

PART ONE THE ORIGINS OF THE FCPA: LESSONS FOR EFFECTIVE COMPLIANCE AND ENFORCEMENT

TOM GORMAN, PARTNER DORSEY & WHITNEY, FORMERLY WITH ENFORCEMENT DIVISION, US SECURITIES AND EXCHANGE COMMISSION

“They trusted us” — Judge Stanley Sporkin explaining why 450 corporations self-reported in the 1970s Volunteer Program without a promise of immunity.

This is the first part of an occasional series. The entire paper will be published by Securities Regulation Law Journal early next year.

Introduction

Can one man make a difference? Stanley Sporkin is proof that the answer is “yes.” In the early 1970s he sat fixated by the Watergate Congressional hearings. As the testimony droned on about the burglary and cover-up, the Director of the Securities and Exchange Commission’s (“SEC” or “Commission”) Enforcement Division sat mystified. Witnesses spoke of corporate political contributions and payments. “How does a public company book an illegal contribution” the Director wondered. “Public companies are stewards of the shareholder’s money – they have an obligation to tell them how it is used” he thought. He decided to find out.

The question spawned a series of “illicit” or foreign payments cases by the Commission resulting in the Volunteer Program. Under the Program, crafted by Director Sporkin and Corporation Finance Director Alan Levinson, about 450 U.S. corporations self-reported illicit payments which had been concealed with false accounting entries. There was no promise of immunity but the Director had a reputation for doing the right thing, being fair. Ultimately the cases and Program culminated with the passage of the Foreign Corrupt Practices Act (“FCPA”), signed into law by President Jimmy Carter in 1977.

Today a statute born of scandal and years of debate continues to be debated. Business groups and others express concern about the expansive application of the FCPA by enforcement officials and the spiraling costs to resolve investigations. Enforcement officials continue to call for self-reporting, cooperation and more effective compliance. While the debate continues, both sides might do well to

revisit the roots of the FCPA. The success of the early investigations and the Volunteer Program is not attributable to overlapping enforcement actions, endless investigations, draconian fines and monitors. Rather, it was a focus on effective corporate governance – ensuring that executives acted as the stewards of shareholder funds. Director Sporkin called this “doing the right thing.” A return to that focus may well end the debate and yield more effective compliance and enforcement.

The beginning

The Watergate Congressional hearings transfixed the country. A scandal was born from a burglary at the Watergate Hotel in Washington, D.C. by the Committee to Reelect the President, known as CREP. The hearings were punctuated by a series of articles in The Washington Post based on conversations with a source known only as “deep throat.” Later the two reporters would become famous. President Richard Nixon would resign in disgrace. His senior aides would be sentenced to prison. *See generally*, Carl Bernstein & Bob Woodward, *All the President’s Men* (1974).

A little-noticed segment of the hearings involved corporate contributions to politicians and political campaigns. Most observers probably missed the slivers of testimony about illegal corporate conduct since they were all but drowned in the seemingly endless testimony about the burglary, cover-up and speculation regarding the involvement of the White House.

One man did not. Then SEC Enforcement Director and later Federal Judge Stanley Sporkin was fixated. He listened carefully to the comments about corporate political contributions. The Director wondered how the firms could make such payments without telling their shareholders: “You know, I sometimes use the expression, ‘only in America could something like this happen.’ There I was sitting at my desk . . . and at night while these Watergate hearings were going on I would go home and they’d be replayed and I would hear these heads of these companies testify. This fellow Dorsey from Gulf Oil . . . and it was interesting that somebody would call Gulf Oil and they would say we need \$50,000 for the campaign.

Now everybody, I knew that corporations couldn't give money to political campaigns . . . what occurred to me was, how do you book a bribe . . . " A Fire Side Chat with the Father of the FCPA and the FCPA Professor, Dorsey & Whitney LLP Spring Anti-corruption conference, March 23, 2014, available at www.SECHistorical.org. at 3 ("Transcript").

What, if any information did the outside auditors have was another key question, according to the Director. Stanley Sporkin, "The Worldwide Banning of Schmiergeld: A Look at the Foreign Corrupt Practices Act on its Twentieth Birthday," 18 Nw. J. Int. L. & Bus. 269, 271 (1998) ("Sporkin"). Not only was he fascinated by the testimony but "something bothered him [Director Sporkin]. It was the thought of all that money moving around in businessmen's briefcases. That money belonged to corporations. Corporations belong to investors. The SEC protects investors. So Sporkin investigated." Mike Feensilber, *He Terrorizes Wall Street*, The Atlanta Constitution, Section C at 19, col. 1 (March 21, 1976) . . .

An informal inquiry was initiated. As Judge Sporkin recounts: "To satisfy my curiosity [about how the payments were recorded in the books and records] I asked one of my staff members to commence an informal inquiry to determine how the transactions were booked." Sporkin at 571. This "was not one of these elaborate investigations where you have 5 people. I called in a guy named Bob Ryan and I said, Bob, go to Gulf Oil." Transcript at 3. A day later the answer came back: "[W]hat happened was that Gulf Oil had set up two corporations; one called the ANEX, one called the ANEY, capitalized . . . with the \$5 million each; took the money back to New York, put it into [Gulf Chairman] Dorsey's safe at the head of Gulf Oil and there he [Dorsey] had a slush fund, a corporate fund of \$10 million." *Id.* at 4. The payments were not reflected in the books and records of the company – the shareholders were not told how their money was being used. It was apparent that corporate officials "knew they were doing something that was wrong because the reason they set [it] up this was . . . is because they didn't want to expense the money so they capitalized it. And why did they want to expense the money . . . [Director Sporkin explained is] Because they were afraid, not of the SEC, but of the IRS. So it . . . right from the beginning . . . it showed me that there was something afoul here," Director Sporkin later recounted. *Id.* at 4. Indeed, it was clear that senior corporate officials had painstakingly designed a methodology to secrete what they knew were wrongful transactions. Sporkin at 271.

