THE WHITE HOUSE

WASHINGTON

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MEMORANDUM FOR THE PRESIDENT

THROUGH: L. WILLIAM SEIDMAN
BRENT SCOWCROFT

FROM: ELLIOT L. RICHARDSON

SUBJECT: Questionable Corporate Payments Abroad

This memorandum seeks your guidance regarding whether or not to propose a legislative initiative, to supplement the unilateral and multilateral initiatives already taken by the Administration, in our attempt to address the "questionable payments" problem.

Current Analysis of the Problem

The Task Force on Questionable Corporate Payments Abroad has received briefings by the IRS, the Department of Justice, the Department of Defense and the SEC. The Task Force staff has held preliminary consultations with businessmen, congressional staff, legal experts, academicians, and other informed individuals and groups.

It is clear, on the basis of information already at hand, that there is a "questionable payments problem." A significant number of America's major corporations, in their dealings with foreign governments, have engaged in practices which violated ethical and in some cases legal standards of both the United States and foreign countries. To carry out these practices, certain American corporations have falsified records, lied to auditors, and used off-the-books "slush" funds. In some cases, improper foreign payments have been unlawfully deducted as ordinary and necessary business expenses for U.S. income tax purposes. The problem is actually a set of problems, often interrelated, but distinguishable as follows:

- The problem of "petty corruption." "Grease" or "facilitating" payments are a business requirement in a number of countries where they are often accepted as a perquisite of an underpaid civil service.

- The problem of "competitive necessity." It is frequently argued that American firms are required to bribe in order to meet foreign competition, and in fact, foreign companies do sometimes make payments with the knowledge of their governments. The SEC has concluded, however, that little if any business would be lost if U.S. firms were to stop

these practices. In a number of cases, payments have been made to gain an advantage over other U.S. manufacturers.

- The problem of extortion. In some instances, improper payments have been extorted from U.S. companies by corrupt officials or agents purporting to speak for such officials.

- The problem of adverse effect on foreign relations. Public disclosure of information and allegations regarding past practices has had adverse impact on the political and social fabric of countries friendly to the United States and has, thereby, adversely affected U.S. foreign relations.

- The problem of adverse impact on multinational corporations (MNC's). Exposure of the questionable payments problem has increased concern that MNC's are unaccountable to national legal constraints and that they have the capacity to conduct independent foreign policy including the suborning of host country political and governmental processes. Such enterprises are an important part of the American economy and offer substantial opportunities for developing nations. The U.S. interest in a healthy international economic order is importantly dependent upon the international acceptability of MNC's.

- The problem of eroding confidence in "free" institutions. Most fundamentally, the uncovering of these improper past practices, as a result of Watergate and subsequent executive and congressional investigations, has eroded confidence in corporate responsibility and in democratic and capitalist institutions generally.

Delineation of the precise dimensions of the questionable payments problem must await further investigation by the SEC, by the IRS, whose review of the problem is in its initial stages, and by the Department of Justice. Nevertheless, the nature of the problem in its presently visible dimensions is sufficient to justify not only the remedial measures already under way but also serious consideration of additional measures.

Issues and Options

Three issues are presented for your consideration. In considering these issues it is important to note that:

1. Existing Administration initiatives will continue to be pursued regardless of the resolution of these issues.

2. If any legislative initiative is proposed now, it would simply be outlined in an appropriate Presidential speech or release. Specific drafting and resolution of related detailed issues would remain for further development by the Task Force.

3. Whether or not a new legislative initiative is proposed, the possibility of further initiatives in other areas, e.g., administrative guidelines with regard to the behavior of U.S. government employees, or a special foreign policy initiative to gain greater international cooperation would remain under review.

Issue 1: Should the Administration undertake a legislative initiative at this time?

The Task Force is divided on the question of whether there is a need for a legislative initiative or whether we should concentrate on accelerating efforts to obtain international agreement on questionable payments.

Option A: Undertake a legislative initiative at this time.

Alternative legislative initiatives are outlined in Issue 2.

Advantages:

- There is a need for clarification of current law. Although SEC Chairman Hills testified that "we do have adequate tools to correct the problem once it is found," it is in fact not entirely clear that the SEC has adequate authority to compel public disclosure of those questionable payments which are not "material" as conventionally defined.

