corporate justification exists or that sufficient facts are not available to the corporation to permit release of a non-misleading statement, such postponement may shield a corporation against liability under Rule 10b-5. Consequently, a corporation which has made foreign payments might defend itself in a Rule 10b-5 action by claiming that the information was not "ripe" and that

must also provide its shareholders with an annual report, which accompanies or precedes the receipt of proxy materials if a shareholders' meeting involves the election of directors. See Rule 14a-3(b), 17 C.F.R. § 240.14a-3(b) (1975).

⁴³ Securities Exchange Act of 1934 § 10(b), 15 U.S.C. § 78j(b) (1970). Rule 10b-5 provides:

It shall be unlawful for any person directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,
(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

17 C.F.R. § 240.10b-5 (1975). For an anecdotal recounting of the promulgation of Rule 10b-5 see *Conference on Codification of the Federal Securities Laws*, 22 BUS. LAW 793, 922 (1967); see also 1 A. BROMBERG, *SECURITIES LAW: FRAUD, SEC RULE 10b-5* § 2.2 (1975). For an analysis of the elements of a cause of action for violation of Rule 10b-5, see A. JACOBS, *THE IMPACT OF RULE 10b-5* §§ 36-67 (1974).

⁴⁴ NEW YORK STOCK EXCHANGE COMPANY MANUAL § A(2) at A-18. The New York Stock Exchange mandate contains an exception for an issuer who is able to confine the information to a small group of top management where adequate security can prevent leakage. Once the group of individuals aware of the information begins to grow, the corporation has a duty to disclose. *Id.* at A-19. See also AMERICAN STOCK EXCHANGE COMPANY GUIDE 101-113.

⁴⁵ *Financial Indus. Fund, Inc. v. McDonnell Douglas Corp.*, 474 F.2d 514, 518 (10th Cir.), cert. denied, 414 U.S. 874 (1973).

⁴⁶ 474 F.2d at 518.

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its withholding was an exercise of discretionary business judgment.⁴⁷

Akin to the requirement of disclosure is the concept of materiality, which runs through the disclosure provisions under both the 1933 and 1934 Acts.⁴⁸ The securities laws mandate the disclosure of *material* facts.⁴⁹ In defining "material" facts, judicial interpretations have tended to adopt a "reasonable investor" approach,⁵⁰ eschewing a test focusing solely on the market impact of the disclosure.⁵¹ Application of the definition to specific actions or events has given rise to problems, however.⁵² Whether a particular fact is material depends upon

⁴⁷ See *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 850 n.12 (2d Cir. 1968), *cert. denied*, 394 U.S. 976 (1969). See also A. JACOBS, *THE IMPACT OF RULE 10b-5* § 88.04 at 4-7 n.15 (1974).

⁴⁸ E.g., Securities Act of 1933 §§ 8(b), 10(b), 11(a), 12, 15 U.S.C. §§ 77h(b), 77j(b), 77k(a), 77l (1970); Securities Exchange Act of 1934 §§ 14(e), 18(a), 15 U.S.C. §§ 78n(e), 77r(a) (1970).

⁴⁹ The broad language of Rule 10b-5, which prohibits the nondisclosure of any material fact, governs statements made in connection with the purchase or sale of any security. 17 C.F.R. § 240.10b-5 (1975). Similarly, Reg. C, governing registration of securities under the Securities Act of 1933, provides:

In addition to the information expressly required to be included in a registration statement, there shall be added such further *material* information, if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made, not misleading.

Rule 408, 17 C.F.R. § 230.408 (1975) (emphasis added). See also Rule 14a-9, 17 C.F.R. § 240.14a-9 (1975). See generally SEC, *Guides for Preparation and Filing of Registration Statements*, 1 CCH FED. SEC. L. REP. ¶ 3,760.

⁵⁰ See *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 153-154 (1972) (Rule 10b-5); *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970) (Securities Exchange Act of 1934 § 14(a)); *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969) (Rule 10b-5); *List v. Fashion Park, Inc.*, 340 F.2d 457, 462 (2d Cir.), *cert. denied*, 382 U.S. 811 (1965).

⁵¹ *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir. 1968) (*en banc*), *cert. denied*, 394 U.S. 976 (1969). The SEC's definition of materiality fuses both the impact on investors and on the market price of a stock. *Investors Mgmt. Co.*, SEC Securities and Exchange Act Release No. 9267 (July 29, 1971), [1970-1971 Transfer Binder] CCH FED. SEC. L. REP. ¶ 78,163 at 80,519. For another effort at the reconciliation of the importance to the reasonable investor and the market impact standards, see *SEC v. Great Am. Indus., Inc.*, 407 F.2d 453, 478 n.5 (2d Cir. 1968) (*en banc*) (Moore, J., dissenting), *cert. denied*, 395 U.S. 920 (1969).

⁵² For instance, events which are likely to be deemed material are negotiations concerning acquisitions, mergers, and joint ventures; changes in dividend rates or earnings; new contracts or loss of a significant contract; annual and quarterly earnings; unfavorable news; financial results and forecasts; a change in management or significant control changes, write-offs; change of accounting methods; dispute with suppliers or customers and significant litigation. H. BLOOMENTHAL, *SECURITIES AND FEDERAL CORPORATE LAW* § 9.13 (1975); *NEW YORK STOCK EXCHANGE COMPANY MANUAL* § A(2) at A-22; *AMERICAN STOCK EXCHANGE COMPANY GUIDE* 103-04.

In *SEC v. Lum's, Inc.*, [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,659 at 92,947 (S.D.N.Y. 1972), the court noted that materiality is presumed for the following: dividend increases or decreases, earnings estimates, significant expansion or curtailment of operations, a significant increase or decrease of orders, significant merger or acquisition proposals or agreements, significant new products or discoveries, extraordinary borrowing, major litigation, liquidity problems, extraordinary management developments, purchases or sale of substantial assets.

an assessment of its significance within the context of the relevant facts and circumstances of a situation.⁵³ Thus, under this concept of materiality, corporate political contributions in foreign countries, the payment of bribes or fees to consultants, the use of slush funds and other accounting machinations would not in themselves be material.

In recent years, the SEC has applied the concept of integrity disclosure to establish the materiality of questionable overseas activities by American corporations and to force the disclosure of such activities. The concept of integrity disclosure and the rationale for such a theory developed from the views of SEC Commissioners, in their personal capacities, and the recent decision in *SEC v. Kalvex, Inc.*⁵⁴

Former Chairman Ray Garrett, Jr.,⁵⁵ and Commissioners A.A. Sommer, Jr.,⁵⁶ Philip A. Loomis, Jr.,⁵⁷ and John R. Evans⁵⁸ have stated that activities which reflect on the quality of management or earnings or on the integrity of corporate financial accounting and reporting are material.⁵⁹ The Commissioners reasoned that the SEC has

⁵³ *Radiation Dynamics, Inc. v. Goldmuntz*, 464 F.2d 876, 888 (2d Cir. 1972). For an exhaustive compilation of facts which plaintiffs have claimed as material, see A. JACOBS, *THE IMPACT OF RULE 10b-5* § 61.04(b) (1974).

⁵⁴ [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226 at 98,184 (S.D.N.Y. July 7, 1975).

⁵⁵ Address by Ray Garrett, Jr., former SEC Chairman, *Homily on the Glories of Right Conduct and the Wages of Sin*, American Soc'y of Corporate Secretaries, Inc., June 27, 1975 [hereinafter cited as Garrett *Homily* Speech], reprinted in *Hearings on the Activities of American Multinational Corporations Abroad Before the Subcomm. on Int'l Econ. Policy of the House Comm. on Int'l Relations*, 94th Cong., 1st Sess. 58-63 (1975) [hereinafter cited as *House Hearings on Activities of Multinational Corps.*]; Address by Ray Garrett, Jr., *Disclosures and Corporate Management*, The Wharton Graduate Business School Club of New York, Inc. and Harvard Business School Club of New York, Apr. 14, 1975 [hereinafter cited as Garrett *Corporate Management* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*; Address by Ray Garrett, Jr., *The Uses of Disclosure*, National Investor Relations Institute, Sept. 30, 1975 [hereinafter cited as Garrett *Uses of Disclosure* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*; Address by Ray Garrett, Jr., *Is The SEC Anti-Business?*, Public Relations Soc'y of America (Wis. Chapter) and Milwaukee Bar Ass'n, Sept. 12, 1975 [hereinafter cited as Garrett *SEC* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*; Address by Ray Garrett, Jr., *Confidence In Business*, 1975 Midwest Public Relations Conf., Sept. 12, 1975 [hereinafter cited as Garrett *Confidence* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

⁵⁶ Address by A.A. Sommer, Jr., SEC Commissioner, *Crisis and the Corporate Community*, Midwest Securities Commissioners Ass'n Conf. July 21, 1975 [hereinafter cited as Sommer *Crisis* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*; Address by A.A. Sommer, Jr., *The Limits of Disclosure*, Wharton School, Univ. of Pa., June 24, 1975 [hereinafter cited as Sommer *Disclosure* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

⁵⁷ *House Hearings on Activities of Multinational Corps.*, *supra* note 55, at 35-39, 57-67, 180-90 (Philip A. Loomis, SEC Commissioner).

⁵⁸ Address by John R. Evans, SEC Commissioner, *Truth or Consequences*, Securities Corporative Enforcement Conf., May 15, 1975 [hereinafter cited as Evans *Truth* Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

⁵⁹ *Id.* at 6-8; Garrett *Homily* Speech, *supra* note 55, at 21-24; Sommer *Disclosure* Speech, *supra* note 56, at 3-8; *House Hearings on Activities of Multinational Corps.*, *supra*

the duty to enforce the federal securities laws which are designed to protect and inform the investor. In order to fulfill this duty, the SEC must examine those foreign corporate activities that might reasonably affect the decision of an investor to buy, sell, or hold a security, or affect the decision of a shareholder in deciding how to cast his corporate vote.⁶⁰ The Commissioners have determined that fictitious entries in corporate books which conceal the true nature of the expenditures and the utilization of slush funds are material facts.⁶¹ The materiality, in the eyes of the Commissioners, turns not on the size of the payments in relation to the total expenses, sales, or earnings of the corporation, but rather on the fact that the falsification of the corporate accounts raises questions regarding the company's financial integrity.⁶² Since a prospective investor, as well as a present stockholder, looks to the financial records of a corporation for guidance in deciding what action to take in respect to that company's stock, any impropriety affecting the financial records, regardless of the size of the amount involved, is material and must be disclosed.⁶³

Linked to the financial integrity of the corporation in maintaining its corporate books is the integrity of the corporation's management. The Commissioners concluded that disclosure that corporate executives approved foreign payments and that corporate records were falsified—even if the payments were proper under foreign laws—would lead a reasonable investor to question the integrity of the officials and their ability to properly discharge their corporate duties.⁶⁴

note 55, at 36-37 (Statement of Philip A. Loomis). Their remarks have often been prefaced with declarations that the SEC is not designed to act as a corporate policeman and that it is not the goal of the SEC to punish the multinational corporations even if their foreign payments are considered illegal or immoral. *See, e.g., Sommer Crisis Speech, supra* note 56, at 8; Garrett *Homily Speech, supra* note 55, at 19; *House Hearings on Activities of Multinational Corps., supra* note 55, at 36 (Statement of Philip A. Loomis, SEC Commissioner); Wall St. J., Dec. 15, 1975, at 2, col. 3. Sommer, in *The Slippery Slope of Materiality*, N.Y.L.J., Dec. 16, 1975, at 1, col. 2, and former Chairman Garrett have warned against using disclosure standards to enforce social policy. *Garrett Laments SEC's Probable Radical Change in Traditional Materiality Disclosure Standards*, BNA SEC. REG. L. REP. No. 321 at A-20 (Oct. 1, 1975).

⁶⁰ Sommer *Crisis Speech, supra* note 56, at 8; Garrett *SEC Speech, supra* note 55, at 2. *See also* Address by Stanley Sporkin, Director, SEC Enforcement Division, National Ass'n of Accountants, Oct. 15, 1975, at 2 [hereinafter cited as Sporkin Speech], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

⁶¹ Sommer *Disclosure Speech, supra* note 56, at 8; Sporkin Speech, *supra* note 60, at 2.

⁶² Sommer *Disclosure Speech supra* note 56, at 3-4; Evans *Truth Speech, supra* note 58, at 7.

⁶³ Garrett *Homily Speech, supra* note 55, at 60; Sommer *Disclosure Speech, supra* note 56, at 7-9; Evans *Truth Speech, supra* note 58, at 7-8; *House Hearings on Activities of Multinational Corps., supra* note 55, at 36 (Statement of Philip A. Loomis, SEC Commissioner); Sporkin Speech, *supra* note 60, at 6; Garrett *Corporate Management Speech, supra* note 55, at 14-15; Garrett *Uses of Disclosure Speech, supra* note 55, at 9-10; Garrett *Confidence Speech, supra* note 55, at 15; Garrett *SEC Speech, supra* note 55, at 2.