PART TWO

The illicit or foreign payments cases

The preliminary inquiry was followed by formal SEC investigations early in 1974. The resulting cases would become known as the “illicit or foreign payments” cases. The focus of the investigations was on corporate accountability and governance, not the propriety of making the payments. Report of the S.E.C. on Questionable and Illegal Corporate Payments and Practices, submitted to the Committee on Banking, House and Urban Affairs, U.S. Senate (May 1976) (“SEC Report”). If shareholder funds entrusted to corporate officials were being used to make political contributions, pay bribes and take other, similar actions, there should be disclosure.

Shareholders are entitled to know how their money is being used, the manner in which their company is operating and the type of stewards who work for them. As Director Sporkin stated: “Our concept was to get the information to the shareholders and let the shareholders make decisions on what they wanted to do.” Transcript at 14. That theme was echoed in the SEC Report to Congress on its enforcement efforts in 1976: “Disclosure of these matters reflects the deeply held belief that the managers of corporations are stewards acting on behalf of the shareholders, who are entitled to honest use of, and accounting for, the funds entrusted to the corporation and to procedures necessary to assure accountability and disclosure of the manner in which management performs its stewardship.” SEC Report at 20. The investigations focused on several prominent corporations. A variety of conduct was uncovered.

In a number of instances facilitation payments were found, that is, those made to obtain the performance by foreign officials of their duties;

- In others, excess sales commissions and kickbacks were uncovered;
- Off the book transactions were discovered;
- Falsified corporate records were discovered along with secret slush funds used for a variety of purposes;

The corporate records did not reflect accurately how shareholder funds were used – they concealed the transactions, the source of the funds and the fact that their application was for illegal purposes. *See, e.g.,* Statement of SEC Chairman Roderick M. Hills Before the Subcommittee on Consumer Protection and Finance, House Committee on Interstate and Foreign Commerce at 2 (Sept. 21, 1976) . . .

Collectively, these practices “cast doubt on the integrity and reliability of the corporate books and records which are the very foundation of the disclosure system established by the federal securities laws.” SEC Report at 3.

In January 1974 the SEC considered the issuance of what would become Securities Act Release No. 5466 (March 8, 1974) and a recommendation from Director Sporkin and the Division of Enforcement to file the first enforcement action stemming from the illicit payment investigations. The Commission carefully deliberated a series of issues before authorizing the Release and the enforcement action. SEC Commissioner John Evans recounted those deliberations: “Before making the decision to file the complaint [in *SEC v. American Shipbuilding*], and before voting to accept the settlement, various members of the Commission expressed concern, and there was considerable discussion that this application of the securities laws and enforcement approach would lead to undesirable results. Although there was some speculation at the time, we could not have known, of course, that our program would result in the disclosure of illegal or questionable payments by many corporations to recipients throughout the world. We could not have known that investigations by independent company committees would bring about the replacement of top management officials of some major corporations. We could not have known that some corporations had made payments which, if disclosed, would result in political crises in foreign countries.” SEC Commissioner John Evans, Remarks at Northwest State-Federal-Provincial Securities Conference at 5 (May 13, 1976), (“Evans”), available at <http://www.sec.gov/news/speech/1976/051376evans.pdf>.

Director Sporkin and the Commission did not think that additional legislative authority was necessary to support the proposed enforcement action. The securities laws provided a firm foundation in their view. Sporkin at 274.

Materiality was a key question carefully evaluated by the five Commissioners and the Enforcement Division. That concept was generally defined at the time in objective terms, considering, information which a reasonable investor might find useful. See e.g., *Mills v. Electric Auto-Lite Co.*, 396 U.S. 375 (1970). Two years later the Supreme Court further developed that standard in *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976). A key point in the materiality discussions, as Commissioner Evans recounted, was the fact that most of the illegal or questionable payment cases involved false and fictitious entries on the corporate books and records and the filing of false and misleading reports with the Commission. These two points “were weighed heavily in our decisions [to bring the actions] . . . Any diversion of funds outside the corporate system, or any deception with respect to corporate books and records, cannot be permitted without undermining the purposes of the securities laws,” the Commissioner noted. Evans at 9.

Later in its Report to Congress the Commission reiterated its view on materiality: “[Q]uestionable or illegal payments that are significant in amount or that, although not significant in amount, relate to a significant amount of business, are material and required to be disclosed . . . [if the payments are] unknown to the board of directors, [it] could be grounds for disclosure regardless of the size of the payment itself or its impact on dependent business because the fact that corporate officials have been willing to make repeated illegal payments without board knowledge and without proper accounting raises questions regarding improper exercise of corporate authority and may also be a circumstance relevant to the ‘quality of management’ that should be disclosed to the shareholders. . . [in addition] a questionable or illegal payment could cause repercussions of an unknown nature which might extend far beyond the question of the significance either of the payment itself or the business directly dependent upon it. For example, public knowledge that a company is making such illegal payments, even of a minor nature, in one foreign country could cause not only expropriation of assets in that country but also similar a similar reaction or a discontinuation of material amounts of business in other counties as well.” SEC Report at 15.

