SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549
(202) 755-4846

CORPORATE MORALITY -- WHOSE BUSINESS IS IT?

An Address By

Roderick M. Hills, Chairman

Securities and Exchange Commission

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TOWN HAL
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For so many weeks now, newspapers and newscasters have paraded a series of corporate misadventures, mostly involving foreign business activities, before a public that already gives the American business community a credibility rating of only 19%. Coming on the heels of Watergate, the new revelations have evoked a marvelous variety of reactions. Numerous legislators and public commentators have strongly condemned our business community, and Senator Proxmire has introduced a bill to make violations of foreign laws a federal crime. But a State Circuit Judge presented a somewhat different view. He writes:

> "I read your bureaucratic blurb in the Wall Street Journal today (about foreign payments). You are out of your mind. Stockholders don't give a good damn."

As so we ask, have we uncovered a cancer lurking at the core of American business that government has the obligation to remove with extensive new civil and criminal laws, or are we naively depriving American corporations and their stockholders of the capacity to do business abroad in the manner it normally is done? In short, whose business is it?

WHAT HAVE WE FOUND

The facts to date can be expressed in painfully simple terms. More than 85 publicly owned companies have voluntarily or involuntarily made disclosures relating to foreign and domestic corporate payments and practices of a questionable nature. The total sales of these companies exceed $190 billion, and they include about 55 of the so-called Fortune 500 companies.

The revelations are of a wide variety. Some corporations have disclosed annual payments of millions of dollars. Other corporations made far smaller payments. Some payments were clearly designed to cause illegal actions by government or business officials; 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 and grow. Some are questionable only because the company is not sure how a foreign business representative has been spending his otherwise legitmate sales commissions. Some were understandable reactions to low or high level extortion, and others intentional and vulgar examples of corporate arrogance. Some result from a careless disregard for elementary standards of responsibility and others were the result of boyish intrigue with the lure of mysterious and supposedly potent foreign agents.

The differences are important. To lump all payments, big and small, into a universal condemnation of American business is a facile deception, and to attempt to deal with them all under a single law or procedure would indeed be naive.

About 7,500 publically traded companies file with the Commission. Fewer than 100 Corporations have admitted questionable payments, and we find less than 20 that appear to have paid very large sums in the nature of bribes to get new business.

As uncomfortable as it is to talk of degrees of illegality -- who does not see the distinction between the bribe of a government official to secure a huge government

contract that would otherwise have gone elsewhere, and one to an official to make him do what he is supposed to do without a bribe. Compare, for example an airplane manufacturer that pays millions to get a contract away from a competing American manufacturer, with an importer who pays hundreds of thousands of dollars over several years to persuade police to guard warehouses, and to get port officials to permit goods to be shipped out. Compare the bribe of a chief of state to change the tax laws with systematic political contributions that are entirely legal in the country where made. Taken as a whole, these incidents have not revealed some new law of corporate morality. Kickbacks, embezzlement and large gratuities have been some part of the commercial scene for centuries. Indeed a thoughtful perspective may well be that there has been a gradual improvement over time in corporate morality.

In short, the problem is serious but we have no reason to condemn the American business community.

But these revelations do raise a serious question of another kind, one that has not necessarily been resolved. They make it clear that there has been a major breakdown in the ability of the private sector, independent auditors, lawyers, and outside directors to provide the kind of self-protection essential to the enforcement activities of the SEC.

The breakdown is comparable to that in the Equity Funding Case, where sophisticated computer programs were used in a deliberately fraudulent scheme.

The present phenomena may present a greater crisis because it has been caused by top officers of major companies who were not stealing for personal gain but who claim that bribery has been one of the rules of the game; that it is necessary for American

business to be competitive worldwide; and that concealment of the truth from auditors and from boards of directors is a proper means to the end of better profits.

The question, as I see it, is whether we can restore the efficiency of our reliance on the private sector's ability to protect itself or whether investor and public protection against corporate misadventures now need a different system.

WHAT GOOD HAVE THE DISCLOSURES DONE

There has, of course, been remarkable change.

We can assert with some assurance and only minor exceptions to date, that the companies reporting questionable payments have taken effective action to stop them. Most have completed investigation of their past actions and have installed workable guidelines to prevent repetition.