⁶⁴ Sporkin Speech, *supra* note 60, at 2; Garrett *SEC Speech, supra* note 55, at 2; Garrett *Confidence Speech, supra* note 55, at 18-19; Evans *Truth Speech, supra* note 58, at 7.

Since the investor's decisions regarding the stock and the election of corporate officers might be affected, such facts are also material and warrant disclosure.⁶⁵

A final aspect of the foreign payments which the Commissioners have emphasized as requiring disclosure is the potential impact such payments may have on the "quality of earnings" of the company.⁶⁶ Such payments expose the company to economic risks, both in the host country and in the United States. Modest initial payments may lead to spiraling demands. If such future demands are not met or if the payments are uncovered, the corporation may face reprisals including loss of licenses or other government privileges, or even expropriation of the company's interests.⁶⁷ Nondisclosure of such foreign payments also creates opportunities for corporate or individual blackmail in the United States.⁶⁸ These risks might lead to substantial losses or expenditures by the corporation. Consequently, a corporation must disclose such payments so that an investor may fully weigh the risks and benefits in making his investment decision.⁶⁹

Despite the strict approach inherent in the concept of integrity disclosure, the Commissioners apparently left open one loophole. If payments are properly recorded on the corporate books, are paid out of normal corporate funds and are not of the type which jeopardize the corporate earnings, such payments may not be material unless

⁶⁵ Garrett *Homily* Speech, *supra* note 55, at 60; *House Hearings on the Activities of Multinational Corps.*, *supra* note 55, at 36 (Statement of Philip A. Loomis); Sporkin Speech, *supra* note 60, at 2; Garrett *Corporate Management* Speech, *supra* note 55, at 15; Garrett *SEC* Speech, *supra* note 55, at 2. The failure to disclose extensive use of corporate funds for personal purposes and other questionable conduct was held material in *Franchard Corp.*, SEC Securities Act Release No. 4710 (July 31, 1964), [1964-1966 Transfer Binder] CCH FED. SEC. L. REP. ¶ 77,113, at 82,038 (stop order proceeding to suspend effectiveness of registration statements under the Securities Act of 1933 §§ 8(c), (d), 15 U.S.C. §§ 77h(c), (d) (1970)).

Present SEC requirements embody a limited degree of competence and integrity disclosure going to the quality of management. See Form S-1, Item 16(d) ("What is required is information relating to the level of his professional competence . . ."), Item 16(e) (disclosure of certain events which occurred during the past 10 years and "which are material to an evaluation of the ability and integrity of any director or executive officer of the registrant . . ."), 2 CCH FED. SEC. L. REP. ¶ 8,195. See also Form 10-K, Item 2(c), 3 CCH FED. SEC. L. REP. ¶ 31,104 at 22,061 and Schedule 13D, Item 2, 2 CCH FED. SEC. L. REP. ¶ 23,685 at 17, 241.

⁶⁶ Garrett *Homily* Speech, *supra* note 55, at 60; Garrett *Confidence* Speech, *supra* note 55, at 14-15; Garrett *Uses of Disclosure* Speech, *supra* note 55, at 10.

⁶⁷ Garrett *Confidence* Speech, *supra* note 55, at 15; Sommer *Disclosure* Speech, *supra* note 56, at 10.

⁶⁸ Evans *Truth* Speech, *supra* note 58, at 8.

⁶⁹ Garrett *Homily* Speech, *supra* note 55, at 60-61; Sommer *Disclosure* Speech, *supra* note 56, at 10-11; Evans *Truth* Speech, *supra* note 58, at 7-8; Garrett *Corporate Management* Speech, *supra* note 55, at 14-15; Garrett *SEC* Speech, *supra* note 55, at 2. In a newspaper interview, Roderick M. Hills, SEC Chairman, indicated that he believes the significant factor in determining materiality, and hence the necessity of disclosure, is the amount of business potentially affected by a payoff rather than the size of the bribe itself. N.Y. Times, Nov. 3, 1975, at 57, col. 8. The quality of earnings test apparently satisfies both the "reasonable investor" and the "market impact" test of materiality.

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they are of substantial size in proportion to the total earnings of the company.⁷⁰

Whether the courts will accept the concept of integrity disclosure proposed by the Commissioners remains uncertain.⁷¹ In *SEC v. Kalvex, Inc.*,⁷² the federal district court adopted the concept of integrity disclosure, albeit in a somewhat different factual situation than that of a transnational bribe. In this action, the SEC charged the defendants Kalvex, Emanuel L. Wolfe (Chairman of the Board of Kalvex), and Robert L. Ingis (a director and Executive Vice-President of Kalvex) with violating sections 13(a) and 14(a) of the Securities Exchange Act of 1934.⁷³ The SEC alleged that the annual and periodic reports and the proxy materials of Kalvex failed to disclose the participation of Ingis and Wolfe in a scheme in which a dummy corporation was used to transmit kickbacks of approximately \$8,500 from a company supplier to the defendant Wolfe.⁷⁴ The SEC further as-

⁷⁰ Successful utilization of the loophole is unlikely. A study of corporate involvement in illegal, improper, or questionable payments conducted by the Investor Responsibility Research Center (IRRC) in Washington D.C. has indicated that most companies failing to disclose foreign payments also appear to have falsified corporate books and records. The Wall Street Journal quotes the IRRC as saying, "Every one of the companies that has admitted illegal contributions or bribes to foreign officials also has conceded that those transactions weren't recorded accurately on corporate books, or to shareholders." Elia, *Large Investors Are Increasingly Concerned About Corporate 'Watergates,' Study says*, Wall St. J., Nov. 20, 1975, at 47, col. 3.

⁷¹ Compare *Rafal v. Geneen*, [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,505, at 92,441 (E.D. Pa. 1972) (failure to disclose in proxy materials that certain directors were defendants in actions alleging transactions which violated § 16(b) of the Securities Exchange Act of 1934 held material), *Robinson v. Penn Cent. Co.*, 336 F. Supp. 655, 658 (E.D. Pa. 1971) (failure to disclose in proxy materials that former directors who had proposed a refinancing plan were currently defendants in numerous actions alleging fraud against the company and breach of fiduciary obligations, and failure to reveal the connection between two of the candidates for re-election and several of those former directors held material), *Beatty v. Bright*, 318 F. Supp. 169, 173 (S.D. Iowa 1970) (failure to disclose in proxy materials that directors were defendants in numerous actions alleging self-dealing against the corporation held material), and *Cooke v. Teleprompter Corp.*, 334 F. Supp. 467, 472 (S.D.N.Y. 1971) (failure to disclose a bribery conviction of a director standing for re-election held material, *with* *Seibert v. Abbott*, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,939, at 93,742 (pending litigation not involving self-dealing or fraud against the company or violations of law bearing on the integrity of the candidates for election held immaterial, *save for* one claim alleging insider trading) and *Ash v. Baker*, 392 F. Supp. 368, 372 (E.D. Pa. 1975) (pending litigation before United States Supreme Court alleging that corporate officers and directors used corporate funds for political advertising and otherwise expended corporate funds in violation of the Federal Corrupt Practices Act, 18 U.S.C. § 610, held immaterial). See also requirements of Form S-1, Item 12, 2 CCH FED. SEC. L. REP. ¶ 8,175; Form 10-K, Item 5, 3 CCH FED. SEC. L. REP. ¶ 31,103 at 22,057-58.

⁷² [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226, at 98,184 (S.D.N.Y. July 7, 1975).

⁷³ 15 U.S.C. §§ 78m(a), 78n(a) (1970). [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226 at 98,184.

⁷⁴ [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226 at 98,186. See *SEC v. TDA Ind.*, 75 Civil 4519 (S.D.N.Y., Sept. 16, 1975), where the SEC moved for the appointment of a receiver for two corporations and the removal of their top executives, alleg-

serted that the corporation failed to disclose that corporate funds were used to reimburse Ingis during 1971-1973 for \$1,000 per year in personal expenses unrelated to corporate purposes.⁷⁵

Noting that the purpose of the reports required by the Securities Exchange Act is to insure that investors periodically receive adequate information regarding the operation and financial condition of corporations, the court held the annual and periodic reports filed by Kalvex to be materially false and misleading in that they "failed to accurately present the accounts of Kalvex and falsely stated the income and expenses of Kalvex."⁷⁶ The court based its finding on the failure of the reports to disclose (1) that Ingis received improper reimbursements by causing false entries to be made in corporate books and (2) that the dummy corporation under Ingis' control had received the \$8,500 in kickbacks from the Kalvex supplier.⁷⁷

The court also accepted the SEC's contention that the proxy statements issued by Kalvex were materially false and misleading even though the elections of directors for which the proxy statements in question were distributed were not contested.⁷⁸ The court stated that "these elections were no less important to the stockholders of Kalvex than they would have been were a proxy contest on the horizon, particularly where the undisclosed facts might have led a reasonable stockholder to question the integrity of Ingis and his ability to discharge his fiduciary obligations."⁷⁹ The materiality test, the court continued, turned on whether the vote of any of the stockholders of the corporate defendant would have been influenced by the full disclosure of an individual defendant's activities, because shareholders would not be expected to elect as a director an individual who had used the corporation for personal gain.⁸⁰

ing that they had participated in a kickback scheme involving finder's fees and in the fraudulent sale and purchase of stock. N.Y. L.J., Sept. 17, 1975, at 1, col. 3.

⁷⁵ [Current Binder] CCH FED. SEC. L. REP. ¶95,226, at 98,185.

⁷⁶ *Id.* at 98,188.

⁷⁷ *Id.*

⁷⁸ *Id.* at 98,187.

⁷⁹ *Id.* (emphasis added).

⁸⁰ *Id.* The court relied on *J.I. Case v. Borak*, 377 U.S. 426 (1964), *Mills v. Elec. Auto-Lite Co.*, 396 U.S. 375 (1970), and *General Time Corp. v. Talley Indus., Inc.*, 403 F.2d 159 (2d Cir. 1968). After establishing the materiality of the undisclosed facts under §§ 13(a) and 14(a), the Court found Ingis guilty of violating, and of aiding and abetting the violation of, these provisions of the Exchange Act. It thus granted the SEC motion for summary judgment and denied Ingis' cross-motion for summary judgment. [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226, at 98,189. Co-defendants Wolf and Kalvex consented to the entry of judgment against them without admitting or denying the SEC allegations. *Id.* at 98,185. Therefore, Ingis became the only active party. Since § 13(a) of the Exchange Act applies only to the issuer (Kalvex), Ingis could only be held as an aider and abettor of Kalvex' violation of § 13(a). Memorandum of Law in Support of the Commission's Motion for Summary Judgment Against the Defendant Robert L. Ingis, at 15 n.7, SEC v. Kalvex, Inc., [Current Binder] CCH FED. SEC. L. REP. ¶95,226, at 98,184 (S.D.N.Y. July 7, 1975). Following the *Kalvex* decision, the SEC barred Ingis from appearing or practicing before it as an accountant unless employed or supervised by another accountant. Wall St. J., Dec. 15, 1973, at 8, col. 2.

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Of particular concern in the development of the concept of integrity disclosure is the court's denial of defendant Ingis' cross-motion for summary judgment. Ingis asserted that a genuine issue of fact did exist as to the materiality of the \$8,500 involved in the kickback arrangement and the \$1,000 per year expense money.⁸¹ He argued that the size of the amounts involved, in comparison to aggregate corporate expenses and per share earnings for the periods in question, rendered the payments immaterial.⁸² The SEC maintained that the relative size of the amounts did not constitute the controlling factor in determining materiality, as it was the "failure to disclose the receipt of improper reimbursements by a director and officer of a public company which caused the statement of expenses in the company's reports to be false and misleading in light of the circumstances in which they were made."⁸³ The court agreed with the SEC.

While *Kalvex* is not completely analogous to the factual situations arising in the case of nondisclosure of foreign activities by American multinational corporations, similarities do exist which suggest possible judicial acceptance of the integrity disclosure concepts in the transnational payments context. The *Kalvex* decision suggests that the falsification of corporate books to conceal the true purpose of the overseas payments will be held material under the integrity disclosure concept regardless of the size of a payment. Thus, reporting corporations and officials who falsify corporate records in order to make overseas payments would violate sections 13(a) and 14(a) of the Exchange Act, and Rule 14a-9.⁸⁴ The failure to disclose the participation or even tacit approval of corporate officials in accumulating funds outside the normal accounting channels might also be material under the integrity disclosure concept, thus creating liability under sections 13(a) and

⁸¹ Memorandum of Law In Opposition To Plaintiff's Motion For Summary Judgment and In Support of Defendant's Cross-Motion For Summary Judgment at 6, SEC v. *Kalvex, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226, at 98,184 (S.D.N.Y. July 7, 1975) [hereinafter cited as Ingis Memo For Summary Judgment].

⁸² Affidavit In Opposition To Plaintiff's Motion For Summary Judgment and In Support of Defendant's Cross-Motion For Summary Judgment, Feb. 10, 1975, at 6-10, SEC v. *Kalvex, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226, at 98,184 (S.D.N.Y. July 7, 1975) [hereinafter cited as Affidavit in Opposition].

