SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

MAR 18 1976

The Honorable William Proxmire
Chairman
Subcommittee on Priorities and
Economy in Government of the
Joint Economic Committee
Congress of the United States
Washington, D.C. 20515

Dear Senator Proxmire:

During my testimony on January 14, 1976, before the Subcommittee on Priorities and Economy in Government, I offered to provide written answers to four questions of particular concern to the Subcommittee. Having missed our self-imposed deadline, I feel compelled to provide you the best information we have with respect to your four questions; but, at the same time, to ask your permission for an extension to May 1, in order to enable us to provide a more comprehensive analysis of the responses to the Commission's enforcement and "voluntary" disclosure programs.

We expect significant additional voluntary filings during the next 45 days, as we go through the peak of the so-called proxy season. We also anticipate further voluntary disclosures in the annual 10-K reports of companies whose fiscal years ended on December 31, 1975, and whose reports are therefore due by March 31. Our enforcement efforts will also provide additional material information regarding the problems that concern you.

It is our intention to provide by May 1 a detailed analysis of the number of companies that have made disclosures of any form of questionable payments, at home or abroad; to group those companies in industry categories; and to provide as many details as we can about the nature of the transactions that have been disclosed. Critical to this report would be a tabulation of companies that have decided to continue some form of questionable payments. This should permit you to decide whether, in your judgment, legislation is needed to stop such further transactions. Also, by May 1 we will have completed our survey of the accounting profession and be in a position to give you our assessment of that profession's capacity to to ferret out the instances of questionable payments which have been the subject of your inquiry and our program.

In short, we should have a better empirical basis from which to assess the depth of the problem and the degree to which our efforts in the voluntary disclosure program, in enforcement actions and in supervision of the professions, has been and will be able both to expose and stop the corporate misconduct of this kind.

As you know, it is my own preliminary view that new legislation providing more automatic civil and criminal sanctions for companies failing to keep accurate corporate records could be useful. It is similarly my preliminary view that further, additional forms of legislation may be ineffective and undesirable. However, it is also quite apparent to me that no final judgment on these matters can be made until we have a better perspective on both what has happened in the past and what is likely to be the future practice.

Notwithstanding the incomplete nature of our analysis and the information that we have collected, the following is an attempt to deal with the questions you have raised.

1. What is the extent and seriousness of corporate abuses? Are the cases isolated and exceptional or do they indicate a pervasive and deep-rooted problem?

It, is clear that the problem of improper and illegal corporate activities is indeed serious. In recent months, disclosures of these corporate practices have badly shaken the public's confidence in the business community's willingness and ability to compete fairly, both at home and abroad.

To date, the Commission has examined and is examining the activities of more than eighty-five corporations pursuant to our enforcement activities and the voluntary disclosure program, whose combined revenues in fiscal year 1974 amounted to well over $220 billion. These corporations include some of America's largest, representing companies in various major industries; transportation, oil, pharmaceuticals, food products, aerospace and others. Fifty five of these corporations figure among the "Fortune 500".

The reports filed as a result of our civil injunctive actions reveal a wide variety of previously undisclosed improper and illegal foreign and domestic corporate activities, including the establishment of "slush funds"; the payment of illegal domestic political campaign contributions; and a wide variety of questionable, improper, or illegal payments or practices in foreign countries. In each of these cases, senior management officials appear to have authorized or condoned many of the practices, and we further have discovered falsified corporate books and records which concealed these activities from the public, the outside directors and, in many instances, the independent auditors as well.

The types of activities discovered in our voluntary program include commission-type payments to foreign government employees in connection with obtaining sales or contracts with their governments; large commission payments to nongovernment persons who, because of the circumstances, might reasonably be suspected of having passed on a portion of those payments to government officials for similar purposes of obtaining sales or contracts with the foreign countries involved; payments to foreign government officials, such as tax assessors or customs officials, to settle the claims against the company; payments to low-level government officials to prompt or expedite consideration or processing of applications or licensing permits or to influence the disposition of those applications; and payments to assure that foreign governments would provide adequate protection for corporate employees operating in remote and hazardous

parts of these countries. Our voluntary disclosure program also has produced revelations of a variety of corporate political campaign contributions, both foreign and domestic. Some of these contributions were legal; others were questionable or clearly illegal.