But one must still ask, as has Congress, have these companies made sufficient disclosure -- have we gotten to the bottom of the problems -- and is their conversion permanent.

No one can be sure, but results to date suggest that American business has the will to cause a permanent change in methods of doing business.

The major accounting firms now make far greater efforts to verify the accuracy of books and records. Their remedial actions to date are impressive and we will by consultation and rulemaking, if necessary, strengthen their own demonstrated resolve to re-establish the reputation of financial statements.

Independent directors now recognize far better their obligations. They surely know that they have, in effect, an affirmative obligation to question both management and outside auditors on the matter of questionable payments.

More important, there is today a large percentage of publically held companies that have audit committees of outside directors that meet privately with the outside auditors.

And the business community must know by now that the Commission's Enforcement Division has the capacity and the will to test the depth of disclosures from time to time and from company to company in such a manner as to give us assurances that their disclosures are sufficient.

When we pass the peak of the current filing season, by May, we will probably conclude:

> As many as one hundred corporations have made disclosures concerning questionable foreign and domestic payments and practices.
>
> Substantially all of that number will have declared their intention to stop past practices and will have adopted codes of conduct to that end, or will have instructed their officials and independent auditors to adopt practies that effectively stop them.
>
> A few companies will disclose their intention to continue some kinds of payments. Most will be small "facilitating" or "grease" payments designed to encourage public officials to perform services that they should perform without them. Others, a few, will see a compelling need to protect their interest by continued bribes and some will chance it and will neither reveal nor discontinue questionable past practices.

If this is to be the state of affairs, is it enough? Will we be able to say that the system works?

The answer, of course, depends on what you expect from the system.

And, the issue persists: have we at the SEC been the bold leaders in a fight against irresponsible corporate behavior, or are we naively destroying the economic base of big business and embarrassing friendly governments. Let me use a coincidence of timing to try to deal better with the issue.

After months of investigation and negotiation, the SEC has reached settlement with Lockheed Aircraft, its former Chairman, and its former President. The complaint against these parties and the settlement agreement are being filed today in Washington, D.C.

Let me offer a brief anatomy of the Lockheed matter. Our complaint includes several violations of the federal securities laws:

1) We charge that at least $750,000 was diverted to a secret corporate fund, between 1968 to June 1975, and a portion of those funds was used for payments to government officials.

2) That since 1970 payments or commitments to pay at least $200 million to various consultants and agents and others were made without adequate records and controls to ensure that the payments were made for the purposes indicated.

3) We further allege that at least $25 million of the $200 was used for making secret payments to government officials rather than for the stated purposes. These payments, we contend, were designed to assist the corporations in obtaining and retaining contracts with foreign governments.

4) We charged that in one instance a total of $100,000 in commissions paid by Lockheed was kicked back by the consultant to Lockheed personnel for their personal use, without the knowledge of the Chairman or President.

We have charged that the defendants violated the federal securities laws by failing to disclose these activities; failing to disclose the roles of the Chairman and President in them; failing to accurately present the expenditure account of the company, falsely stating the nature of the income, costs, and expenses of the company; and failure to disclose the business risks created by securing business contracts by means of these payments.

Without admitting these charges, the parties have consented to a court decree which requires the creation of a Special Review Committee and a Special Counsel, consisting of persons satisfactory to the Commission, who will compile a full report on all matters, including the direct or indirect use of corporate funds for unlawful domestic payments.

The Committee and its Special Counsel will have full access to all information. Within 150 days (unless we extend the time) the Special Counsel and the Committee will report with recommendations to those members of the Lockheed Board that are found by the Special Committee not to have been involved in the questionable activities.

Within thirty days thereafter, the report must be filed with the Commission and the Court and thereafter in the public 8-K Report. Lockheed can only secure deletions from this report with the court's approval, upon a determination that public disclosure of these materials would be harmful to Lockheed and the shareholders and, moreover, that the matters are not material under the federal securities laws.

The Commission will, of course, monitor the investigation to make whatever supplementary investigation we deem necessary.

The settlement is a profound example of how a tiny enforcement unit of 400, including secretaries, can monitor the action of thousands of corporations. The study to be undertaken is quite comparable to that done in the Gulf case and in the Northrup and Mattell cases. When successful, this approach means that private industry, prompted by the SEC and under court order, is helping to correct its own failures.