One major oil company that made such payments, for example, had that fact asserted as the basis for an expropriation by a Latin American Republic. *Id.* Another point considered was the fact that substantial criminal penalties could be imposed on the organization –something shareholders should be told, according

to Director Sporkin. Sporkin at 275. Likewise, concealing the fact that the company is securing business through the payment of bribes could also shroud underlying difficulties with the business. If, without the payment of the bribes, the company cannot compete effectively, there may be difficulties with the business model, its products or the manner in which it is competing in the international market place. Shareholders would have a right to such information. *See, e.g.,* Edward Herlihy and Theodore Levine, *Corporate Crisis: The Overseas Payment Problem*, 8 *Law & Policy In International Business* 547, 575-576 (1976) (“Herlihy & Levine”).

And, all of these factors reflected on the stewards of the corporation, the management entrusted with the funds of the shareholders: “This factor is important because investors have a right to be informed regarding the integrity of management in connection with the administration of corporate affairs and assets,” Commissioner Evans noted in recounting the SEC’s discussions on the point. Evans at 10.

The SEC authorized the issuance of the Release and the filing of its first enforcement action from the illicit payment investigations at the January meeting. Evans at 2. The enforcement action was against American Ship Building Company and its CEO. The complaint centered on the payment of about \$120,000 in political contributions and other payments falsely booked as payments to employees in the corporate records. *SEC v. American Shipbuilding Co.*, Civil Action No. 74 -588 (D.D.C. Filed October 4, 1974). It alleged violations of the proxy and periodic reporting requirements by failing to disclose that corporate funds had been used to make political contributions. The complaint also alleged that the books and records of the company had been falsified to conceal these facts from the shareholders. This would become the first of the illicit or questionable payments cases. *Id.*

In the Commission’s view the filing of this enforcement action should have indicated that “the standard for disclosure in such a case was not traditional economic materiality, but that such payments reflected on the integrity of management.” Evans at 4.

The Release focused on disclosure obligations when there was a conviction, a guilty plea, or pending indictment alleging that the federal election laws had been

violated. It also noted that in other instances management was in the best position to assess the issuer's disclosure obligations. The Release was issued as Securities Act Release No. 5466 (March 8, 1974).

The *American Shipbuilding* enforcement action was settled at the time of filing with a consent decree. It would become a predicate for other similar cases. The focus of the settlement was an injunction effectuated by Court-ordered undertakings which included:

- A requirement to establish a review committee which included a chairman not affiliated with the company;
- A directive that the committee examine all the books and records of the company beginning with September 1970;
- A directive that the examination focus on expenses or payments entered on the books and records of the company for purposes other than those indicated;
- The Committee was required under the order to prepare a report and submit its findings to the court, the Commission and the board of directors; and
- A requirement that the board reviews the report and take the appropriate action to implement its recommendations.

PART THREE

The foreign payments cases held the organization and the individuals involved accountable while improving corporate governance for the benefit of the shareholders in the future. A series of cases followed the initial filings. Examples include:

- *SEC v. Gulf Oil Corporation*, Civil Action No. 75-00563 (Filed March 11, 1975) in which the complaint alleged that the company disbursed over \$10 million to various subsidiaries, including the Bahamas Exploration Company, through false book entries in the records of the company. About \$5.4 million was converted to cash and returned to the United States to make domestic political contributions or to disburse overseas.

· *SEC v. Lockheed Aircraft Corporation*, Civil Action No. 76-0611 (D.D.C. Filed April 13, 1976) in which the complaint alleged that the company paid at least \$25 million in corporate funds to foreign government officials, including officials in Japan and Italy. In addition, over \$200 million was paid to various consultants and agents without adequate records or controls to ensure that the payments were used for the purpose indicated in the records and that the services were received. The complaint also alleged that the company maintained a secret cash fund of at least \$750,000 which was used in part to make payments to foreign government officials.

· *SEC v. Foremost-McKesson, Inc.*, Civil Action No. 76-1257 (D.D.C. Filed July 7, 1976) in which the complaint alleged that the firm made payments of \$6 million in cash and merchandise to retailers and wholesalers to induce the purchase of wine and spirits distributed by the company. It also alleged that at least \$213,000 was paid to various government officials to impact government policy and that the books and records were falsified.

· *SEC v. General Tire & Rubber Co.*, Civil Action No. 76-0799 (D.D.C. Filed May 10, 1976) in which the Commission alleged that under the direction of the president of the company funds were diverted for political purposes by purporting to increase bonuses and salaries. Slush funds were created, including one with the knowledge and approval of senior management of the international division, which totaled \$3.9 million. It was used to pay foreign government officials. Another fund maintained by a foreign subsidiary was used in conjunction with five major tire companies to finance efforts to secure a price increase from a foreign government. *See also* SEC Report at 7.

The Commission's illicit payment actions were brought against some of the most prominent corporations in the U.S. They included: Minnesota Mining & Manufacturing Co. (1975); Phillips Petroleum Co. (1975); Northrop Corporation (1975); Gulf Oil Corporation (1975); United Brands Company (1975); Ashland Oil, Inc. (1975); General Refractories Co. (1975); Braniff Airways, Inc. (1976); Waste Management, Inc. (1976); Lockheed Aircraft Corporation (1976); General Tire & Rubber Company (1976); Firestone Tire & Rubber Company (1976); and Foremost-McKesson (1976). Herlihy & Levine at 578 n. 185 (collecting cases); *see also* SEC Report at 3.