Many of these payments clearly were designed to cause illegal actions by the recipients. In other cases, however, the payments appear to have been made for the purpose of encouraging persons to perform legitimate activities or services that should have been forthcoming without them. Some of the companies have contended that their payments represent their response to foreign extortion rather than attempts at bribery. And in some cases the companies have asserted that some payments are entirely proper and have publicly disclosed their intention to continue the practices.

In many of the cases we have examined in the voluntary program, the payments were disguised by some falsification or inaccuracy in corporate books, records, and underlying documentation relating to the transactions. In a number of instances, the corporations have maintained that the payments were unknown to senior management in this country. In other cases, however, senior management has admitted to awareness of and participation in the practices.

The tremendous variation in the types and amounts of payments disclosed in reports filed with the Commission and in discussions with the staff makes it difficult to categorize or quantify the extent and seriousness of corporate practices. Copies of the disclosures made in public filings are appended for your information. They generally are representative of the types of conduct that have been described to the staff by companies that have not yet made public disclosures. It should be noted, however, that the Commission does not yet have complete information from all of these companies, since our staff is at various stages of discussion with them.

In the final analysis, the Commission's successes or failures in this area will be significantly affected by the responses of the professional communities that advise corporate officials regarding their compliance with the federal securities laws. Our own resources are too limited to be able carefully to scrutinize the many thousands of publicly-owned corporations in America to detect and disclose practices of the nature I have described. We cannot assert that we are entirely satisfied with the responsibilities assumed by the professional communities to date. Developments in this area are promising, however, and the Commission fully intends to encourage the increasing assumption of initiative and responsibility on the part of the professional community.

2. How seriously is economic policy being distorted to serve the demands of private companies?

Although the Commission is committed to increasing the effectiveness of economic analysis in connection with its administration of the securities laws, we do not presently have the capability to assess the possible distortion of national economic policies that may have resulted from improper corporate payments.

3. What are the estimated costs of corporate abuses to the taxpayer, the consumer and the shareholder?

The great variety of improper or illegal corporate practices that have been publicly disclosed as a result of Commission actions makes it impossible to provide responsible dollar estimates of the costs of those practices to the constituencies you have identified. Certain generalizations can, however, be made.

A. Cost to the Consumer:

First, in cases in which improper or illegal corporate payments have been made to obtain or retain business abroad, it appears that this expense frequently was added to the price of the goods sold in the recipient country. Thus, in large measure, the foreign consumer may have borne the costs of many of the corporate practices we have identified. Similarly, it might be assumed that improper or illegal domestic political campaign contributions and other domestic payments might ultimately have been treated as corporate expenses and thus passed on to the American consumers of those corporations' products and services. Our information does not, however, allow any quantification of the amount or actual incidence of these presumed costs.

B. Cost to the Shareholder:

It is equally difficult to quantify the costs of these practices to the shareholders of the corporations engaging in them. To the extent that improper or illegal payments actually succeed in obtaining or retaining business that otherwise would have gone to another company, the shareholders of the paying corporation may actually have realized some short-term benefit at the expense of the shareholders of corporations unwilling to engage in these practices. It appears, however, that in many cases these immediate gains may be more than offset by the ultimate consequences of revelation of the practices that produced them.

Some of the conduct in question recently has subjected companies to substantial economic reprisals by concerned foreign countries. For example, Bolivia has threatened to withhold millions of dollars owed the Gulf Oil Corporation for its previous nationalization of that company's assets because of the recent discovery of Gulf's improper payments in that country. These same revelations of improper Bolivian payments were asserted by the Government of Peru as a justification for the nationalization of some $5 million of Gulf's assets in Peru. It also appears that the Northrop Corporation has been "fined" $8 million by Iran because of alleged improper payments in that country, and that Venezuela has threatened to withhold millions of dollars from Occidental Petroleum for similar reasons.