- There is a substantive question as to the adequacy of current law. The Internal Revenue Code reaches only those transactions in which a questionable payment is improperly deducted as a business expense, and in no way constrains a corporation which does not seek the tax benefit of such deductions. SEC's authority applies only to issuers of securities, and does not reach certain significant U.S. firms doing international business. Since SEC authority as currently applied does not require disclosure of the names of recipients, it may not be a fully effective deterrent of extortion. A summary of the applicability of relevant current U.S. law is attached at Tab A.

- Since there is skepticism regarding the seriousness of the Administration in its quest for remedies, there is a need to act in a way that is publicly perceived as positive. The Task Force has been criticized for its failure to have independent full-time staff, its mandate to report "before the end of the current calendar year," its alleged "stalling," etc. Continued disclosure will compound the problems of public skepticism and Congressional pressure. Secretary Richardson has promised Senator Proxmire a response with respect to his bill by June 10, and Senator Church will soon be holding hearings on his newly introduced bill.

- A legislative initiative would provide an effective means to restore public confidence and to reduce cynicism with respect to business.

- It is in the long-term interest of the United States to allay concerns regarding the accountability of multinational business enterprises. Unilateral legislative action could improve the standing of the U.S. and U.S.-based firms within the international community.

Disadvantages:

- The U.S. Government has taken steps to curtail illicit payments by U.S. firms under current legal authorities. There is a broad consensus in the business community and enforcement agencies that the disclosure being required by SEC and IRS, as well as publicity resulting from Congressional inquiries, has modified the behavior of U.S. firms abroad. The steps that have been taken by DOD and State, and that will be taken pursuant to the new Security Assistance Act, will eliminate illicit payments from the sensitive sector of military sales.

- Legislative proposals at this time may be premature. Additional time and analysis is required for a more complete definition of the true dimensions of the problem. Unilateral legislative action might undercut our bargaining position in international negotiations.

- U.S. regulation of payments by U.S. firms abroad could potentially cause serious damage to U.S. foreign relations because it involves U.S. authorities in the examination of the conduct of foreign officials in their own countries. Disclosures in the United States of alleged corruption abroad could threaten leaders and institutions in friendly foreign countries. General disclosure legislation would tend to expand and institutionalize this process. When deterrence fails and disclosure results, U.S. interests abroad could be seriously damaged.

- Unilateral legislative action by the United States might cause a substantial competitive handicap to American corporations leading to a loss of business, jobs, etc.

- A legislative initiative is not the only means available to counter skepticism and to help restore confidence. An alternative course would be to defend more vigorously the adequacy of the current Administration approach -- and to supplement it with a visible effort to accelerate the progress of international negotiations. The current Administration approach is summarized at Tab B.

Option B. Accelerate U.S. efforts to obtain an international agreement on questionable payments. Do not propose any new legislation at this time.

In March the United States made a proposal in the United Nations for negotiation of an international agreement to curb illicit payments. In presenting this proposal, the United States outlined a number of principles on which we felt the agreement should be based, including the following: (1) the agreement would apply equally to those who offer or make improper payments and to those who request or accept them; (2) importing governments would agree to establish clear guidelines concerning the use of agents and to establish appropriate criminal penalties for defined corrupt practices by enterprises and officials in their territories; and (3) uniform provisions for disclosure by enterprises, agents, and government officials of political contributions, gifts, and payments made in connection with covered transactions. We expect that a group of experts will be formed this summer to undertake the negotiation of the agreement.

An intensification of our efforts to obtain such an agreement might include the following steps:

1. Major policy statements by you and members of the Task Force to convey the Administration's determination to reach a workable international agreement on bribery;

2. Renewal of approaches to foreign governments through our embassies abroad to generate additional support for our initiative; and

3. Preparation of an interim report -- which you would make available to Congress in a few weeks -- setting forth the accomplishments of the Task Force to date and outlining the Administration's proposed plan of action with respect to the international agreement.

Advantages:

- This approach would provide time for more careful consideration of what kind of additional disclosure legislation, if any, is needed.

- This approach does not foreclose the possibility of subsequently proposing additional legislation. Indeed, a result of the international negotiations may be that we would need to propose some sort of new disclosure requirements, but such a proposal would be made in accordance with the terms of the international agreement and parallel actions by other countries.

- There is a risk that many countries might use unilateral U.S. action as an excuse for avoiding taking effective action on their own.