Many of the cases brought named senior corporate officials as defendants in addition to the company. The following are examples of actions brought against the firm where one or more senior executives were named as defendants:

- American Shipbuilding Company — George M. Steinbrenner, III, CEO;
- Minnesota Mining & Manufacturing — Harry Heltzer, CEO; Irwin Hansen, Director and former vice president; Bert Cross, former Chairman of the board;
- Phillips Petroleum — William Keeler, former Chairman of the Board of Directors and CEO; John Houchin, former president and chairman of the board; William Martin, Chairman of the Board and CEO; Carstens Slack, vice president;
- Gulf Oil Corporation – Claude Wilde, Jr. former vice president; and
- Northrop Corporation — Thomas Jones, President and CEO; James Allen Director and former vice president.

The naming of the executives was consistent with the overall approach of these cases.

Each action centered on the notion that corporate officials were the stewards of shareholder funds. In that capacity they had an obligation to account to the shareholders whose money they utilized, and tell them how their funds were used. *See generally* Sporkin at 274.

The remedies in these cases were driven by Director Sporkin's vision of what the cases were about: I "always tried to look at how to create something for the overall good; to create something with a purpose. The purpose was if we could get all companies to have honest books and records and what not that would be a good purpose," the Director later noted. Transcript at 17. Thus the consent decrees typically included an injunction based on the Sections of the securities laws cited in the complaint. The injunction was implemented and given meaning through a series of court ordered undertakings which were carefully crafted to ensure that shareholders were informed how their funds were being utilized to strengthen corporate governance. Typically a special board committee would be

created, chaired by independent director since many firms did not have an audit committee. A report would be prepared under the direction of the committee with the assistance of outside counsel and the auditors. That report would be filed with the SEC and distributed to the board of directors. It would contain recommendations for improving corporate governance systems. Those recommendations would be implemented by the company as ordered by the court. Summaries of these reports are available in Appendix B to the SEC Report.

The reports generated in these actions served as models for other companies and the future. One of the most comprehensive was that of Gulf Oil.

- The report was prepared by a special committee headed by John J. McCoy, Esq.
- The nearly 300 page report was supported by six appendices;
- It analyzed more than \$12 million of corporate funds for payments to government officials in the U.S. and overseas;
- The report detailed the responsibility of corporate management for years of misusing funds;
- It contained recommendations to avoid the reoccurrence of the improper conduct; and
- Following the completion of the report the independent directors on the Gulf board replaced senior management.

The reports prepared in other cases were similar. The specific recommendations were tailored in those reports to the facts and circumstances at the company. They included revisions to corporate policies and procedures, requirements that restitution be made by those involved and directives that employees be discharged. Summaries of these reports are available in Appendix B to the SEC Report. In each instance the focus was on using the equitable powers of the court – the SEC did not have the authority to impose fines and did not seek disgorgement – to “make sure things went well” according to Director Sporkin. Transcript at 6.

The approach to remedies centered on halting violations and preventing a reoccurrence of wrongful conduct. A central point was the impact on long-term corporate practice and governance. In this regard what two SEC officials stated at the time regarding the Gulf report applies equally to the significance of the program:

“Long after the present furor in reaction to overseas corporate payments has passed, the Gulf report will survive as an invaluable resource tool providing a revealing portrayal of the operations of a major company, the evolution of ethical practices in business, and as a model for remedial action in the future.” Herlihy & Levine at 584.

PART FOUR

The volunteer program

The corporate payments issue and the SEC investigations and actions garnered significant publicity, spurring controversy that continues today. Congress initiated hearings that went on for the next two years. In corporate and business circles in the U.S. and abroad there were discussions on topics which ranged from the propriety of the payments to the authority of the SEC to bring the actions. Remarks of SEC Chairman Roderick Hills, Yale Law School (May 1, 1976) (“Hills at Yale”).

As the contours of the problem emerged it became apparent that a new approach was required. SEC Commissioner Philip Loomis, testifying before the Subcommittee on International Economic Policy, the House of Representative Committee on International Relations, suggested that corporations potentially facing a difficulty could have discussions with the SEC staff about the issue. See *generally* SEC Report at 6-7; Herlihy & Levine at 585. Commissioner Loomis’ suggestion grew into a program crafted by the Directors of the SEC’s Divisions of Enforcement, Stanley Sporkin, and Corporation Finance, Alan Levenson. It was called the Volunteer Program.

The program called for corporations that had made questionable payments to self-report to the SEC. Modeled on the early enforcement cases and settlements,

it required that the company take a series of steps to resolve the situation voluntarily rather than be subjected to an SEC investigation. Those included:

- *Investigation:* A careful, in-depth investigation into the facts surrounding the questionable or illegal payments had to be conducted. A committee of the board of directors would supervise the investigation. Members of the committee could not be officers or involved in the activity. The committee should seek the assistance of the outside auditors and retain outside counsel.

- *Scope of the inquiry:* The investigation should cover the prior five years since that is the period reflected in the financial statements. Periods prior to that time should also be reviewed if the activities appear to be part of continuing actions or related to those within the period.

- *Report:* A report should be prepared by the committee at the conclusion of the inquiry and submitted to the full board of directors. That report should contain detailed information about each payment, its purpose and amount, the recipient and the country where it was made along with the surrounding circumstances.

- *SEC Staff access:* The SEC staff was required to have access to the report and its underlying documentation. The materials would be subject to the Freedom of Information Act. In practice certain accommodations were made. Some issuers expressed concern regarding the publication of sensitive information. In those instances the company initially declined to produce or file the requested materials.

The Commission then initiated a subpoena enforcement action. In that action the Commission would obtain an order directing the production of the materials. At the same time the Court would typically enter a protective order regarding certain sensitive materials. *See, e.g. SEC v. Lockheed Aircraft Corp.*, 404 F. Supp. 651, 652 (D.D.C. 1975) (subpoena enforcement action in which the documents were ordered produced and a protective order was entered).