These examples provide some idea of the immediate costs to shareholders of the practices engaged in by some of the corporations whose conduct we have examined. Any ultimate quantification of the costs of these corporate practices necessarily would have to take into account the added impact of the loss of respect and good-will in the countries in which these companies do business. Unfortunately, it seems likely that some of these more general costs may fall upon corporations that did not engage in such practices as well as those that did.

Equally important from the standpoint of the federal securities laws is the fact that these practices were not disclosed to investors. Absent disclosure of material facts relating to the conduct of a corporation's business, investors are unable to make the kinds of informed decisions that our law contemplates. In many instances, the practices I have described, and the risks attendant to those practices, were factors that should have been available to investors and shareholders in order to enable them to assess the soundness of the company's business and the integrity and ability of the management team that conducted the company's affairs.

C. Cost to the Taxpayer:

The Commission's inquiries have indicated a significant number of cases in which certain illegal payments have deliberately or inadvertently been deducted as business expenses on U.S. tax returns. Since such payments are not deductible under U.S. law, the taxable incomes of some corporations have been improperly reduced and the proper amount of taxes have not been paid to our government.

As is apparent from the disclosures we are providing the Subcommitte, a tremendous variation exists in the amounts that may be involved in improper deductions and in the impact that disallowance of these deductions may have in the tax liabilities of those corporations. Many of the participants in our voluntary disclosure program are still conducting internal investigations to determine the amount of improper or illegal payments and the manner in which they were treated for tax purposes. Corporations having such potential tax problems that have come to our attention are, however, in contact with the Internal Revenue Service to remedy the situation. Some of the companies under investigation by our Division of Enforcement likewise appear to have potential tax problems as a result of possible improper tax characterization of some of the payments they have made.

The substantiated variations in the nature of these payments and of their tax treatment, combined with the fact that many inquiries are in various stages of completion, make it impossible to quantify the magnitude of the tax deficiencies that may ultimately be assessed. Moreover, in some cases the final tax consequences of some of the activities revealed as a result of our activities may turn on difficult questions of tax law that are not within our range of special competence. The Commission likewise is not in a position to determine the possible extent of underpayment of corporate taxes that may never be discovered.

4. Are new solutions, including legislation, needed to deal with these problems?

The Commission supports the efforts of this Subcommittee and other Congressional bodies to inquire broadly into the nature and magnitude of the problems of corporate abuses of power. These activities, and the President's complimentary effort to establish a Cabinet-level body to examine the problems presented by improper or illegal foreign payments, should produce a more profound understanding of the problems and their possible solutions.

As you are aware, the federal securities laws the Commission administers are primarily designed to assure full and fair disclosure of material facts regarding the nature of the business operations of registrant companies. To date, the Commission is proud of the results of our activities in discovering and assuring the adequate disclosure of material facts regarding the conduct of publicly-held corporations. As I indicated in my testimony before the Subcommittee in January, the Commission thus far has not felt handicapped by any lack of statutory authority to perform these responsibilities. We therefore do not presently propose any modification of the statutes that we administer in order to enable us more effectively to require disclosure of the material facts relating to these practices.

I should reemphasize that we are continuing to accumulate knowledge and experience in this area. The close of the proxy season and the season in which many corporations will file their annual 10-K reports for the past fiscal year should produce a greater body of public knowledge from which the nature of these kinds of corporate conduct and our own efforts to assure their adequate disclosure can be assessed. Similarly, continued activity by the Commission and staff in our enforcement efforts and our voluntary disclosure program, as well as in efforts to increase the assumption of responsibilities by the relevant professional communities, may generate new insights into the complicated problems under examination by the Subcommittee. We will, of course, keep the Subcommittee informed of any relevant developments in this regard.

I hope that these responses will be of assistance to the Subcommittee. If the Commission can be of any further assistance, please contact me.

Sincerely,

Roderick M. Hills,
Chairman

Enclosures