Disadvantages:

- This approach may be perceived politically as a smoke screen for Administration unwillingness to take effective action on the questionable payments problem.

- Negotiation of an international agreement may take up to 2 years to complete. There would likely be few immediate results from this approach.

- There is a possibility that it may prove impossible to negotiate successfully such an agreement.

Decision

Option A _____ Undertake a legislative initiative at this time.

Supported by: Commerce, Justice, the Special Representative for Trade Negotiations, Counsel's Office, OMB

Option B _____ Accelerate U.S. efforts to obtain an international agreement on questionable payments. Do not propose any new legislation at this time.

Supported by: State, Treasury, Defense, Marsh, Friedersdorf, Morton

If you approve undertaking a legislative initiative at this time, the Task Force is divided on what form the legislative initiative should take.

Issue 2: What form should a legislative initiative take?

The Senate Banking and Urban Affairs Committee has scheduled a June 22 markup session for "questionable payments" legislation. Three principal legislative proposals are currently pending in the Congress. A summary of their principal provisions is attached at Tab C.

The "Proxmire bill" requires disclosure to the SEC of all payments above $1,000 made in connection with business with foreign governments, and "criminalizes" payments made to influence actions of foreign officials.

The "Church bill" requires annual disclosure to the SEC of certain corporate payments abroad (including "commercial" as well as "official" payments) without imposing criminal sanctions for acts done abroad, and also contains a number of other provisions creating private rights of action for damages, and mandating certain internal, corporate reforms.

The "Hills bill" would force increased internal accountability within SEC-regulated corporations by making it a criminal offense to keep false books or to lie to auditors.

The Proxmire and Church bills have substantial defects. The Task Force does not recommend support of either. Consideration of whether the Administration should endorse the Hills bill is presented in Issue 3.

Option A. Propose a form of "disclosure" legislation.

A Presidential initiative for "disclosure" legislation might take the following form: It would require reporting of all payments in excess of some fixed amount made directly or indirectly to any person employed by or representing a foreign government and to any foreign political party or candidate for foreign political office in connection with obtaining or maintaining business with, or influencing the conduct of, a foreign government. These reports would be required to be made to some Executive Branch Department and not to the SEC. The State Department would have discretion to relay reports of these payments to the foreign government(s) affected and these reports would be publicly disclosed after an appropriate interval. Criminal and civil penalties would be set for willful or negligent failure to report. (Deliberate misrepresentation in such reports would be covered by current criminal law, 18 USC Section 1001.) The requirement of such reports would apply to all American business entities and their controlled foreign

subsidiaries and agents. Penalties for failure to report would apply only to American parent corporations and their officers.

The State Department, which opposes a legislative initiative, has suggested that if you decide to propose a legislative initiative it should be narrower than the disclosure approach outlined above. The State Department approach would require U.S. firms doing business abroad to report to a single, designated agency of the Executive Branch all payments made to foreign officials, directly or indirectly, in connection with business dealings with foreign governments. The reports would be made available to other interested agencies of the United States government and would also be made available, upon request, to committees of Congress which need the information for legislative purposes as well as to foreign governments under the procedures developed in the Lockheed case. Public disclosure would only be made in those cases where agency or congressional processes required it.

If you decide to propose some form of disclosure legislation, a supplementary options paper will be prepared promptly to resolve the issues which distinguish the State Department approach from the broader disclosure approach and to resolve the remaining issues of detail, e.g., definitions of "controlled foreign subsidiaries and agents," minimum payment levels above which reporting would be required, etc.

Advantages

- Disclosure legislation should help build public confidence in the accountability and responsibility of MNCs without requiring the degree of extra-territorial enforcement implied by unilateral "criminalization."

- More systematic reporting and disclosure, including the name of "payees," would provide more effective protection for U.S. business from extortion or other improper pressures that would result from disclosure of a payment to their own government as well as public disclosure of their names in the United States. Virtually all foreign governments have statutes forbidding official corruption.

- An initiative limited to disclosure legislation avoids the difficult problems of defining bribery or determining whether certain transactions are bribery or distortion which would be entailed in any criminalization legislation.

Disadvantages

- To the extent that deterrence fails and disclosure results, it could pose foreign policy problems by aggravating relations between the United States and certain countries.