- *Adoption of policies:* The board of directors should issue an appropriate policy statement regarding questionable or illegal payments. It should typically include a statement that the activities have ceased. The adoption of such a policy should be communicated to appropriate corporate personnel and implemented by adequate internal controls and safe guards.

· *Filing*: At the conclusion of the investigation a final report of material facts had to be filed with the Commission, generally on Form 8-K. That filing should include a discussion of the inquiry and a commitment to complete it if necessary; an undertaking by the company regarding the termination of the payments; and a detailed discussion of the transactions. SEC Report at 8-10.

The program did not offer issuers or those involved immunity from prosecution, or even promise “cooperation credit.” It did not require the company to consult with the SEC staff. It was an effort to spur corporate self-governance since the illicit or questionable payment cases graphically illuminated serious corporate self-governance issues. As then Chairman Roderick Hills stated at the time:

“It is apparent that our system of corporate self-regulation policed by independent auditors, directors and counsel and ultimately enforced by the SEC has broken down.

Hundreds of millions of dollars have been siphoned out of corporate cash flow and spent out of slush funds with the knowledge of some members of top corporate management but without the knowledge of the outside directors, outside auditors and stockholders. No matter that it is only a score or so out of thousands, some are among the biggest and the most audited corporations in the world. If they can do it, who can't? ” Hills at Yale at 7.

The Volunteer Program was a step toward repairing and strengthening corporate self-governance under the supervision of the board of directors and its independent directors and outside auditors and counsel. It also had certain pragmatic aspects: “The voluntary program offers advantages to both the company and the Commission. It enables the company to conduct its own investigation without the involvement of the staff of the Commission, which would tend to tie up the company’s personnel and disrupt its business. From the Commission’s point of view, the program permits a substantial number of companies to be examined without cutting into the availability of the Commission’s limited staff for other enforcement work. Herlihy & Levine at 586.

The program was a huge success. Overall about 450 corporations stepped forward, conducted comprehensive internal investigations, remediated the issues and provided their heir findings to the SEC staff and shareholders. Sporkin at 273. Within months of its announcement, nearly 100 companies joined the program. A wide variety of corporate conduct was uncovered. As SEC Chairman Hills stated in analyzing the early returns for the program in May 1976: “The revelations are of a wide variety. Some corporations have disclosed annual payments of millions of dollars. Others indicate that they made far smaller payments. Some payments were clearly designed to cause illegal actions by government or business officials, but some were to persuade persons to do jobs they were supposed to do without ‘tips.’ Some were authorized, or at least known of, by top corporate officials who deliberately permitted corporate books to be distorted in order to deceive outside directors, lawyers, and accountants and shareholders; others were carried out by low-level officials, either in violation of general corporate policy or under corporate procedures that carelessly permitted the practices to continue to grow.” Hills at Yale at 3.

The SEC report to Congress shed additional light on the kinds of conduct uncovered as the program unfolded:

- The two largest identifiable groups of companies that self-reported were drug manufacturers and those in the petroleum refining and related services business;
- The most common transactions were payments to foreign officials;
- A significant number of companies reported that at least some member of corporate management had knowledge of the transactions;
- Most reported the falsification of corporate records or the maintenance of records that appear to be inadequate; and
- Many of the defects in the financial systems represented intentional efforts to conceal the activity. SEC Report at 37-41, Appendix (chart summarizing the initial findings from the program, identifying the company, the nature of the issues, the knowledge of management and the steps taken).

PART FIVE

The Congressional debates

The revelations from the Watergate hearings and the Commission's investigations and enforcement actions sparked two years of Congressional hearings. Those revelations also spawned a widespread debate in the United States and abroad regarding the corporate conduct, the Commission's actions and what, if anything, should be done. In some quarters the revelations engendered reform efforts. "In the business community many companies initiated reform efforts, separate and apart from those organizations involved in the volunteer program. In a number of instances the disclosures "prompted outside directors to increase their involvement in and knowledge of corporate affairs. In many cases, these outside directors reportedly have been instrumental in initiating internal investigations and requiring more stringent auditing controls." *Id.* at 44-45.

The boards of directors at many companies issued orders directing that the kind of conduct identified in the Commission's cases be halted. *Id.* Many companies adopted or reformed their corporate code of conduct.

Many of those policies prohibit the use of corporate funds or assets for unlawful or improper purposes. A number of firms also included provisions regarding the documentation of payments. The new or revised policies were typically distributed to employees. SEC Report at 48-49.

The accounting profession also instituted reforms keyed to the type of conduct identified in the SEC's actions. Many firms digested the Commission's cases and related news articles, distributing the material throughout the firm. The major accounting firms instituted a series of specific steps which included:

- 1) Establishing procedures to ensure that information relating to questionable payments is brought to the attention of senior personnel;
- 2) Establishing policies to assure that questionable or sensitive transactions are brought to the attention of the board of directors, preferably the audit committee;
- 3) Preparing educational materials for clients which encourage the adoption of policies relating to ethics in business transactions;

- 4) Adopting policies that encouraged clients to voluntarily disclose information regarding questionable payments to the Commission;
- 5) Extending audit procedures in appropriate circumstances; and
- 6) Modifying representation letters to include statements about questionable or illegal payments. *Id.* at 52.