⁸³ Reply Brief For Plaintiff at 13-14, SEC v. *Kalvex, Inc.*, [Current Binder] CCH FED. SEC. L. REP. ¶ 95,266, at 98,184 (S.D.N.Y. July 7, 1975) [hereinafter cited as Reply Brief For Plaintiff]. The SEC declared "the fact that Ingis' improper expense reimbursements were 'small' is irrelevant. Ingis was a director and officer of *Kalvex* and was placed in a position of trust; that he abused this trust and failed to disclose this breach of trust is not disputed." *Id.* at 10. Relying on *Sonesta Int'l Hotel Corp. v. Wellington Assoc.*, 483 F.2d 247, 252 (2d Cir. 1973) and *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375, 384 (1970), the SEC advocated as the test for determining materiality whether a shareholder "might have been" influenced by the information. Reply Brief For Plaintiff, *supra*, at 15-16. See also *Rafal v. Geneen*, [1972-1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,505, at 93,441 (E.D. Pa. 1972); *Robinson v. Penn Cent. Co.*, 336 F. Supp. 655, 657 (E.D. Pa. 1971); *Beatty v. Bright*, 318 F. Supp. 169, 173 (S.D. Iowa 1970).

⁸⁴ See *Kalvex*, [Current Binder] CCH FED. SEC. L. REP. ¶ 95,226, at 98,188. Such conduct probably would also be defined as material for Rule 10b-5 purposes.

14(a) of the Securities Exchange Act and under Rule 10b-5.⁸⁵

The factual situation in *Kalvex* may, however, be distinguishable in one respect from the foreign activities of multinational corporations. The court in *Kalvex* emphasized the fact that the individual defendant had used the corporation for *personal* gain,⁸⁶ whereas multinational corporations and their officers and directors may claim that the foreign payments promoted the interest of the *corporation*. Based on developments in the *Kalvex* case, however, it appears that the SEC would reject this defense. In *Kalvex*, the defendant argued that he was not liable for securities violations since he did not personally benefit from the kickback scheme.⁸⁷ In reply to this argument, the SEC relied on the Second Circuit's statements in *SEC v. North American Research and Development Corp.*⁸⁸ that the defendant's failure to benefit personally from an illegal scheme does not preclude an SEC action for injunctive relief since "the absence of economic motivation is no defense to an action by the SEC to enjoin conduct the continuation of which would lead to improvident decisions by the investing and speculating public on the basis of misleading or incomplete information."⁸⁹ It appears that the court adopted the reasoning of the SEC.⁹⁰ Where self-dealing is not involved, however, other courts have imposed a more lenient standard regarding disclosure.⁹¹

Armed with the disclosure provisions of the securities laws, supplemented by the concept of integrity disclosure, the SEC has recently investigated the overseas activities of several American corporations. These investigations have culminated in the SEC's filing complaints against Gulf Oil Corporation, Phillips Petroleum Co., Northrop Corporation, Ashland Oil, Inc., and United Brands Co.⁹² The SEC complaints alleged that these companies violated sections 13(a) and 14(a) of the Securities Exchange Act of 1934⁹³ and Rules 12b-20, 13a-1, and 14a-9 promulgated thereunder⁹⁴ by filing false and misleading reports and proxy statements which failed to state material facts.⁹⁵

⁸⁵ See *id.* at 98,187.

⁸⁶ *Id.*

⁸⁷ Affidavit in Opposition, *supra* note 82, at 3.

⁸⁸ 424 F.2d 63 (2d Cir. 1970).

⁸⁹ 424 F.2d at 82. Reply Brief For Plaintiff, *supra* note 83, at 9.

⁹⁰ [Current Binder] FED. SEC. L. REP. at 91,188.

⁹¹ *E.g.*, Siebert v. Abbott, [1973 Transfer Binder] CCH FED. SEC. L. REP. ¶ 93,939 at 93,742 (E.D. Pa. 1973).

⁹² SEC v. Gulf Oil Corp., Civ. Action No. 75-0324 (D.D.C., filed Mar. 11, 1975); SEC v. Phillips Petroleum Co., Civ. Action No. 75-0308 (D.D.C., filed Mar. 6, 1975); SEC v. Ashland Oil, Inc., Civ. Action No. 75-0794 (D.D.C., filed May 16, 1975); SEC v. United Brands Co., Civ. Action No. 75-0509 (D.D.C., filed Apr. 9, 1975); SEC v. Northrop Corp., Civ. Action No. 75-0563 (D.D.C., filed Apr. 16, 1975).

⁹³ 15 U.S.C. §§ 78m(a), 78n(a) (1970).

⁹⁴ 17 C.F.R. §§ 240.12b-20, 240.13a-1, 240.14a-9 (1975).

⁹⁵ The complaint filed against United Brands omitted allegations of violations under § 14(a), but alleged violations of § 10(b), 15 U.S.C. § 78j(b) (1970) and Rules 10b-5, 13a-11, 13a-13, 17 C.F.R. §§ 240.10b-5, 240.13a-11, 13a-13 (1975). The complaint charged that, in a letter to shareholders and reports to the SEC, the company re-

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The SEC asserted that the corporations had failed to disclose the following material actions: (1) the maintenance and utilization of secret funds of corporate monies for unlawful political contributions and other purposes,⁹⁶ (2) the charging as expenses and costs on corporate books or those of subsidiaries of substantial sums of monies, ostensibly for business purposes, but in fact for the systematic diversion of funds for unlawful uses,⁹⁷ (3) the making of agreements with various consultants, agents, or other legal representatives, under which substantial sums were or would be disbursed to them without adequate accounting or auditing procedures to ensure that such payments were actually made for business purposes or that the services provided were commensurate with the amounts paid,⁹⁸ (4) the filing with the Commission of financial statements which did not accurately represent the accounts of the corporations with regard to the income, expenses, and assets of the corporations,⁹⁹ and (5) the failure to identify and state the extent of involvement of any director, officer, or employee in the

ferred to an agreement with the government of Honduras, but failed to divulge all material terms of the agreement, including that the company had agreed to pay \$2.5 million to government officials. United Brands Complaint, *supra* note 92, at 2-5.

⁹⁶ Ashland Complaint, *supra* note 92, at 3; Phillips Complaint, *supra* note 92, at 3; Northrop Complaint, *supra* note 92, at 3; United Brands Complaint, *supra* note 92, at 3; Gulf Complaint, *supra* note 92, at 3. Specifically, the SEC charged that United Brands had paid \$750,000 to European governmental officials since 1970. United Brands Complaint, *supra* note 92, at 4.

⁹⁷ Ashland Complaint, *supra* note 92, at 3-4; Phillips Complaint, *supra* note 92, at 3; Northrop Complaint, *supra* note 92, at 3; United Brands Complaint, *supra* note 92, at 3; Gulf Complaint, *supra* note 92, at 3. The complaints against Ashland, Phillips, Northrop and Gulf also charged that the failure to disclose such activities, payments, and false bookkeeping violated the Securities Exchange Act, §§ 13(a), 14(a). Ashland Complaint, *supra* note 92, at 5-6; Phillips Complaint, *supra* note 92, at 4-5; Northrop Complaint, *supra* note 92, at 4-5; Gulf Complaint, *supra* note 92, at 4. Specifically, the Ashland Complaint alleged the diversion of \$779,997 to a secret fund since 1967. Ashland Complaint, *supra* note 92, at 4. The SEC accused Phillips of disbursing more than \$2.8 million since 1963 to two Swiss corporations by means of false entries in corporate books and records. Phillips Complaint, *supra* note 92, at 3. Gulf was charged with disbursing over \$10 million since 1960 to a Bahamian subsidiary and others by means of false entries in records; then returning \$5.4 million to the U.S. in cash and distributing the balance in cash overseas. Gulf Complaint, *supra* note 92, at 3.

⁹⁸ Ashland Complaint, *supra* note 92, at 4; Northrop Complaint, *supra* note 92, at 3-4. Specifically, Ashland was charged with the transfer or disbursement of over \$4 million in cash overseas pursuant to contractual or other agreements with various consultants, legal representatives, and others. Ashland Complaint, *supra* note 92, at 4. The Northrop complaint charged that corporation with disbursing in excess of \$1,100,000 to one foreign consultant since 1961, and with disbursing or agreeing to disburse \$30 million to various consultants, agents, or others during 1971-73. Northrop Complaint, *supra* note 92, at 3-4.

⁹⁹ Ashland Complaint, *supra* note 92, at 5; Phillips Complaint, *supra* note 92, at 4. Northrop Complaint omits the allegation of filing false financial statements, but charges the filing of annual reports which did not accurately present the accounts and falsely stated the income and expenses of Northrop. Northrop Complaint, *supra* note 92, at 4. While the United Brands Complaint alleges the filing of false and misleading annual and periodic reports, it does not specifically allege that these reports falsely stated the income, expenses, and assets of the corporations. United Brands Complaint, *supra* note 92, at 4-5.

use of corporate funds for unlawful purposes.¹⁰⁰ No opinions were rendered in the actions against Gulf, Northrop, Ashland, Phillips and United Brands. These corporations and the officials involved consented to the entry of final judgments and permanent injunctions against future violations.¹⁰¹

By consenting to an entry of final judgment and permanent injunction, the corporations avoided further litigation without admitting or denying guilt.¹⁰² The permanent injunction obtained against each corporation prohibited future violations of sections 13(a) and 14(a) of the Securities Exchange Act and Rule 14a-9, including specifically the use of funds for unlawful political contributions or similar unlawful purposes and the failure to disclose (1) the nature and extent of any expenditure of corporate funds for unlawful political contributions or other unlawful purpose, (2) the nature and extent of false or fictitious accounting entries, or (3) the establishment or maintenance of funds or assets which have not been fully and properly recorded.¹⁰³ In addition, the SEC secured ancillary relief in the form of an "undertaking" incorporated into the final judgment to supplement the injunction.¹⁰⁴ This ancillary relief included the appointment of a special master to inquire into and examine the books and records of the corporation, to render a proper accounting, and to submit a report to the court and the corporation's shareholders regarding the matters set forth in the complaint.¹⁰⁵ The undertaking in the Ashland proceeding, for in-

¹⁰⁰ Gulf Complaint, *supra* note 92, at 3-4; Ashland Complaint, *supra* note 92, at 5-6; Phillips Complaint, *supra* note 92, at 4-5; Northrop Complaint, *supra* note 92, at 5.

¹⁰¹ Final Judgment and Order of Permanent Injunction Against Ashland Oil, Inc., Civ. Action No. 75-0794 (D.D.C., filed May 16, 1975); Final Judgment of Permanent Injunction Against Gulf Oil Corp., Civ. Action No. 75-0324 (D.D.C., filed March 11, 1975); Final Judgment of Permanent Injunction Against Northrop Corp., Civ. Action No. 75-0563 (D.D.C., filed Apr. 16, 1975); Final Judgment of Permanent Injunction Against Phillips Petroleum Co., Civ. Action No. 75-0308 (D.D.C., filed Mar. 6, 1975). The SEC suit against United Brands was recently settled. SEC v. United Brands Co., [Current Binder] CCH FED. SEC. L. REP. ¶ 95,420, at 99,139 (D.D.C. 1976).

While Gulf consented to the entry of final judgment, Claude C. Wild, Jr., Gulf's former vice president in Washington is fighting the SEC charges. Wall St. J., Dec. 12, 1975, at 5, col. 1; N.Y. Times, Nov. 15, 1975, at 35, col. 7; Wall St. J., Nov. 12, 1975, at 3, col. 2.

¹⁰² Ashland Final Judgment, *supra* note 101, at 1; Gulf Final Judgment, *supra* note 101, at 1; Phillips Final Judgment, *supra* note 101, at 1; Northrop Final Judgment, *supra* note 101, at 1. See 3 L. LOSS, SECURITIES REGULATION 1982-83 (2d ed. 1961).

¹⁰³ Ashland Final Judgment, *supra* note 101, at 1-5; Gulf Final Judgment, *supra* note 101, at 1-4; Phillips Final Judgment, *supra* note 101, at 1-4; Northrop Final Judgment, *supra* note 101, at 1-5. The final judgment against United Brands bars the company from future anti-fraud violations in connection with foreign payments. The corporation must also make full disclosure of any future "unlawful" payments, as specified, of corporate funds. SEC v. United Brands Co. [Current Binder] CCH FED. SEC. L. REP. ¶ 95,420, at 99,139-40 (D.D.C. 1976).

¹⁰⁴ Ashland Final Judgment, *supra* note 101, at 1; Northrop Final Judgment, *supra* note 101, at 1; Phillips Final Judgment, *supra* note 101, at 1; Gulf Final Judgment, *supra* note 101, at 1.