It means that the control of the board of directors has been changed, not by putting government representatives in charge of a company, but by creating a new committee, independent of the alleged misconduct, still responsible to the stockholders to protect their interest, to report to the stockholders.

HOW DO WE EVALUATE THIS KIND OF ACTION?

The fact remains that many doubt the wisdom of what we are doing. That Circuit Judge I mentioned at the outset quoted from a noted columnist who wrote that the corporate officials in Lockheed-type cases were not at fault. The columnist says they:

> "Are being shaken down. They were told greasing the palms of local bigwigs was a necessary condition of doing business."

"No tickee no laundry." is the quaint, but I think offensive, phrase that the judge and the noted columnist use to describe the purpose of corporate bribery abroad.

Obviously, we could save ourselves a lot of trouble if the issue were that simple. But look at the Lockheed case, because that was the focus of the columnist. He says that Lockheed had to give major bribes to get the business. But the competition was from other American companies. Does he have evidence of competing bribes? Does he know whether the offer or the solicitation came first?

The point is that:

Lockheed outside board members say they didn't know.

Lockheed stockholders did not know. The auditors say they did not know. But we know that our relations with a major friendly country were jeopardized by these acts of company officials.

Is it naive to say that our country's security should not be left to such conduct?

Is it naive to point out that we have the largest, strongest and most competitive business organizations in the world? If these companies renounce bribery, will West German, French, English or even Soviet companies risk the scandal of perpetuating the practice?

I suggest that I do not see the hard evidence in this case or others that American business will lose major contracts abroad to other countries if they compete with price and product alone and give up bribery and grease.

I also submit that most of those who have bribed have been unwilling to prove their case to their own boards, and I will guess that most bribes have been foolish and ineffective.

Most, but of course, not all.

What is to be done when a company from a third country bribes to divert business from an American company? Are we helpless? And, how should business react to extortion where major assets or peoples lives are threatened by extra legal governmental action. Finally, how are the so-called grease payments to be treated?

Assuming first that management has the integrity to seek approval from its own board and to account properly when faced with these problems, it is obvious that they must where possible protect shareholders' interests and employee lives. There, no doubt,

will be hard cases where a payment in response to extortion or to force an official to do what he is supposed to do will be necessary. Nothing the SEC has done interferes with the decision to make such payments, provided the accounting is accurate and the board is not deceived, and adequate disclosure of material facts is made to investors and shareholders.

But the obvious bribe to persuade an official to give the company business or to change laws is a different matter. I see no way to leave such conduct to the discretion of American business. Who can decide from hindsight who is the corrupted and who is the corrupter. If that kind of bribery is tolerated, it will be used, and not just abroad. It is far too easy to see what it can do to our international relations.

I suggest also the answer does not lie in international codes of conduct or U. N. debates, even though both will be helpful to expose the problem.

Rather, the answer lies with the dedicated and forceful use of the economic power of this nation to retaliate directly and immediately against any company that takes business away from American business with bribes.

Our State, Treasury, Defense, Commerce and Agriculture Departments have enough collective economic authority to stop such practices if they do occur. How many large international companies will bribe business away from an American company if they know that the American market and American corporations are to be cut off from them?

If a manager has enough evidence of a competitor's bribe to contemplate a retaliatory bribe, he should have enough evidence to get a government agency to lodge a protest and initiate an inquiry into the matter.

If the proof of the need is too ambiguous or uncertain, or the identity of the competitor unknown, there is, I suggest, no justification for resorting to bribery anyway.

My point is that our government can do much more to help, and I trust that the White House Task Force chaired by Secretary Richardson will point in that direction.

Of course, the premise of my proposals is my belief that bribery is not a material factor in the success of American business. I take comfort that I am not alone in this belief. John McCloy's report of the activities of the Gulf Oil Corporation makes it clear that Gulf's bribery was, at best, foolish.

In a similar fashion, David Lewis, Chairman of the Board of General Dynamics, recently stated:

> "Disclosures of unbelievably bad business practices by some companies plunged the image of American business to what is probably its lowest point in history. Because most people believe that the actions of the few are typical of the whole business community the black tar which so justly covers the few now splatters us all."