The Auditing Standards Executive Committee of the American Institute of Certified Public Accountants also considered reform and the SEC urged the Exchanges to consider new listing requirements. The former prepared an exposure draft on "Illegal Acts by Clients." *Id.* at Exhibit C. As to the latter, SEC Chairman Roderick Hills wrote a letter to the Chairman of the New York Stock Exchange suggesting that the Exchange consider adopting a requirement that firms have an audit committee composed of independent directors as part of its listing standards. The Commission had been seeking to have boards establish an audit committee composed of independent directors since 1940. Letter of SEC Chairman Roderick Hills to William Batten dated May 11, 1976, discussed in SEC Report, Exhibit D.

Many were highly critical of the actions taken by the Commission. Some thought the cases should not have been brought. Others claimed that the sums involved were not material. Still others argued that since many of the transactions took place in foreign countries the issue was one of local law in the particular country. Then SEC Chairman Roderick Hills summarized many of these points in a speech delivered at Yale Law School in 1976:

· One commentator stated that the questionable payments cases were just another experiment doomed to fail, comparing the cases to prohibition: "America's unlamented noble experiment with prohibition in the 1920's made more sense than this new crackdown. Back then, the do-good arguments for banning booze worked out as a bonanza for crime, corruption, and conspiracy. Now the SEC's new experiment in righteousness is about to backfire too. It will register more laughter abroad than sales. Washington's cleanup code for corporations under pressure to pay off abroad is reducing America to a role of 'a pitiful, helpless giant' . . ."

· Another comment from a distinguished Washington lawyer and former SEC staff member noted: ““What function remains for the SEC here? I submit; none. The Commission is plainly out of its ballpark . . . ””

· A state court judge wrote: ““I read your bureaucratic blurb in the *Wall Street Journal* today (about foreign payment cases). You are out of your mind. Stockholders don’t give a good damn.”” Hills at Yale at 2.

Throughout the Congressional hearings there was a significant debate regarding how to address the question. Opinions ranged from doing nothing to drafting additional disclosure requirements or to criminalizing foreign bribery. The SEC considered its existing authority adequate. At the same time the Commission favored adding additional provisions focused on disclosure and internal controls. The agency did not advocate anti-bribery legislation as the topic was out of its traditional disclosure role and such a provision could be difficult to enforce. As Director Sporkin later noted:

“we were a disclosure agency . . . Our concept was to get the information to the shareholders and let the shareholders make decisions on what they wanted to do.” Transcript at 14. It also sidestepped suggestions that the agency be given authority to bring criminal prosecutions as an unnecessary consideration at the time.

The Commission advanced proposed legislation to strengthen reporting requirements and internal controls. It had three key components: A prohibition against the falsification of corporate accounting records; a prohibition against making false statements to auditors; and a requirement that the company maintain a system of internal accounting controls. A draft bill reflected these points: 1) A proposed new Section 13(b) had two primary subcomponents: a) proposed 13(b)(2)(A) would require that every issuer “make and keep books, records and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer. . . .” ; b) A new proposed Section 13(b)(2)(B) would require every issuer to “devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that . . .” transactions were executed as authorized and in accord with GAAP; 2) A proposed Section 13(b)(3) would make it unlawful to falsify records required to be maintained, for an accounting purpose; and 3) A proposed new Section 13(b)(4)

would prohibit the making of false statements to the auditors. SEC Report at 63-64.

The Business Roundtable stated that it was opposed to the kind of conduct uncovered in the Commission's investigations. At the same time it argued that existing authority was sufficient to deal with the questions. Accordingly, no additional legislation was required. Koehler at 949. Other commentators thought that the passage of anti-bribery laws would strengthen the position of U.S. corporations doing business abroad who could then resist requests for the payment of bribes and gratuities as illegal. *Id.* at 944.

Departments within the Government took divergent views. The Department of State strongly opposed U.S. corporations making such payments. Such acts could interfere with and weaken U.S. foreign policy. *Id.* at 965. For example, some thought that payments made by Lockheed Corporation in Italy and Japan may well have damaged U.S. relationships. Indeed, in August 1976 the former Prime Minister of Japan was indicted for accepting \$1.7 million from Lockheed. The Netherlands was rocked by the Lockheed scandal. *Id.* at 941.

The State Department, however, opposed legislation that would directly prohibit and criminalize such actions when undertaken in foreign countries. *Id.* at 965. The Department also expressed concern that the disclosure of such transactions might make it more difficult for the U.S. Government to assist American firms in pursuit of their legitimate business interest with friendly government. *Id. See also*, Statement of the Chairman of the House Subcommittee on Int. Econ. Pol., 94th Cong. At 1-2 (1975) (Disclosure of these types of transactions could have ramifications not just for the country involved but also for the business enterprise in other countries. For example, the Republic of Peru expropriated the property of Gulf Corporation. Other Latin American countries were also considering expropriation legislation based on what the disclosures about corporate payments potentially impacting foreign elections).

The Department of Defense was in a difficult position. It produced a series of documents as well as witnesses. Later, Senator Proxmire, a leading proponent of the legislation that ultimately became the FCPA, summarized his views regarding the Defense Department noting: "One of the most disturbing aspects of this is the role the Defense Department has played, especially with respect to defense

contractors who sold abroad. We have a document which indicates that at one point a top official in the Defense Department had counseled defense contractors on paying bribes and urged them to do so under circumstances where it was necessary." *Foreign and Corporate Bribes: Hearings Before the Senate Comm. On Banking, Housing and Urban Affairs, 94th Cong. 46 (1976)* (statement of Senator William Proxmire, Chairman, Senate Committee on Banking, Housing and Urban Affairs at 110).