¹⁰⁵ See SEC v. United Brands Co., [Current Binder] CCH FED. SEC. L. REP. ¶ 95,420, at 99,141-43 (D.D.C. 1976).

stance, required a Special Committee to complete an investigation within 90 days after the entry of final judgment and submit a written report to Ashland's Board of Directors who in turn must take the necessary action to implement the report's recommendations.¹⁰⁶ It also required that the report be filed as an exhibit to SEC Form 8-K not later than the month following that in which it would be submitted to the Board of Directors.¹⁰⁷

These examples demonstrate that the overseas activities of American corporations may, in some cases, be effectively regulated by the SEC's enforcement of the disclosure provisions of the securities laws. In enforcing these provisions, however, the SEC must be sensitive to the potential harm which may result from *full* disclosure of all overseas activities. Full disclosure may open a Pandora's box plaguing not only the specific corporation involved, but ultimately the competitive position of virtually all American corporations with subsidiaries in foreign countries. The SEC must attempt to establish a means of disclosure that will inform investors of the facts they need to know and yet avoid the sometimes drastic consequences that may result if disclosure of every detail of every payment made overseas is required. The SEC must devise procedures to deal specifically with two problems: (1) handling current disclosures by companies which have made undisclosed overseas payments in the past, and (2) establishing

¹⁰⁶ Undertaking of Ashland Oil, Inc., SEC v. Ashland Oil, Inc., Civil Action No. 75-0794 at 1-3 (D.D.C., filed May 16, 1975). The Special Committee's report did not disclose the names of the recipients of Ashland's payments. I REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL, INC. 121-29 (June 26, 1975). However, the SEC demanded that Ashland disclose these names, and the company acceded to the demand. N.Y. Times, Aug. 10, 1975, § 1a, at 1, col. 3. The Special Committee's report contains recommendations regarding the corporation's policy with respect to future political contributions. ASHLAND REPORT, *supra*, at 180-83. Future payments of an illegal nature by the law of the jurisdiction in which the transactions occur should be clearly opposed by the company. *Id.* at 184. Payments to consultants involving contracts or agreements above a specified amount or for longer than one year should require the approval of two to three specified corporate executives and an attestation by the consultant, at the time of the formalization of the contract or agreement and annually thereafter, that he "has not and will not make payments to third parties which the consultant knows or has reason to know are illegal in the jurisdiction in which the transaction takes place." *Id.* at 184-86. The Committee also asserted the company should adopt a policy prohibiting undisclosed or improperly recorded expenditures. *Id.* at 188-89. For Ashland Board resolutions declaring corporate policy against contributions of corporate funds or other assets, whether legal or illegal, to public office-holders or candidates for public office, see II REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL, INC., Exhibit R-2 (June 26, 1975), "reaffirming" corporate policy against illegal payments, whether directly or indirectly from corporate funds, see *id.* Exhibit R-3; and declaring corporate policy against the maintenance of undisclosed corporate funds, see *id.* Exhibit R-4. For an analysis of the report of the Special Review Committee formed as a result of the settlement of the SEC's suit against the Gulf Oil Corporations, see Smith, 'Illegality' Cited in Gulf Payments, N.Y. Times, Dec. 31, 1975, at 1, col. 1; Wall St. J., Jan. 2, 1976, at 5, col. 2. The report apparently played a critical role in the ouster by the board of directors of Bob R. Dorsey as chairman of Gulf. Wall St. J., Jan. 15, 1976, at 1, col. 6.

¹⁰⁷ Undertaking of Ashland Oil, Inc., *supra* note 106, at 3.

workable guidelines to adequately explain what conduct will constitute violations of the securities laws in the future. The SEC's present disclosure policy does not adequately take into account these two problems.

In view of the consequences following disclosures by the companies formally charged by the SEC, most companies have been reluctant to come forward in the absence of some sort of definite guidelines. Realizing this, the SEC has adopted an amnesty arrangement. A corporation which believes it may have violated the federal securities laws by failing to disclose past foreign payments may: (1) notify the SEC of its suspicions; (2) conduct a thorough investigation under the direction of independent auditors or outside directors to obtain all information concerning the company's activities; (3) inform the SEC of the results of the investigation and if violations have been uncovered, suggest what disclosure the company believes is appropriate; and (4) take steps to stop all such payments and adopt policies prohibiting such conduct in the future.¹⁰⁸ Companies following the SEC suggestions would apparently be spared the embarrassment of having the SEC file an enforcement action against them.¹⁰⁹ Also, the SEC has implied that such volunteers would only be subject to limited disclosure, thereby avoiding possible serious damage to their foreign interests.¹¹⁰

Corporate reaction to the SEC recommendations has thus far been less than enthusiastic. Only recently has there been any appreciable response to the offer, announced in July, 1975, of amnesty in exchange for voluntary revelation of questionable payments overseas.¹¹¹ This lack of enthusiasm is probably due to the fact that the SEC has not guaranteed that compliance with the suggested procedures will definitely preclude future enforcement actions against a firm or that in

¹⁰⁸ *SEC Offers Amnesty In Corporate Payoffs*, BUS. WEEK, Aug. 4, 1975, at 20; Wall St. J., Sept. 9, 1975, at 1, col. 6; *Hearings on the Activities of American Multinational Corporations Abroad Before the Subcomm. on Int'l Econ. Policy of the House Comm. on Int'l Relations*, 94th Cong., 1st Sess. 63-64, 66 (1975) [hereinafter cited as *House Hearings on Activities of Multinational Corps.*] (statement of Philip A. Loomis, SEC Commissioner).

¹⁰⁹ Wall St. J., Sept. 9, 1975, at 1, col. 6.

¹¹⁰ Address Ray Garrett, Jr., former SEC Chairman, *Confidence in Business*, 1975 Midwest Public Relations Conf., Sept. 12, 1975 at 15-16 [hereinafter cited as *Garrett Confidence Speech*], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

¹¹¹ Firms which apparently have followed the SEC's suggestion include Cities Serv. Co. (Wall St. J., Sept. 24, 1975, at 6, col. 2); Castle & Cooke, Inc. (Wall St. J., Nov. 25, 1975, at 7, col. 1); Exxon Corp. (Wall St. J., Sept. 9, 1975, at 1, col. 6); American Home Prod. Corp. (N.Y. Times, Oct. 18, 1975, at 39, col. 1); Rockwell Int. Corp. (Wall St. J., Jan. 2, 1976, at 5, col. 1; N.Y. Times, Jan. 1, 1976, at 23, col. 6); G.D. Searle & Co. (Wall St. J., Jan. 12, 1976, at 2, col. 2; Wall St. J., Feb. 23, 1976, at 2, col. 5); A-T-O, Inc. (Wall St. J., Feb. 2, 1976, at 4, col. 3); Tenneco, Inc. (N.Y. Times, Feb. 15, 1976, § 1, at 1, col. 6; Wall St. J., Feb. 17, 1976, at 2, col. 3); Santa Fe Int'l Corp. (Wall St. J., Feb. 17, 1976, at 3, col. 2); Baxter Laboratories, Inc. (N.Y. Times, Feb. 24, 1976, at 49, col. 1; Wall St. J., Feb. 24, 1976, at 4, col. 2); and Levi Strauss & Co. (Wall St. J., Feb. 24, 1976, at 4, col. 3).

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all cases limited disclosure will be sufficient.¹¹² Another consideration is that leniency on the part of the SEC does not forestall the possibility of shareholders' suits alleging nondisclosures.¹¹³ These factors suggest that the SEC amnesty arrangement will not be an adequate solution to the foreign activities problem.

Several courses of action exist for the SEC. The Commission could develop a theory based on more traditional concepts of materiality and distinguish payments on the basis of size or custom. Small payments are immaterial because of the slight chance for economic reprisal by the foreign government or even by the particular official involved. Thus such payments, if "small" in size, made in accordance with locally accepted practices, properly recorded on the corporate books, and paid from authorized funds, would be deemed immaterial, thereby obviating the need for disclosure. Former Chairman Garrett espoused the view that the "small" bribes, so called "mordidas," should not be deemed material. Mordidas—*e.g.*, payments to the local postman to obtain regular mail service, to a fire inspector, customs inspector or tax collector—are commonplace and are rarely regarded as improper by many host countries.¹¹⁴ Garrett indicated that neither he nor any of the other Commissioners believed that these "small" payments were anything "to get excited about" as long as such payments follow local custom and usage.¹¹⁵ This approach, however, raises the problem of devising a standard of quantitative materiality. Other difficulties arise if the activity in which the corporation has engaged is illegal under the laws of the host country, but is generally not prosecuted or is routinely "winked at;" for example, the filing of a false tax statement. These problems undermine the utility of this approach.

Another approach would be to distinguish different types of payments in delineating a concept of materiality. Payments made to speed the performance of a duty which the recipient is already bound to perform would not be matters for disclosure, while those aiming to induce illegal behavior or conduct other than in the best interests of the host country would be subject to disclosure. Suggested by former Chairman Garrett,¹¹⁶ this approach apparently did not receive serious

¹¹² Wall St. J., Sept. 9, 1975, at 1, col. 6. Apparently, however, the steps taken by G.D. Searle & Co. will avoid a SEC enforcement action. Wall St. J., Jan. 12, 1976, at 2, col. 2.

¹¹³ SEC Offers Amnesty in Corporate Payoffs, BUS. WEEK, Aug. 4, 1975, at 21.

¹¹⁴ Griffith, Payoff Is Not "Accepted Practice," FORTUNE, Aug. 1975, at 122, 125.

¹¹⁵ Address by Ray Garrett, Jr., Former SEC Chairman, *Homily on the Glories of Right Conduct and the Wages of Sin*, American Soc'y of Corp. Secretaries, Inc. June 27, 1975 [hereinafter cited as Garrett Homily Speech] reprinted in *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 61. *Accord*, Address by Stanley Sporkin, Director, SEC Enforcement Division, National Ass'n of Accountants, Oct. 15, 1975, at 6, on file at the offices of the *Boston College Industrial and Commercial Law Review*. *Contra*, Address by John R. Evans, SEC Commissioner, *Truth or Consequences*, Securities Corporate Enforcement Conf., May 15, 1975, at 10-11, on file at the offices of the *Boston College Industrial and Commercial Law Review*.

¹¹⁶ Garrett Homily Speech, *supra* note 115, at 62. See also Wall St. J., May 9, 1975, at 1, col. 1.

consideration by the other Commissioners.

The most desirable approach, it is submitted, is based on an acceptance of the concept of integrity disclosure as a standard of materiality, and involves the requirement of only limited disclosure of foreign activities. Commissioner Sommer has recommended that a corporation be required to: (1) disclose it is making foreign payments; (2) indicate what portion of the earnings of the business depended on, or were jeopardized by, the payments; and (3) describe what effects the disclosure or discontinuance of the payments would have on the business.¹¹⁷ Such details as the names of the recipient and the countries where the payments were made could be omitted, however, if the companies specified that disclosure of these details would adversely affect the business overseas.¹¹⁸ The rationale for limited disclosure is

¹¹⁷ Address by A.A. Sommer, Jr., SEC Commissioner, *The Limits of Disclosure*, Wharton School Univ. of Pa., June 24, 1975, at 17 [hereinafter cited as *Sommer Disclosure Speech*], on file at the offices of the *Boston College Industrial and Commercial Law Review*; Address by A.A. Sommer, Jr., SEC Commissioner, *Crisis & The Corporate Community*, Midwest Securities Commissioners Ass'n Conf., July 21, 1975, at 10 [hereinafter cited as *Sommer Crisis Speech*], on file at the offices of the *Boston College Industrial and Commercial Law Review*.

¹¹⁸ *Sommer Crisis Speech*, *supra* note 117, at 10; *Sommer Disclosure Speech*, *supra* note 117, at 17. See statement of John Burton, SEC chief accountant, in *To Tell or Not To Tell*, *FORBES*, Feb. 1, 1976, at 41, 43. A recent prospectus filed by Cities Service Company utilized this limited disclosure concept by disclosing a \$30,000 expenditure in a foreign country for political purposes, a \$15,000 payment to a lobbyist in the country where a subsidiary is located, and the existence of a \$600,000 cash fund of an overseas subsidiary, while withholding the names of the recipients and the countries involved. *CITIES SERVICE CO.*, PROSPECTUS 27-28 (Sept. 30, 1975). For a copy of the SEC Form 8-K filed on Sept. 23, 1975 by Cities Service Co., see *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 182-85. The \$600,000 Fund has now been terminated. See also *CITIES SERV. CO.*, Form 8-K Current Report to SEC 1-3 (Sept. 23, 1975), on file at the offices of the *Boston College Industrial and Commercial Law Review*. Interestingly, both the Prospectus and the Form 8-K of the Cities Service Co. contain the statement that "[n]one of the foreign operations or subsidiaries in which any of the above-described activities have been discovered to date are material in relation to the Company's operation as a whole." *Id.* at 3 (emphasis added); *Cities Service Co.*, PROSPECTUS 28 (Sept. 30, 1975).

A similar declaration is contained in a prospectus issued by Exxon Corporation. After disclosing: (1) \$740,000 in payments to various foreign officials between 1963-75; (2) two foreign political contributions totaling \$31,000 in 1972 that were improperly booked; and (3) payments of \$13,000 per year between 1969-75, now terminated, to a government legislator for consultant service. Exxon states the above payments are not material in view of the corporation's total operations and the steps taken by Exxon management to prevent recurrences of this type of activity. *EXXON CORP.*, PRELIMINARY PROSPECTUS, *EXXON PIPELINE CO.* 31-32 (Sept. 30, 1975).