- Disclosure could constitute a substantial additional paperwork burden on American corporations. Moreover, various ambiguities would be involved in the case of some payments and disclosure might unjustly implicate legitimate intermediaries.

- It may be argued that a disclosure approach is unwieldy and does not go far enough -- that criminalization of certain foreign payments should be required, that "bribery" is "wrong"; and that our law ought to reflect that moral judgment.

Option B. Propose legislation which would criminalize corrupt payments to certain foreign officials.

The Task Force has considered a wide range of possible criminalization initiatives. The Attorney General has proposed for your consideration legislation that would apply only to bribes of officials in foreign countries that (a) have appropriate laws prescribing domestic bribery (the State Department advises that virtually all nations already have such laws); and (b) have bilateral enforcement agreements with the United States similar to those being concluded with various nations in connection with the Lockheed matter. A draft statute is attached at Tab D.

Advantages

- This proposal would facilitate cooperation by counterpart law enforcement agencies and would avoid involvement of United States law enforcement where there is not a foreign commitment to enforcement of its own laws.

- The bilateral agreement and foreign law requirement of the proposed statute would help minimize any possible adverse impact on the competitive position of American multinational corporations; entry into an agreement would evince the foreign nation's intention to enforce its corrupt practices laws, particularly against its own officials.

- Unlike a disclosure provision, this proposal would not create additional and burdensome reporting requirements for American multinational corporations, nor would a new bureaucracy have to be created within any Executive department or agency to implement the statute.

Disadvantages

- This proposal would have force only in relation to countries willing to enter into bilateral enforcement agreements. And it is conceivable that exactly those countries which are least inclined to enforce bribery statutes--and most problematic in this respect--would fail to enter such bilateral agreements.

- For countries unwilling to enter enforcement agreements, this approach--as distinguished from the disclosure approach--would fail to deter extortion.

- Such an initiative would be inherently difficult to enforce because it would pose definitional problems--such as distinguishing between corrupt payments on the one hand and legitimate political contributions and fees on the other.

Decision

Option A _____ Propose a form of "disclosure" legislation.

Supported by: Commerce[1] State[2] Counsel's office[3] STR[4] OMB

Option B _____ Propose legislation which would criminalize corrupt payments to certain foreign officials.

Supported by: Justice[5] Treasury, Marsh

1 A memorandum outlining Secretary Richardson's views and specifications for a reporting and disclosure bill is attached at Tab E.

2 A memorandum from Deputy Secretary of State Robinson is at Tab F.

3 A memorandum from Ed Schmults is at Tab G.

4 A memorandum from Ambassador Dent is at Tab H.

5 A memorandum from the Attorney General is at Tab D.

Treasury opposes any legislative initiative at this time. However, if a decision is made to propose legislation, Treasury supports criminalization legislation, but only extending as far as the draft legislation in the Attorney General's memorandum.

Issue 3: Should the Administration endorse the Hills bill?

The Hills bill would require SEC-regulated firms to devise and maintain internal accounting controls intended to improve accountability while criminalizing falsification of associated books, records, accounts or documents and criminalizing the making of false or misleading statements to an accountant in connection with an issuer's audit. The bill does not criminalize bribery, and it does not reach non-SEC-regulated firms. Even with the proposed new authority, disclosure requirements would remain linked to a determination of "materiality" from the perspective of investors (as viewed by management, auditors and the SEC).

It is important to remember that the Hills bill is a limited legislative initiative. Since Senator Proxmire has indicated he will incorporate the Hills approach in his bill, it could not be claimed as a Presidential initiative, even though it would be viewed as a positive Administration action.

Recommendation: That you endorse the Hills bill.

Approve _____ Supported by: Commerce, State, Justice, Counsel's Office, Marsh, Morton

Disapprove _____ Supported by: Treasury*, Friedersdorf,

STR defers to other agencies.

* Treasury does not support the Hills bill, although we are not strongly opposed to it. While the bill is relatively harmless, (1) it does not purport to deal directly with the bribery issue and, therefore, does not meet the need, and (2) it adds further Government regulation on how SEC registered corporations are to keep books and deal with auditors, which is an ineffective and unnecessary intrusion in business procedures.

OMB feels that greater study of the implications of the Hills bill for the power and responsibility of the SEC is required before formal Administration support is given to the Hills bill.