The questionable payments by corporations also had ramifications under other statutes and government programs such as the Internal Revenue Code, the antitrust laws, the role of the Overseas Private Investment Corporation in overseas investments and the Civil Aeronautics Board. See Herlihy & Levine beginning at 595; Koehler at 950-61.

Over the two years that Congress debated the foreign payments issues approximately twenty different bills were introduced. Koehler at 980. By the second year, a rough consensus developed that some form of legislation was required. The critical question became the approach – disclosure or criminalization. The SEC favored the former, concluding that criminal anti-bribery provisions would prove difficult to enforce and unworkable. Others thought the disclosure approach would prove ineffective.

Two key legislative proposals emerged. In March 1976 Senator Proxmire introduced S.3133 in the Senate. It combined the two approaches using both disclosure and criminalization. S.3133 contained a criminal payment provision and disclosure requirements. The bill was unique since it included both approaches. In May 1976 Senator Church, another leading proponent of legislation, introduced S.3418. This bill used the disclosure approach for a variety of payments. In June 1976 Representative Solarz, another leader on this issue, introduced H.R. 1434. It essentially used the approach of Senator Church's bill. Koehler at 985.

As these bills were being introduced, President Gerald Ford issued a memorandum to various federal agencies establishing a "Task Force on Questionable Corporate Payments Abroad." Gerald R. Ford, *Memorandum Establishing the Task Force on Questionable Corporate Payments Abroad*, available at <http://www.presidency.ucsb.edu/ws/?pid=5772>. The Task Force was chaired by Secretary of Commerce Elliott Richardson. Subsequently, the views of

the Task Force were summarized in a June 1976 letter to Senator Proxmire from its Chairman. The letter rejected the combined disclosure-criminal approach adopted by the Proxmire bill: “There are two principal competing general legislative approaches – a disclosure approach or a criminal approach. While it is possible to design legislation – as indeed is the case with S.3133 – which requires disclosure of foreign payments and makes certain payments criminal under U.S. law, the Task Force has unanimously rejected this approach. The disclosure-plus criminalization scheme would, by its very ambition, be ineffective. The existence of criminal penalties for certain questionable payments would deter their disclosure and thus the positive value of the disclosure provisions would be reduced. In our opinion, the two approaches cannot be compatibly joined.” Letter from Secretary of Commerce Richardson to Senator Proxmire, quoted in Koehler at 989-91.

The Task Force also rejected the criminalization approach, noting that while it would “represent the most forceful possible rhetorical assertion by the President and the Congress” on the issue it would “be very difficult if not impossible [to enforce].

Successful prosecution of offenses would typically depend upon witnesses and information beyond the reach of U.S. judicial process. Other nations, rather than assisting in such prosecutions, might resist cooperation because of considerations of national preference or sovereignty. Other nations might be especially offended if we sought to apply criminal sanctions to foreign-incorporated and/or foreign-managed subsidiaries of American corporations. The Task Force has concluded that unless reasonably enforceable criminal sanctions were devised, the criminal approach would represent poor public policy.” *Id.*

The Task Force adopted the disclosure approach, although it recognized that this might increase the paper work burden on American business. This approach is preferable because it “would supplement current SEC disclosure . . . [and] would provide protection for U.S. businessmen from extortion and other improper pressures, since would-be extorters would have to be willing to risk the pressures which would result from disclosure of their actions to the U.S. public and to their own governments . . .” Letter from Elliot Richardson, U.S. Secretary of Commerce to Senator William Proxmire, Chairman, Senate Committee on Banking, Housing

and Urban Affairs, quoted in Koehler at 990-91. Subsequently, President Ford issued new initiatives based on the Task Force report. *Id.* at 992.

With the election of President Carter and the opening of the 95th Congress after the 1976 election, the Task Force proposals lost force. *Id.* at 995. Subsequently, bills were introduced in the House and Senate which eventually, after modification in committee, became the FCPA. In February 1977 Representative Eckhardt introduced H.R. 3815. The bill used the criminalization approach based on the notion that the disclosure approach would be burdensome for business. In May 1977, Senator Proxmire introduced S.305 which was substantially similar to his earlier bill which had passed unanimously in the Senate during the prior legislative term. By November both bills had passed in their respective Chambers. Differences were reconciled in conference. *Id.* at 998.

The criminalization approach was adopted. As the Committee report stated: “The prevailing view was that the criminalization approach embodied in S.305 and H.R. 3815, along with supplemental books and records and internal control provisions that were agreed to in conference, represented the best legislative response to the foreign corporate payments problem.” *Id.*

Nevertheless, there continued to be strong minority views as noted in the House Report: “We support, without reservation, the goal of H.R. 3815, which is the elimination of foreign bribery. We are concerned, however, that the approach adopted by H.R. 3815 is not the most effective to eliminate questionable foreign payments [for the reasons stated by the Task Force] . . . We believe that adoption of the disclosure approach would, in no way, imply that payoffs would be condoned as long as they are disclosed. Rather, we believe that this approach would prove ultimately to be a much more effective deterrent . . . ” Quoted in Koehler at 998-99.

In December 1977 President Carter signed the bill into law. The journey was summarized by one leading commentator: “After more than two years of investigation, deliberation and consideration of the foreign corporate payments problem and the policy ramifications of such payments, and despite divergent views as to the problem and the difficult and complex issues presented, Congress completed its pioneering journey and passed the first law in the world governing

domestic business conduct with *foreign* government officials in *foreign* markets.”
Id. at 1002 (emphasis added).