Merck & Co. has disclosed foreign payments of approximately \$3.9 million in 36 foreign countries between 1968-75. The company states that except for one \$12,500 payment to a cabinet-level official, these payments were to middle and lower echelon officials. Merck & Co., Form 8-K Current Report to SEC 1-2 (Dec. 17, 1975). In its Form 8-K, Merck declares that the "management of the Company is of the opinion that any such payments that have been made in the past have not been, individually or in the aggregate, material to, and that the termination of such payments will have no material adverse effect upon, the Company's business, financial position or results of operations considered as a whole." *Id.* at 3. Merck has also withheld the names of the reci-

that disclosure of the names of the recipients or the countries where payments were made might jeopardize the future business prospects of a corporation in that nation.¹¹⁹ This rationale is sound: full disclosure of all details surrounding foreign payments would undoubtedly be economically counterproductive. In addition, governmental relations with nations friendly to the United States may also be damaged as a result of freely disclosing American payments abroad.¹²⁰

It does not appear, however, that the SEC is willing to accept this approach of limited disclosure other than in the context of the amnesty program. The SEC has recently forced Lockheed Aircraft Corp. to disclose to the SEC the identities of its foreign payoff recipients,¹²¹ despite Lockheed's contention that disclosure of specifics regarding its foreign payments could jeopardize present and future contracts and adversely affect American foreign policy.¹²² The SEC originally subpoenaed certain documents from Lockheed which included the identities of foreign recipients.¹²³ Lockheed, fearing that the information might become public under the Freedom of Information Act,¹²⁴ refused to honor the subpoena.¹²⁵ The SEC then sought a court order

pipients and countries involved, although the SEC has requested such information. *Id.* at 4. See also Wall St. J., Sept. 15, 1975, at 2, col. 3; Wall St. J., Dec. 18, 1975, at 10, col. 3.

¹¹⁹ See, e.g., Wall St. J., July 30, 1975, at 4, col. 2; Wall St. J., Aug. 6, 1975, at 6, col. 2. Merck & Co. has stated that it is withholding names of recipients "out of concern for the safety and well-being of the individuals concerned . . ." Merck & Co., Form 8-K Current Report to SEC 4 (Dec. 17, 1975).

¹²⁰ In the action by the SEC against Lockheed to compel testimony and the production of documents, the U.S. Department of Justice filed a suggestion of interest of the United States at the request of the U.S. Secretary of State. The State Department noted that "premature disclosure to third parties of certain of the names and nationalities of foreign officials at this preliminary stage of the proceedings in the present case would cause damage to United States foreign relations." SEC v. Lockheed Aircraft Corp., [Current Binder] CCH FED. SEC. L. REP. ¶95,375, at 98,871 (D.D.C. 1975). See N.Y. Times, Dec. 14, 1975, § 1, at 23, col. 1. United States relations with its allies may be jeopardized by disclosures casting doubt on the integrity of high foreign officials. Crittenden, *Closing In On Corporate Payoffs Overseas*, N.Y. Times, Feb. 15, 1976, § 3, at 1, col. 1. For reactions by foreign governments in which payments were made, especially Japan and the Netherlands, see *The Global Costs of Bribery*, BUS. WEEK, March 15, 1976, at 22-24.

¹²¹ The SEC requested the information in order to prepare a possible case against Lockheed charging the firm with violations of the federal securities laws. Wall St. J., July 30, 1975, at 4, col. 2; Wall St. J., Aug. 6, 1975, at 6, col. 2. The requested documents concern \$22 million which Lockheed has admitted paying to foreign officials and political organizations since 1970. N.Y. Times, Aug. 2, 1975, at 1, col. 3; Wall St. J., Aug. 4, 1975, at 2, col. 2.

¹²² *Hearings on Lockheed Bribery Before the Senate Banking, Housing and Urban Affairs Comm.*, 94th Cong., 1st Sess. 27, 29 (1975) (Statement of Daniel J. Haughton, Lockheed Chairman) [hereinafter cited as *Senate Lockheed Hearings*]; Wall St. J., Aug. 6, 1975, at 6, col. 2; Wall St. J., July 30, 1975, at 4, col. 2; Wall St. J., Dec. 16, 1975, at 7, col. 1.

¹²³ N.Y. Times, Oct. 29, 1975, at 55, col. 2.

¹²⁴ The Freedom of Information Act, 5 U.S.C. § 552 (Supp. IV, 1975) provides that governmental agencies must honor requests for data in their files unless the information falls under a specific exemption of the Act.

¹²⁵ Wall St. J., Dec. 16, 1975, at 7, col. 1; N.Y. Times, Oct. 29, 1975, at 55, col. 2; Wall St. J., Oct. 29, 1975, at 5, col. 1.

requiring Lockheed's compliance.¹²⁶ After attempts at compromise failed,¹²⁷ the federal district court ordered Lockheed to turn the documents over to the SEC, but took steps to guard against premature disclosure of the information.¹²⁸

The limited disclosure plan poses questions of practicality. Once a firm discloses the existence of payments it may be difficult to keep confidential the specific details.¹²⁹ Other branches of the federal government, including the courts, less sensitive to the business realities faced by corporations in foreign nations, may force more disclosure or attempt to unilaterally prohibit American corporations from engaging in certain activities. While limited disclosure in theory strikes a workable balance between the interests of the stockholders and of the corporation in releasing information about covert corporate activity, it would be difficult to ensure that, in operation, the disclosure would truly be limited. Consequently the concept of limited disclosure does not adequately resolve the problem of informing shareholders of corporate activities while protecting the legitimate business interests of the corporation.

II. EXECUTIVE AND LEGISLATIVE RESPONSE TO CORPORATE PAYMENTS ABROAD

At the present time, SEC regulation is supplemented by the enforcement efforts of several other federal agencies which indirectly af-

¹²⁶ Application For An Order Requiring Obedience To Subpoena, SEC v. Lockheed Aircraft Corp., Misc. No. 75-0189 (D.D.C., filed Dec. 11, 1975).

¹²⁷ The district court attempted to sidestep the provisions of the Freedom of Information Act by requiring Lockheed to give the documents to the SEC with the names of the recipients who would be identified only by a code. Lockheed would give the court a key to the code, and the court would grant the SEC access to the key whenever it needed to learn the name of a recipient. This proposal was rejected by the SEC. N.Y. Times, Oct. 29, 1975, at 55, col. 2; Wall St. J., Oct. 29, 1975, at 5, col. 1.

¹²⁸ Order Requiring Obedience to Subpoena, SEC v. Lockheed Aircraft Corp., [Current Binder] CCH FED. SEC. L. REP. ¶95,375, at 98,870 (D.D.C. 1975). The court decreed that the documents in question will remain under the jurisdiction of the court, and the SEC may not release to any third parties any information from the documents, except to a grand jury, until it gives 10 days notice to all interested government agencies and the court rules upon the request for the information. *Id.* at 98,871. Occidental Petroleum Corp. also must comply with a SEC subpoena requesting documents regarding possible bribes to foreign officials between 1969 and 1975. Occidental's order also provides 10 days notice before release of the information. Wall St. J., Dec. 18, 1975, at 8, col. 3. BNA SEC. REG. & L. REP. NO. 333, Dec. 24, 1975, at A-3. The SEC has also moved to force Boeing Co. and its president to comply with a subpoena. In its plea for confidentiality, Boeing alleged that the documents contained highly confidential proprietary information. Wall St. J., Feb. 13, 1976, at 3, col. 1; N.Y. Times, Feb. 13, 1976, at 1, col. 7. A federal district court issued an order to compel production of the documents. N.Y. Times, Feb. 21, 1976, at 31, col. 1; Wall St. J., Feb. 23, 1976, at 2, col. 3.

¹²⁹ Garrett *Homily* Speech, *supra* note 115, at 62; Sommer *Disclosure* Speech, *supra* note 117, at 18-19. The problem of confidentiality is highlighted by the varied reactions to the somewhat ambiguous disclosures by and to the U.S. Senate Subcommittee on Multinational Corporations of payments by Lockheed Aircraft Corp. See N.Y. Times,

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fect the overseas activities of American corporations.¹³⁰ Commissioner Sommer has expressed his belief, however, that, in view of the effect on the American economy and foreign relations, the primary responsibility lies with Congress and the executive branch which must assess the propriety of corporate activities and prohibit undesirable conduct by new statutory proscriptions and sanctions.¹³¹

The Internal Revenue Service, the Department of Justice, and the Department of Defense have become involved in scrutinizing the foreign activities of American multinational corporations.¹³² Under section 162(a) of the Internal Revenue Code, a corporation may deduct ordinary and necessary business expenses from gross income.¹³³ Disclosure of foreign corporate payments, the existence of large slush funds, and the falsification of corporate books has led the Internal Revenue Service to question whether such foreign payments were taken as deductions on corporate tax returns.¹³⁴ The Code differen-

Feb. 5, 1976, at 1, col. 5; N.Y. Times, Feb. 7, 1976, at 1, col. 2; N.Y. Times, Feb. 10, 1976, at 1, col. 8; N.Y. Times, Feb. 11, 1976, at 1, col. 6.

¹³⁰ Recent events concerning the Lockheed Aircraft Corp. demonstrate the overlapping roles of Congress and executive agencies in areas of corporate multinational activity. The Emergency Loan Guarantee Board, established by 15 U.S.C. § 1841 (Supp. IV, 1975), administers the Emergency Loan Guarantee Program for Lockheed through which bank loans are guaranteed to Lockheed to a maximum amount of \$245 million. Recent hearings have evinced Congress' interests in reports of Lockheed bribery overseas. See *Senate Lockheed Hearings*, *supra* note 122, at 25. During the summer of 1975, Lockheed admitted paying \$22 million over the last five years to unidentified foreign officials and political organizations. N.Y. Times, Aug. 2, 1975, at 1, col. 3. Expressing concern that Lockheed had not advised the Board of these practices earlier, Secretary of the Treasury and Loan Guarantee Board Chairman, William E. Simon, strongly condemned the bribes, declaring that such practices "can only increase the distrust and suspicion that is straining our national institutions." *Senate Lockheed Hearings*, *supra* note 122, at 11. Later the Board said that it would require Lockheed to halt any future payments to foreign officials or face the possibility of losing the government backing. Wall St. J., Aug. 26, 1975, at 2, col. 3. Lockheed has agreed to this requirement and has adopted a new policy permitting only those payments which qualify as deductions for income tax purposes and which comply with U.S. and foreign laws. *Hearings on Political Contributions to Foreign Governments Before the Subcomm. on Multinational Corps. of the Senate Foreign Relations Comm.*, 94th Cong., 1st Sess., pt. 12, at 346 (1975) [hereinafter cited as *Senate Hearings on Political Contributions*] (statement of Daniel J. Haughton, Lockheed Chairman). If followed, this policy would prohibit Lockheed from making payments, directly or indirectly, to foreign governmental officials. See also *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 66-69 (statement of Edward C. Schmults, Under Secretary of the Treasury, Executive Director, Emergency Loan Guarantee Board); N.Y. Times, Aug. 11, 1975, at 1, col. 6; N.Y. Times, Aug. 4, 1975, at 29, col. 8.

¹³¹ Sommer *Disclosure Speech*, *supra* note 117, at 15. The Ford Administration may undertake a Cabinet-level study of U.S. corporate practices abroad. Wall St. J., Feb. 11, 1976, at 3, col. 2.

¹³² SEC Chairman Roderick Hill believes the SEC and other government agencies should coordinate their policies on the issue of corporate bribery to avoid inconsistent action. N.Y. Times, Nov. 3, 1975, at 57, col. 8.

¹³³ INT. REV. CODE OF 1954, § 162(a).

¹³⁴ *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 42-43 (Statement of Donald C. Alexander, Commissioner of Internal Revenue).

tiates between payments to government officials and payments to persons other than governmental officials. Under section 162(c)(1) of the Code,¹³⁵ payments to an official or employee of any government, agency, or instrumentality of any government are deductible if the payment would be lawful if made in the United States. Thus, the legality or illegality of the payment under the laws of the foreign country is immaterial.¹³⁶ The regulations also prohibit indirect payments to government officials through an agent.¹³⁷

Bribes or kickbacks to persons other than governmental officials are nondeductible, if the taxpayer is subject to criminal penalty or the loss of license to engage in a trade or business under the laws of the United States or any state of the United States.¹³⁸ Thus, under the Code some payments made to non-governmental officials or employees in foreign countries may be deducted as ordinary and necessary business expenses if the taxpayer is not subject to criminal penalty or the loss of license. This conclusion also follows from the reasoning of the Supreme Court in *Lilly v. Commissioner*,¹³⁹ where the Court held that an optician could deduct payments made to a physician who prescribed the glasses which the optician made and sold.¹⁴⁰ The Court based its decision on the fact that the practice was wide-spread¹⁴¹ and that no declared public policies prohibited the payments.¹⁴² Thus, foreign payments to non-governmental individuals are deductible if they represent a wide-spread practice and, as qualified by Internal Revenue Service Commissioner Donald Alexander, are made with the knowledge of the recipient's employer and are made without an intent to corrupt.¹⁴³ The inducement of the deductibility of proper foreign payments affords at least a measure of indirect control over the foreign activities of American corporations.