Speaking specifically of his Company's success in obtaining a major contract for the sale of its F-16 aircraft to several foreign counties and in the United States, he stated:

> There were zero payoffs, there were zero bribes, there were zero offers. There's nothing in the future and there's nothing in the past, and there's no one in any of these governments that has to be awake nights wondering when the whistle is going to blow on him because it isn't going to happen.

Mr. A. W. Clausen, President of the Bank of America, recently stated:

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

government regulators -- won't be to blame. We will.

The simple fact is that the bribers have not made their case.

HAVE WE FIXED IT?

Let me return to an earlier theme. Can we establish the integrity of our system of enforcement, which has depended so heavily on the private sector for help?

Or should we seek pervasive new laws,

-- laws making it a federal crime to violate the laws of all other countries

-- laws forcing public members on private boards to protect the public interest, or

-- laws providing federal charters and rules for large multinational corporations?

I must say I trust we will not be so rash, but it has been all too easy to do so in the past. We have as a society had the unfortunate notion for too long that a new law or two here and there can solve problems of human behavior that have been with us since the beginning of commerce.

There is a marvelous passage in Gore Vidal's new book, "1876". There he relates a conversation between a Charlie Schyler, who returned to America in 1875 from a 38-year European exile to write about the scandals of the Grant Administration -- and his daughter a French Princess. Asking about small bribes taken by a government official, the princess comments:

> "Why is it so wrong to take money in this way? Who is hurt?"

Charlie replies:

> "It's not the gifts. It's what (the official) does in exchange. Like trying to obstruct the court of justice."
>
> "But in Europe everyone steals, says Emma."
>
> "But we are not Europeans. We are protestants and believe in God and in the absolute necessity of being good," responds Charlie.
>
> "I shall never be an American" is Emma's victorious rejoinder."

The fact that we cannot legislate morality does not mean that we cannot ferret out immorality when it has a material impact on business. My own belief is that we can continue to look to the corporate officials and to the professionals that advise them, but the keystone of their capacity to respond depends on the integrity of corporate books and records.

The Commission has been the toughest where the books are deliberately falsified by top management. This pressure, plus the current effort by independent accountants, may give us the assurance now missing.

My own tentative judgment, however, is that the laws must be made tighter by creating far tougher and more automatic civil and criminal sanctions for corporate officers who permits false records to be maintained.

Given accurate records, the boards of directors must maintain and exercise a position of independence from top management. A board's responsibility is to make certain that it knows what is happening in the company and to ask itself periodically

whether it is time for a change. Decisions on major policies and on whether to keep or replace management must be made by a board that is adequately informed and sufficiently independent to assess management's conduct.

The question is whether we can depend upon the independence of sufficient numbers of board members of large American companies. If not, then heed must be given to the type of criminal laws proposed by Senator Proxmire or to the call for public direction as they exist in some European countries, or to the recent proposal with Ralph Nader for federal chartering for multinational corporations.

A different course is still open. The requirement, voluntarily accepted, demanded by outside auditors or imposed by the listing requirements of the stock exchanges -- create a truly independently based committee to review audit procedures, and general management can accomplish much. The final recognition by lawyers that there is an inherent conflict when a lawyer serves his client both as director and as securities counsel will also help.

CONCLUSION

Different people will react in different fashions to what we now see. Some will condemn all of American business. Others may deplore the revelations as self-flagellation in a world that needs a strong America.

I take the middle ground. As disheartening as it is to see how some firms have intentionally or negligently done business abroad, I prefer to be optimistic.

We will, by any standard, continue to have the best community in the world and when this saga is complete, both the Congress and the public will have a better opinion of the ability and willingness of that business community to compete fairly.

That private industry, spurred by the SEC, can right the wrong is dramatically evidenced by the remarkable Gulf Oil report.

Allow me to leave you with a quote from recent comments by an Ivan Hill of North Carolina.

> "The predominance of honesty throughout a free society is essential to justice and to the effectiveness of law. Without an overwhelming pattern of honesty among its citizens, a free society cannot function and becomes unmanageable. We should know that without a high degree of honesty, government will be expensive and inefficient. We have already seen the effects of the law of the seasaw--when honesty and ethics sink down, centralized authority and coerced regulations rise up.