PART 6

Conclusion: The FCPA Today

The FCPA was unique in the world at passage. It was born of controversy and scandal. The Watergate hearings which transfixed Director Sporkin and the rest of the country spawned unprecedented and far ranging issues and questions. The hearings ushered in a new era of moral questioning.

In the turmoil of that environment Director Sporkin focused on corporate governance, viewing corporate boards and officers as stewards of investor funds. That principled view propelled the SEC investigations, enforcement actions and the Volunteer Program, all of which culminated after two years of Congressional hearings and debate in the Foreign Corrupt Practices Act.

The statute was intended to implement the principles that gave rise to its birth. It was tailored and focused:

- *Bribery prohibited*: The anti-bribery provisions prohibit issuers and other covered persons from corruptly attempting, or actually obtaining or retaining, business through payments made to foreign officials;
- *Accurate books and records*: The books and records provisions were designed to ensure that issuers – those using money obtained from the public – keep records in reasonable detail such that they reflect the substance of the transactions;
- *Auditors get the truth*: Making misstatements to auditors examining the books and records of issuers was barred; and
- *Effective internal controls*: Companies were required to have internal control provisions as an assurance that transactions with shareholder funds are properly authorized and recorded.

The impetus for the passage of the FCPA was not a novel crusade but the basic

premise of the federal securities laws: Corporate managers are the stewards of money entrusted to them by the public; the shareholders are entitled to know how their money is being used. The settlements in the early enforcement actions and the Volunteer Program were designed to implement these principles. The FCPA was written to strengthen these core values.

Today the statute continues to be surrounded by controversy. While the FCPA is no longer unique in the world, U.S. enforcement officials are without a doubt the world leaders in enforcement of the anti-corruption legislation. A seemingly endless string of criminal and civil FCPA cases continues to be brought by the Department of Justice (“DOJ”) and the SEC. The sums paid to resolve those cases are ever spiraling. What was a record-setting settlement just a few years ago is, today, not large enough to even make the list of the ten largest amounts paid to settle an FCPA case. The reach of the once focused statute seems to continually expand such that virtually any contact or connection to the United States is deemed sufficient to justify applying the Act.

For business organizations the potential of an FCPA investigation, let alone liability, is daunting. Compliance systems are being crafted and installed which often incorporate each of the latest offerings in the FCPA market place at significant expense. If there is an investigation, the potential cost of the settlement is only one component of the seemingly unknowable but surely costly morass facing the organization. Typically business organizations must deal with the demands of two regulators in this country and perhaps those of other jurisdictions. The internal investigations that are usually conducted to resolve questions about what happened are often far reaching, disruptive, continue for years and may well cost more than the settlements with the regulators. Since most companies cannot bear the strain of litigating an FCPA case, enforcement officials become the final arbitrator on the meaning and application of the statutes – arguing legal issues may well mean a loss of cooperation credit with a corresponding increase in penalties.

Enforcement officials today continue to call for self-reporting as the SEC did at the outset of the Volunteer Program. Today, however, while many companies do self report since they may have little choice, there can be an understandable reluctance in view of the potential consequences. Indeed, self-reporting might be viewed as effectively writing a series of blank checks to law firms, accountants,

other specialists and ultimately the government with little control over the amounts or when the cash drain will conclude.

This is not to say that companies that have violated the FCPA should not be held accountable. They should. At the same time it is important to recall the purpose of the statutes: To halt foreign bribery and to ensure for public companies that corporate officials are accountable as faithful stewards of shareholder money. While business organizations may express concern about enforcement, accountability begins with the company, not the government. That means installing effective compliance systems using appropriate methods, not just adopting something off the shelf or purchasing the latest offering in the FCPA compliance market place. It means programs that are effective and grounded in basic principles, not just ones that furnish good talking points with enforcement officials if there is a difficulty.

The key to effective programs is to base them on the principles of stewardship which should be the bedrock of the company culture. Accountability for the funds of the shareholders begins with effective internal controls, a key focus when the statute was passed which remains critical today. As Judge Sporkin recently commented: “The problem I see in compliance is that they are not really putting in the kinds of effort and resources that’s necessary here. And I really think that you’ve got to get your compliance department, your internal audit department working together; in too many instances you find that they’re working separately.” Transcript at 18.

The focus is also critical. These systems are not just a defense to show regulators if something goes wrong. Rather, the systems should reflect the culture of the organization. As SEC Commissioner John Evans stated as the events which led to the passage of the FCPA were unfolding:

“I am somewhat concerned that the issue of illegal and questionable corporate payments is being considered by some in a context that is too narrow, legalistic, and short-sighted. In view of the objectives of the securities laws, such as investor protection and fair and honest markets, compliance with the spirit of the law may be more meaningful and prudent than quibbling about meeting the bare minimum legal requirements. I would submit that many companies and their profession accounting and legal advisers would serve their own and the public

interest by being less concerned with just avoiding possible enforcement action by the SEC or litigation with private parties and more concerned with providing disclosure consistent with the present social climate. Such a course of conduct should promote the company's public image, its shareholder relations, its customer relations, and its business prospects . . .” Evans at 14-15.

Accountability is also critical on the part of enforcement officials. Every case does not demand a draconian result with a large fine, huge disgorgement payments, multiple actions or a monitor. Every case need not be investigated for years at spiraling costs which may bring diminishing returns. The statutes need not be interpreted as an ever expanding rubber band with near infinite elasticity. Rather, enforcement officials would do well to revisit the remedies obtained in the early enforcement cases and those employed with great success in the Volunteer Program. And, they would do well to recall the reason 450 major corporations self-reported without a promise of immunity or an offer of cooperation credit: As Judge Sporkin said, “They trusted us.”