The Department of Justice possesses the authority to deal with

¹³⁵ INT. REV. CODE OF 1954, § 162(c)(1).

¹³⁶ Treas. Reg. § 1.162-18(a)(2) (1975).

¹³⁷ Treas. Reg. § 1.162-18(b) (1975). The term official or employee of a government is defined in Treas. Reg. § 1.162-18(c) (1975).

¹³⁸ INT. REV. CODE OF 1954, § 162(c)(2). See generally Note, *Federal Income Taxation—Public Policy and the Deductibility of Kickbacks Under § 162 (c)(2)*, 35 OHIO ST. L.J. 686 (1974).

¹³⁹ 343 U.S. 90 (1952). See *Tank Truck Rentals, Inc. v. Commissioner*, 356 U.S. 30 (1958); *Commissioner v. Sullivan*, 356 U.S. 27 (1958). But see *United Draperies, Inc. v. Commissioner*, 340 F.2d 936 (7th Cir. 1964). See also Paul, *The Use of Public Policy by the Commissioner In Disallowing Deductions*, 1954 S. CAL. TAX. INST. 715; Schwartz, *Business Expenses Contrary to Public Policy: An Evaluation of the Lilly Case*, 8 TAX. L. REV. 241 (1953).

¹⁴⁰ 343 U.S. at 9.

¹⁴¹ *Id.* at 93.

¹⁴² *Id.* at 97.

¹⁴³ *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 45 (statement of Donald Alexander, IRS Commissioner). An increase in the number of interviews by the IRS of corporate executives to gather information on illegal deductions of corporate bribes may be underway. *Wall St. J.*, Feb. 11, 1976, at 3, col. 2; *N.Y. Times*, Feb. 11, 1976, at 1, col. 8.

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foreign activities of American corporations by enforcing federal criminal and antitrust statutes.¹⁴⁴ Corporate operations may violate a federal criminal statute prohibiting citizens of the United States from attempting directly or indirectly to influence a foreign government or its agents in any dispute or controversy with the United States.¹⁴⁵ Ralph Nader and four members of Congress have suggested that the Department of Justice establish a Division on Corporate Crime to prosecute under this and other statutes what they regard as a "corporate crime wave"¹⁴⁶ exemplified by the "numerous and confirmed reports of payoffs to foreign political parties by major American companies."¹⁴⁷ They also recommend the enactment of new legislation which would prohibit the establishment of a fund for making illegal payments to foreign governmental official or political figures. Violation of this statute would result in substantial fines and jail sentences.¹⁴⁸

The foreign activities may also raise questions regarding possible antitrust violations. The Department of Justice has concluded that "payments to foreign governmental officials, could be the subject of [an] antitrust suit where they were part of a scheme to restrain or monopolize U.S. imports or exports . . ."¹⁴⁹ The Department also noted, however, that it would weigh the doctrines of sovereign immunity,¹⁵⁰ act of state,¹⁵¹ and foreign governmental compulsion,¹⁵²

¹⁴⁴ Under the Federal Trade Commission Act § 6, 15 U.S.C. § 46 (1970), the Federal Trade Commission has broad authority to investigate the organization, business, conduct, practices and management of any corporation engaged in commerce, and under the Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1970) may declare designated practices an unfair method of competition. In addition to authority to scrutinize corporate activities for possible antitrust violations under the Clayton Act, 15 U.S.C. § 21 (1970), and the Federal Trade Commission Act § 5, 15 U.S.C. § 45 (1970), the Federal Trade Commission may establish other "unfair" means of competition. See, e.g., *FTC v. Sperry & Hutchinson Co.*, 405 U.S. 233 (1972). It is arguable that a corporation seeking to obtain foreign contracts by bribes may place its competitors at an unfair disadvantage. See Letter from Sen. Lee Metcalf, Rep. Benjamin Rosenthal, Rep. Toby Moffett, Rep. Thomas Downey, Ralph Nader and Mark Green to Hon. Edward H. Levi, Aug. 22, 1975, at 7, on file at the offices of the *Boston College Industrial and Commercial Law Review*. The F.T.C.'s authority to curtail activities abroad by U.S. corporations has been questioned. *Wall St. J.*, Oct. 7, 1975, at 22, col. 4.

¹⁴⁵ 18 U.S.C. § 953 (1970).

¹⁴⁶ Letter from Sen. Lee Metcalf, Rep. Benjamin Rosenthal, Rep. Toby Moffett, Rep. Thomas Downey, Ralph Nader and Mark Green to Hon. Edward H. Levi, Aug. 22, 1975, at 25, on file at the offices of the *Boston College Industrial and Commercial Law Review*.

¹⁴⁷ *Id.* at 1.

¹⁴⁸ *Id.* at 5-6. See also *N.Y. Times*, Aug. 25, 1975, at 1, col. 5.

¹⁴⁹ *Hearings on Activities of Multinational Corps.*, *supra* note 108, at 89 (Testimony of Donald I. Baker, Deputy Assistant Attorney General Antitrust Division) [hereinafter cited as *Baker Testimony*]. The main antitrust weapons are §§ 1 and 2 of the Sherman Act, 15 U.S.C. §§ 1, 2 (1970).

¹⁵⁰ *Baker Testimony*, *supra* note 149, at 89.

¹⁵¹ *Id.* See *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 404 (1964). See also *Occidental Petroleum Corp. v. Buttes Gas & Oil Co.*, 331 F. Supp. 92 (C.D. Cal. 1971), *aff'd per curiam*, 461 F.2d 1261 (9th Cir.), *cert. denied*, 409 U.S. 950 (1972).

¹⁵² *Baker Testimony*, *supra* note 149, at 89. See H. BRIGGS, *THE LAW OF NATIONS*

and considerations of comity¹⁵³ in deciding whether to institute an antitrust suit.¹⁵⁴ These defenses may minimize any regulation of corporate conduct abroad by the Justice Department on the basis of the antitrust statutes.

The Department of Defense (DOD) occupies a unique position with respect to the foreign payments controversy. Acting as the middleman in the purchase of U.S. arms by foreign governments, the DOD must determine whether to allow the payment of agent's fees as part of the selling costs of foreign military sales (FMS) contracts.¹⁵⁵ The Department's Armed Service Procurement Regulation (ASPR) authorizes the payment of contingent agent's fees to "bona fide employees" and "bona fide established commercial or selling agencies" if the fee is "reasonable" and allocable to the specific contract in question.¹⁵⁶

404-08 (2d ed. 1952). See also RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

¹⁵³ Baker Testimony, *supra* note 149, at 89. See RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965).

¹⁵⁴ Several situations must be distinguished. An attempt by a group of American firms or a domestic monopolist to bribe foreign officials to tie up the main foreign source of an essential raw material used in the United States would give rise to a claim for relief under the antitrust laws, subject to the defense that the essential act constitutes an act of state. See *United States v. Sisal Sales Corp.*, 274 U.S. 268 (1927). Payments for favorable consideration in general, payments of foreign government fees or contributions, and payments for specific preferences in foreign government procurement would not in themselves constitute antitrust violations because such payments would not likely have any direct and identifiable effect on U.S. foreign commerce. But see *Continental Ore Co. v. Union Carbide & Carbon Corp.*, 370 U.S. 690, 707 (1962) where the Court noted that "acts which are in themselves legal lose that character when they become constituent elements of an unlawful scheme."

The impact of payments to procure foreign government action is uncertain. See *House Hearings on Activities of Multinational Corps.*, (Statement of Donald R. Baker), *supra* note 108, at 90-94. Baker, *Antitrust and World Trade: Tempest in an International Teapot?*, 8 CORNELL INT'L L.J. 16 (1974). On the extraterritorial reach of U.S. antitrust laws, see Haight, *International Law and Extraterritorial Application of the Antitrust Laws*, 63 YALE L.J. 639 (1954); Miller, *Extraterritorial Effects of Trade Regulation*, 111 U. PA. L. REV. 1092 (1963).

¹⁵⁵ *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 128-29 (Statement of Brig. Gen. James W. Stansberry, Deputy Ass't Sec. of Defense, Procurement, Installations, and Logistics) [hereinafter cited as Stansberry Statement]. Wall St. J., Feb. 27, 1976, at 16, col. 1.

¹⁵⁶ Armed Services Procurement Regulation (ASPR) ¶¶ 1-503, 1-505.2, 1-505.4 *et seq.* (1974). Stansberry Statement, *supra* note 155, at 129-32. ASPR ¶ 1-505.4(e) provides that "any agency or agent is not 'bona fide' which seeks to obtain any Government contract or contracts for its principals through the use of improper influence or which holds itself out as being able to obtain any Government contract or contracts through improper influence." Improper influence is defined in ASPR ¶ 1-504. See ASPR ¶¶ 15-205.37 (defining selling costs), 15-107 (allocation of indirect costs), 15-201.4 (defining allocability), 15-203 (defining indirect costs), 15-205.31 (dealing with allowability of consultant fees). Commissions have been questioned by the Defense Contract Audit Agency for a variety of reasons. See *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 146-47 (Statement of Charles O. Starrett, Jr., Assistant Director, Policy and Plans, Defense Contract Audit Agency, Department of Defense).

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What constitutes reasonableness is often difficult to determine. The ASPR states that compensation "should not be excessive as compared with the fees customarily allowed in the trade concerned for similar services related to commercial (non-Government) business."¹⁵⁷ However, the scarcity of data regarding fees paid to agents by commercial businesses resulted in a 1973 directive that "[t]he basic test of reasonableness is an assessment of the services provided compared to the amount of the fee."¹⁵⁸ The workability of this test depends on the Department's success in obtaining a verified accounting of the actual services performed by the agents. In large contracts where agents' fees add up to millions of dollars, it is often impossible to obtain an accurate accounting of the services rendered and to verify the fact that those particular services produced the contract. Recognizing these shortcomings, the DOD adopted a policy of notifying foreign governments when it is unable to determine that a fee is reasonable.¹⁵⁹ The countries of Kuwait, Saudi Arabia, Iran and Israel have requested that no fees for an agent's services be included in contracts unless allowed by the foreign government in advance.¹⁶⁰ However, the DOD's decision to approve a fee is reviewed by Congress only where the deal for military weapons exceeds \$25 million and is under the auspices of the United States government.¹⁶¹ Thus, while the Department has drawn congressional criticism for its approval of multimillion dollar fees in FMS contracts, few, if any, changes have been effected in its policies.¹⁶²

¹⁵⁷ ASPR 11-505.4(a). The factors bearing on the reasonableness of a specific cost are:

(i) whether the cost is of a type generally recognized as ordinary and necessary for the conduct of the contractor's business or the performance of the contract; (ii) the restraints or requirements imposed by such factors as generally accepted sound business practices, arm's length bargaining, Federal and State laws and regulations, and contract terms and specifications; (iii) the action that a prudent businessman would take in the circumstances, considering his responsibilities to the owners of the business, his employees, his customers, the Government and the public at large; and (iv) significant deviations from the established practices of the contractor which may unjustifiably increase the contract costs.

ASPR 115-201.3. See generally Stansberry Statement, *supra* note 155, at 7-8. See also proposed ruling by Dept. of State regarding contingent fees and commissions. 40 Fed. Reg. 37043 (Aug. 25, 1975).

¹⁵⁸ Item VIII, Defense Procurement Circular (DPC) No. 117 (Nov. 1973), republished as Item IX, DPC No. 74-1 (Aug. 26, 1974). For the text of DPC No. 74-1, see *House Hearings on Activities of Multinational Corps.*, *supra* note 108, Appendix 3, at 214.

¹⁵⁹ Office of the Secretary of Defense Directive (Aug. 6, 1975); Stansberry Statement, *supra* note 155, at 132; Wall St. J., Oct. 1, 1975, at 32, col. 1.

¹⁶⁰ *Hearings on Activities of Multinational Corps.*, *supra* note 108, at 119 (Statement of Lt. Gen. Howard M. Fish, director, Defense Security Assistance Agency); Stansberry Statement, *supra* note 155, at 132; Wall St. J., Oct. 1, 1975, at 32, col. 1.

¹⁶¹ Foreign Military Sales Act § 36(b), 22 U.S.C.A. § 2776(b) (Supp. 1976). Wall St. J., Feb. 27, 1976, at 16, col. 1.

¹⁶² Wall St. J., Oct. 1, 1975, at 32, col. 1. Wall St. J., Feb. 17, 1976, at 12, col. 3. It has been suspected that the United States Government may have been aware of the

The congressional response to the overseas activities of American firms has been inadequate. Hearings have been held by various congressional committees. The Multinational Corporation Subcommittee of the Senate Committee on Foreign Relations, the International Economic Policy Subcommittee of the House Committee on International Relations, and the Senate Committee on Banking, Housing and Urban Affairs have heard testimony on the subject and proposals on appropriate legislative action.¹⁶³ Although these hearings spanned most of 1975, apparently the only legislation to be reported out of these committees is a bill authored by Senator Frank Church. The proposed legislation imposes fines and provides for automatic cancellation of arms-export licenses of those involved in bribes or kickbacks. The bill also prohibits the creation of dummy corporations overseas as conduits for arms agents' fees.¹⁶⁴

Individual Congressmen, acting independently of the committees, have also either introduced or are about to introduce bills regulating foreign activities of American corporations. These bills focus on the regulation of foreign arms sales¹⁶⁵ and the monitoring of busi-

behavior of American aircraft manufacturers. Crittenden, *Closing in on Corporate Payoffs Overseas*, N.Y. Times, Feb. 15, 1976, § 3, at 1, col. 1.

¹⁶³ For example, Gulf Chairman B.R. Dorsey urged Congress to enact legislation prohibiting foreign contributions by American companies to aid American firms in resisting foreign pay-off demands. *Senate Hearings on Political Contributions*, *supra* note 130, at 13 (statement of B.R. Dorsey).

¹⁶⁴ Wall St. J., Dec. 15, 1975, at 2, col. 2.

¹⁶⁵ Senator Hubert H. Humphrey (D-Minn.), Senator Gaylord Nelson (D-Wis.), Representative Robert N. C. Nix (D-Pa.) and Representative Les Aspin (D-Wis.) want strict controls over foreign arms sales. Senator Humphrey's bill would: (1) require public disclosure of all foreign arms deals, including agents fees, (2) transfer primary control over arms exports licensing to the State Department, (3) require the President to submit an annual report to Congress justifying country-by-country foreign military sales, and (4) allow Congress to revoke any sales contracts and export licenses it deems necessary in the national interest. S. 2662, 94th Cong., 1st Sess. (1975); 121 CONG. REC. S. 19880-90 (daily ed. Nov. 13, 1975). See also N.Y. Times, Nov. 14, 1975, at 8, col. 1.

Senator Nelson favors requiring the President to prepare a yearly report of potential sales of arms to foreign countries, with authority in Congress to review the report and alter and/or place restrictions on sales to individual countries. S. 854, 94th Cong., 1st Sess. (1975); 121 CONG. REC. S. 2653, 2655-56 (daily ed. Feb. 26, 1975). See also Lyons, *U.S. Arms-Sale Rise Stirs Capital Concern*, N.Y. Times, Oct. 19, 1975, at 1, col. 2; Wall St. J., Oct. 1, 1975, at 32, col. 1. Senator Nelson has also introduced amendments that would give Congress 30 calendar days while in continuous session to veto a proposed arms sale and would require the President to submit for congressional review any arms sale which places the amount of sales to a given country over \$50 million for the year. Amend. Nos. 581, 582 to S. 1816, 94th Cong., 1st Sess. (1975); 121 CONG. REC. S. 10449-50 (daily ed. June 12, 1975).

Congressman Aspin's proposal requires annual congressional approval of a maximum dollar value of weapons to be sold and limitations on both numbers and types of weaponry sold to each country and the filing of a statement by the director of the Arms Control and Disarmament Agency regarding the effects of the sales and the quality of weapons sold in relation to certain outlined areas. H.R. 7835, 94th Cong., 1st Sess. (1975). See also Press Release from Congressman Les Aspin, *Aspin Introduces Arms Sales Bill*, June 12, 1975.

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ness activities of American firms in foreign nations.¹⁶⁶ The legislation aimed at regulating arms sales would create undesirable consequences for the depressed American economy. Foreign military sales totaled \$9.5 billion for the fiscal year 1975, almost a tenth of all United States exports.¹⁶⁷ The dramatic rise in arms sales in the last two years (sales totalled \$3.9 billion in 1973)¹⁶⁸ has helped the United States bolster its balance of trade payments, particularly with the oil-producing countries of the Middle East.¹⁶⁹ The increase has also given a needed lift to the nation's sagging aerospace industry.¹⁷⁰ Thus, congressional action to restrict foreign arms sales by American corporations or to require disclosure of information which could in turn cause the loss of United States arms contracts to foreign competitors may have a negative impact on this country's economy.¹⁷¹

Representative Nix would force disclosure of commissions paid on foreign arms sales. H.R. 10144, 94th Cong., 1st Sess. (1975). Senator Frank Church (D-Idaho), Chairman of the Subcommittee on Multinational Corporations of the Senate Foreign Relations Committee reportedly may propose legislation setting mandatory disclosure requirements on civilian as well as military deals. Washington Outlook, BUS. WEEK, Oct. 6, 1975, at 105. The Senate has passed S. 2662, *supra*, as amended, which requires all arms deals in excess of \$25 million to be sold through the United States Government, thus allowing Congress to block the sale. The bill also requires disclosure of commissions, fees, gifts or political contributions, together with dates and names, to the State Department which would be required to submit periodic reports to Congress which could be made public. 122 CONG. REC. S. 1916 (daily ed. Feb. 18, 1976); Wall St. J., Feb. 19, 1976, at 8, col. 2; Christian Science Monitor, Feb. 13, 1976, at 3, col. 1; Christian Science Monitor, Feb. 20, 1976, at 7, col. 1.

¹⁶⁶ Representative Stephen J. Solarz (D-NY) has introduced two bills. H.R. 7563 would direct the State Department to monitor the business activities of American companies in foreign countries in order to detect any activities which may violate federal law. Such violations would be reported to the federal agency having responsibility for enforcement of the law being violated. H.R. 7563, 94th Cong., 1st Sess. (1975). H.R. 7539 incorporates the provisions of H.R. 7563, but, in addition, proposes to amend 18 U.S.C. § 201 (1970) to prohibit payments by any American company or its officials or employees made with intent to influence the official acts of any foreign government, official, or political organization. The maximum penalty for such activity would be \$10,000 or one year in prison or both. H.R. 7539, 94th Cong., 1st Sess. (1975). See *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 4. (Statement of Hon. Stephen J. Solarz, N.Y. Rep.).

¹⁶⁷ Wall St. J., Oct. 1, 1975, at 32, col. 1.

¹⁶⁸ The State Dept. released the following figures: Foreign Military Sales Program by Number of Recipient Countries and Dollar Program Value, Fiscal Years 1971-75:

Fiscal Year	Number of Recipient Countries	Dollar Program Value (Millions)
1971	61	\$1,644
1972	69	3,272
1973	66	3,866
1974	70	10,808
1975	72	9,510

House Hearings on Activities of Multinational Corps., *supra* note 108, at 162.

¹⁶⁹ Statement of Sen. Gaylord Nelson, 121 CONG. REC. S. 2655 (daily ed. Feb. 26, 1975). Wall St. J., Oct. 1, 1975, at 32, col. 1.

¹⁷⁰ *Exports Provide A Needed Lift*, BUS. WEEK, March 17, 1975, at 18.

¹⁷¹ *The Boom in the Death Business*, N.Y. Rev. of Books, Oct. 2, 1975, at 7. For commentaries on the spiraling rate of foreign arms sales, see Jensen, *U.S. Arms Exports*

The attempt to pass legislation aimed at monitoring corporate business or prohibiting specific activities has also been criticized. The State Department, for example, has condemned illegal activities by American firms abroad, but cautioned against the passage of legislation making it a crime for American corporations to engage in activities abroad which would be illegal if conducted at home.¹⁷² Speaking before a House Subcommittee, Deputy Legal Advisor for the State Department, Mark B. Feldman, stated that such legislation would be resented by the host countries as American interference in their internal affairs. Enforcement would require surveillance of foreign officials as well as American personnel and would be viewed as an attempt to force American law upon the foreign territory.¹⁷³

While the State Department's argument is persuasive, it is submitted that the United States should at least condemn subversive political intervention by American multinational corporations aimed at overthrowing a host country's government or at creating situations conducive to such action. Presumably, such legislation would be welcomed by host countries, as it would signal an official policy of noninterference by Americans in foreign internal affairs.¹⁷⁴ Prohibiting multinational firms from engaging in local political controversies or identifying themselves with partisan political activities in host nations should be left to the foreign countries which should define permissible activities and establish sanctions. Subjecting the payment of bribes overseas to domestic criminal sanctions encounters the further problem that such actions may not be illegal in the foreign country. National action by various administrative agencies must, of course, be carefully coordinated to avoid the imposition of contradictory standards on corporate activities.

A national solution to the problem posed by surreptitious corporate activity abroad thus suffers from at least two shortcomings: (1)

Boom, Particularly to the Mideast, N.Y. Times, Apr. 14, 1975, at 1, col. 1; Jensen, *Sales for Arms Are Complex*, N.Y. Times, Apr. 15, 1975, at 53, col. 1; Lyons, *U.S. List of Arms Producers and Exporters Shows More Than 1,000 Concerns*, N.Y. Times, Oct. 21, 1975, at 14, col. 1; Lyons, *Arms Lobby Relies on Varied Sources, Including Liberals Seeking to Protect Workers' Jobs*, N.Y. Times, Oct. 20, 1975, at 52, col. 1; Lyons, *U.S. Arms-Sale Rise Stirs Capital Concern*, N.Y. Times, Oct. 19, 1975, § 1, at 1, col. 2; Farnsworth, *The F-16 and How It Won Europe*, N.Y. Times, July 27, 1975, § 3, at 1, col. 1; Aspin, *The Arms Sales Threat*, PROGRESSIVE, June, 1975, at 10-11.

¹⁷² *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 22, 24 (Statement of Mark B. Feldman, Deputy Legal Advisor, Department of State).

¹⁷³ *Id.* at 27, 31. *But see* Statement of Arthur F. Burns, Chairman of the Federal Reserve Board and a member of the Emergency Loan Guarantee Board, supporting a law making the payment of bribes overseas a crime in the United States. N.Y. Times, Feb. 12, 1976, at 53, col. 7.

¹⁷⁴ See Address by Secretary of State Henry A. Kissinger, *Global Consensus and Economic Development*, United Nations, New York, Sept. 1, 1975, on file at the offices of the Boston College Industrial and Commercial Law Review [hereinafter cited as Kissinger *Global Consensus Speech*]. N.Y. Times, Sept. 2, 1975, at 20, col. 1. *The Impact of Multinational Corporations on Development and on International Relations*, U.N. Doc. E/5500/Rev. 1 ST/ESA/6 at 46 (1974).

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the traditional regulatory measures of executive agencies do not sufficiently discourage foreign payments; and (2) considerations of the state of the economy and foreign relations present countervailing factors which weigh against the adoption of a strong position by the United States. Any national solution faces an additional impediment: regulation would reduce the freedom of American multinational corporations while failing to control the practices of entities incorporated in other nations. An adequate response to the problem of corporate activities abroad therefore requires a *transnational* approach, which could take the form of either a code of conduct or an international treaty covering transnational corporations.

III. A TRANSNATIONAL APPROACH TO THE PROBLEM OF FOREIGN CORPORATE PAYMENTS

There are several methods of implementing a transnational approach to the problem of foreign corporate payments. A code of conduct could be promulgated under the auspices of an international body, such as the United Nations, by a group of industrialized governments, such as the Organization for Economic Cooperation and Development, or by an international business group, such as the International Chamber of Commerce. A code of conduct for multinational enterprises envisions the establishment and acceptance of certain basic principles which would serve as guidelines for the activities of multinational corporations in host countries.¹⁷⁵ Although nations may disagree on many issues, including transfer pricing¹⁷⁶ and the control over technology exported by multinational firms to host countries, agreement could probably be secured regarding, at a minimum, the imposition of an obligation on multinational enterprises to obey local laws and refrain from illegal intervention in the domestic affairs of host countries.¹⁷⁷

This minimum obligation may, however, be inadequate, because of the absence of laws regarding bribery and corporate political contributions in some host countries. The Organization for Economic Cooperation and Development (OECD), which is composed of industrialized nations, is drafting "principles of behavior" for multinational corporations. The provisional guidelines of the principles, which will

¹⁷⁵ The U.S. Senate has passed a resolution calling on U.S. trade diplomats to negotiate an "international code of conduct" to halt bribes and kickbacks by multinational corporations. Wall St. J., Nov. 13, 1975, at 12, col. 3. The State Department has also suggested the need for international guidelines. *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 24 (Statement of Mark B. Feldman, Deputy Legal Advisor, Dept. of State). See also Kissinger *Global Consensus* Speech, *supra* note 174, at 8.

¹⁷⁶ Transfer pricing involves agreements between an American parent corporation and a foreign subsidiary whereby products are transferred at prices other than fair market value. For example, a parent may sell goods to a foreign subsidiary at a price in excess of fair market, thereby lowering the subsidiary's profit on the finished product and making exportation more expensive.

¹⁷⁷ Kissinger *Global Consensus* Speech, *supra* note 174, at 8.

be voluntary, are equivocal on the subject of bribery. The present draft of the code provides that multinational corporations should, "within the framework of laws and regulations of the host country, observe the best standards set by relevant local customs and practices with regard to rendering gifts and other benefits to public servants."¹⁷⁸ As drafted, the guidelines are keyed to local laws and customs which may not bar bribery or corporate political contributions. The principles, however, are still under negotiation by member governments of the OECD.¹⁷⁹

It is suggested that the final guidelines should prohibit multinational corporations located in the respective member nations of the OECD from: (1) bribing government officials, directly or indirectly, through the use of agents, in host nations; (2) engaging in local political controversies or identifying themselves with any political side in host nations, including a ban on contributions to government officials, political parties or candidates; and (3) intervening directly or indirectly in the domestic affairs of a host nation. The OECD guidelines should, however, permit transnational corporations to continue to represent their views to governmental officials in host countries, at least on those issues which directly affect their interests.

Alternatively, a transnational code might be modeled after the General Agreement on Tariffs and Trade,¹⁸⁰ and could initially establish several generally accepted principles of conduct. Signatory nation-states and perhaps the multinational corporations themselves could consult and bargain regarding standards, thereby laying the basis for the development of additional principles. Procedures would also be created to facilitate the settlement of disputes. For example, an agency might be established with the power to investigate activities and make non-binding recommendations which would, hopefully, be accepted by the parties in interest on a voluntary basis. The precedents developed by the agency would also form the basis for a more formal treaty system to regulate the activities of multinational corporations.

Another possibility is that corporations, on an individual basis, through national or international trade associations, or on an industry wide basis (either nationally or transnationally) could take the lead in formulating standards of conduct. Some corporations have already seized the initiative in formulating corporate codes of conduct or

¹⁷⁸ Farnsworth, *O.E.C.D. Asks Data on Big Companies*, N.Y. Times, Oct. 27, 1975, at 41, col. 8; Farnsworth, *U.S. Seeks World Pact on Control of Bribery*, N.Y. Times, Feb. 25, 1976, at 49, col. 2.

¹⁷⁹ Letter from Dr. Klaus W. Grewlich, OECD, to Lewis D. Solomon, Nov. 17, 1975, on file at the offices of the *Boston College Industrial and Commercial Law Review*.

¹⁸⁰ 61 Stat. A3 (1947). See Goldberg & Kindleberger, *Toward a GATT for Investment: A Proposal for Supervision of the International Corporation*, 2 LAW & POLICY INT'L BUS. 295 (1970). But see Rubin, *Multinational Enterprise and National Sovereignty: A Skeptic's Analysis*, 3 LAW & POLICY INT'L BUS. 1 (1971). See generally INTERNATIONAL CONTROL OF INVESTMENT: THE DUSSELDORF CONFERENCE ON MULTINATIONAL CORPORATIONS (D. Wallace, Jr. ed. 1974).

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statements of policy to guide their multinational activities.¹⁸¹ In the final analysis, however, the developed nations, especially the United States, must be careful in formulating standards to avoid forcing Western moral and ethical standards on developing nations.

Agreement on a basic set of principles is difficult at present, not only because of a lack of common interests between developed and developing countries but also because of the diverse perceptions of the economic, political and social impact of multinational corporations. The United Nations Commission on Transnational Corporations, formed in 1974 to act as a forum within the United Nations for the comprehensive consideration of the impact and regulation of transnational business, attempted to take the lead in formulating a code of conduct.¹⁸² The first meeting of the Commission in 1975, however, produced a split between developed nations and developing countries on the scope and the content of a code of conduct and on whether such a code would apply to host governments, as well as to

¹⁸¹ See, e.g., CATERPILLAR TRACTOR CO., A CODE OF WORLDWIDE BUSINESS CONDUCT Oct. 1, 1974, on file at the offices of the *Boston College Industrial and Commercial Law Review*, which declares: "A basic requirement levied against any business enterprise is that it know and obey the law," *id.* at 8, and "[t]he Company will not attempt to influence such activity [partisan political activity] in any city, state or nation. Caterpillar will not contribute money, goods or services to political parties and candidates, or support them in any way," *id.* at 10; LOCKHEED POLICY ON THE SELECTION AND USE OF INTERNATIONAL CONSULTANTS, reprinted in *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 167-69; POLICY STATEMENT OF CITICUS SERVICE CO., reprinted in *House Hearings on Activities of Multinational Corps.*, *supra* note 108, at 184. See also UNITED STATES CHAMBER OF COMMERCE, ELEMENTS OF GLOBAL BUSINESS CONDUCT FOR POSSIBLE INCLUSION IN INDIVIDUAL COMPANY STATEMENTS at 2 (Jan. 1975); INTERNATIONAL CHAMBER OF COMMERCE, GUIDELINES FOR INTERNATIONAL INVESTMENT at 12-13 (1972), both on file at the offices of the *Boston College Industrial and Commercial Law Review*.

Resolutions by the Board of Directors of Ashland Oil pursuant to the final judgment entered against the corporation, see text at notes 101-107 *supra*, provide for sanctions in the form of "appropriate disciplinary action" for violation of corporate policy (1) against contributions of corporate funds to public officeholders; (2) against illegal payments from corporate funds; and (3) against the maintenance of undisclosed corporate funds. II REPORT OF THE SPECIAL COMMITTEE TO THE BOARD OF DIRECTORS OF ASHLAND OIL, INC. Exhibits R-2, R-3, R-4 (June 26, 1975).

United Brands is in the process of formulating a code of conduct for the company. Wall St. J., Aug. 19, 1975, at 7, col. 1. The Investor Responsibility Research Center, Inc. notes in its report, "The Corporate Watergate," that a number of experts feel that companies can themselves control questionable activities abroad. The Center believes corporations wishing to prevent unethical or illegal behavior could: (1) adopt a statement of practices to be avoided with severe disciplinary penalties for violations, (2) implement controls to monitor the behavior of employees, (3) utilize outside directors to monitor the conduct of senior corporate officials, and (4) make public information such as a brief description of the company's policies and a statement of any "untoward" transactions, or the lack thereof, which have occurred. N.Y. Times, Nov. 10, 1975, at 52, col. 1. See also N.Y. Times, Feb. 2, 1976, at 35, col. 4; *How Companies React to the Ethics Crisis*, BUS. WEEK, Feb. 9, 1976, at 78-79. See also Brown, *Ethics & Earnings, Profit-Minded Chief At Bendix Tries to Set A Businessmen's Code*, Wall St. J., Nov. 18, 1975, at 1, col. 1.

¹⁸² Commission on Transnational Corporations, Report on the First Session, 59 U.N. ECOSOC, Supp. 12, at 9, U.N. Doc. E/5655 E/C.10/6 (1975).

private and public enterprises engaged in foreign direct investment.¹⁸³ Agreement appears unlikely. Developing nations, because of the importance of raw materials in a world facing resource scarcities, see their bargaining position on the upswing.¹⁸⁴ They probably will not want to enter into a code embodying various compromises and using the present institutional norms as the starting point for the delineation of basic principles.

Even if developed and developing nations could agree on standards of conduct for multinational enterprises, the code or treaty must include a satisfactory sanctioning mechanism to operate either through an international agency or through the respective signatory nation-states. Several problems surround the establishment of an international enforcement agency. Regulation by a branch of the United Nations or newly created international agency outside the United Nations might prove too weak, slow, or inefficient. Nevertheless, developing countries would probably feel more comfortable with a United Nations agency. Developing nations may also contend that any international regulatory agency, whether under the auspices of the United Nations or not, may develop a "sympathy" for the corporate entities regulated, with business interests taking precedence over "public interest." Multinational corporations and developed countries, on the other hand, might desire a transnational regulatory body not connected with the United Nations due to the large number of developing countries who, as members, wield much power as a voting bloc.

It is also possible that business groups, corresponding to bar associations, could be established to police an ethical code. Such a code would be most practical if it imposed standards and sanctions on major global firms headquartered in different nations. Adequate enforcement provisions may prove a problem, however. Corporations will probably resist any code containing strict sanctions unless all corporations in an industry, at least nationally and preferably, internationally, are bound by the same sanctions and enforcement machinery. In such event, corporations may prove more amenable to industry-wide standards.

Agreement must also be reached on the specific functions of an international enforcement agency. The agency could perform several possible tasks, including consultation, information gathering, pro-

¹⁸³ *Id.* at 9-10. The disparate list of areas of concern regarding the operations and activities of transnational corporations submitted by the Group of 77 and the note submitted by the delegations of France, the Federal Republic of Germany, Italy, the United Kingdom, and the United States also indicated the different concerns of developing and developed nations. *Id.* Annex I, II at 18-21.

¹⁸⁴ See *id.*, Annex I at 18-19, Items 12-21; Martin & Ricklefs, *Commodity Power, Third World Presses to Stabilize the Prices of U.S. Raw Materials*, Wall St. J., July 3, 1975, at 1, col. 6.

mulgation of detailed regulations with the power to enforce such standards, investigation and preparation of non-binding reports, and arbitration of disputes, the decisions in which nation-states and multinational corporations would be "obligated" to effectuate.¹⁸⁵ However, as evidenced by the refusal of many developing nations, particularly Latin American nations, to sign the Convention on the Settlement of Investment Disputes between States and Nationals of other States, formulated by the World Bank,¹⁸⁶ Third World nations remain unwilling to surrender autonomy to a dispute-resolving mechanism which they perceive as dominated by developed nations.¹⁸⁷ Developed nations will also manifest intransigence if they view the agency as unduly favorable to the interests of developing countries. The functions of any agency would have to be structured with these concerns in mind. Other problems involved in setting up an international regulatory agency include the financing of such a body; the composition of the membership of the agency—for example, whether multinational corporations should be eligible for membership; the selection of the voting system; and the corollary question of who will have the controlling voice in the selection of the top administrators and the personnel who resolve disputes.

Facing such a magnitude of enforcement difficulties, it may be preferable to abandon the agency approach and opt instead for home and host nations to impose sanctions for violations of code or treaty standards. This approach is not without several problems, however. Unless the sanctioning is mandatory, home nations may choose not to invoke sanctions against multinational corporations in certain instances. Even if the sanctioning systems were mandatory, the sanctions imposed probably would lack uniformity. The transnational code or agreement should, therefore, contain a requirement that home and host countries impose sanctions in accordance with due process of law in the respective nation. This solution may nonetheless be unsatisfactory to developed nations and multinational corporations, as due process of law of a host nation may allow expropriation without timely payment of adequate compensation.

¹⁸⁵ See Vagts, *Formal and Structural Problems of International Organization for Control of Investment*, INTERNATIONAL CONTROL OF INVESTMENT 234-45 (D. Wallace ed. 1974).

¹⁸⁶ The Convention on the Settlement of Investment Disputes between States and Nationals of other States created the International Centre for Settlement of Investment Disputes. The Convention was designed to facilitate the flow of funds to developing countries by providing arbitration and conciliation facilities to deal with investment disputes between governments of signatory states and nationals (private investors) of other signatory states. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, done March 18, 1965, [1966] 1 U.S.T. 1270, T.I.A.S. No. 6090, 575 U.N.T.S. 160.

¹⁸⁷ See, e.g., Szasz, *The Investment Disputes Convention and Latin America*, 11 VA. J. INT'L L. 256 (1971); Diaz Alejandro, *Direct Foreign Investment in Latin America*, THE INTERNATIONAL CORPORATION 319, 338 (C. Kindleberger ed. 1970).

Theoretically, then, the formation of a transnational code of conduct would seem to present the optimal solution to the problem of regulating the activities of multinational corporations. In view of all the problems surrounding implementation of such a code—including reconciling divergent interests of developing and developed nations, prescribing effective sanctions, and determining what organizational format the code would adopt—it is unlikely that a transnational code is presently practicable.

CONCLUSION

A meaningful solution to the problem of corporate foreign payments is necessary if we are to both instill confidence in American corporations at home and preserve the competitive position of American corporations abroad. Regulation of corporate activity may take place on several levels: national, corporate, or international. As has been demonstrated, attempts at resolving the problem of multinational corporate activities has met certain obstacles at each level. The machinations of American corporations are subject to legal scrutiny at home. Thus, the disclosure provisions of the securities laws may afford a partial solution—particularly if the concept of integrity disclosure is given full recognition—as may action by Congress or such executive agencies as the Treasury and Justice Departments. Yet regulation solely by the United States may weaken the corporations' business position abroad, as competing foreign firms would not be held to the same standards. A partial solution may also derive from adoption of firm policy standards by corporations that have chosen to police themselves. While several corporations have taken the initiative in this area, it remains to be seen whether the delineation of strict standards for international conduct is matched by effective self-imposed enforcement procedures.

Given the realities of the market place and the international situs of the transactions, the only complete solution to the problems engendered by transnational corporate political and financial schemes is one which would govern the conduct of all corporations and one to which all host countries would be signatories; that is, a pervasive transnational code of conduct. However, while some organizations, notably the OECD, are attempting to formulate such a code, it appears unlikely that the diverse interests of the developing and developed nations and the multinational corporations can be presently reconciled in the manner necessary to effectuate such a solution. Until such an international agreement can be

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reached, the responsibility to curb nefarious corporate activity remains with the individual home and host countries and with the corporations themselves.

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