Case Western Reserve Journal of International Law

Volume 8 | Issue 2 Article 10

1976

A Look at Questionable or Illegal Payments by American Corporations to Foreign Government Officials

Richard Verri

*A Look at Questionable or Illegal Payments By American Corporations to Foreign Government Officials**

NEWSPAPER REPORTS are replete with accounts of bribery, payoffs and "commissions" by American multinational corporations to foreign government officials and citizens. The revelations to date indicate that as many as 70 multinational corporations have paid 100's of millions of dollars[1] to government officials at various levels and private citizens of foreign nations in order to promote their goods and to influence the awarding of government contracts to their companies.

Much has been reported about the obvious ethical considerations involved, the subsequent reorganization of corporate boards of directors and executive offices in this country, and the reverberations that have been felt in the capitals of the nations whose officials have so far been implicated, but surprisingly little has been said about the anticompetitive nature of these bribes or about the possible violations of the Securities and Exchange Commissions' rules requiring disclosure. This note will explore the antitrust implications which arise from these bribes and their relationship to basic international law doctrines as presented in testimony by Mr. Donald I. Baker. Mr. Baker, Assistant Attorney General of the Antitrust Division, in testimony before the Subcommittee on International Economic Policy of the House Committee on International Relations, described the Justice Department's policy toward payments by American firms abroad to foreign government officials. This article will expand upon Mr. Baker's remarks and examine and contrast them with the Securities and Exchange Commission's approach to this problem.

* This author wishes to express his appreciation to Donald I. Baker, newly appointed Assistant Attorney General of the Antitrust Division for his advice and assistance in the preparation of this article and wishes to acknowledge that this note derives its basis from Mr. Baker's testimony before the House Subcommittee on International Economic Policy of the House Committee on International Relations on July 24, 1975, reprinted in 5 CCH Trade Regulation Reports, 50, 238 at p. 55, 439 (1975).

1 A. R. Immel and H. G. Lawson, *A Thin Line*, Wall Street Journal, Mar. 5, 1976, at 1, col. 4. *See also* REPORT OF THE SECURITIES AND EXCHANGE COMMISSION ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES, submitted to the Senate Banking, Housing and Urban Affairs Committee, May 12, 1976, which tabulates information on 89 corporations which have disclosed information publicly on or before April 26, 1976.

JUSTICE DEPARTMENT'S ANTITRUST APPROACH

As international commerce grows, so do the incentives to foreign governmental officials to extract payments from private corporations as a condition to doing business and gaining access to the markets and raw materials which their countries control.[2] When bribery is used to further a conspiracy which restrains the domestic or international trade of U.S. corporations or which tends to monopolize such trade, then U.S. antitrust laws may apply. The basic law which protects trade and commerce against unlawful restraints and monopolies is the Sherman Act.[3] The Act declares illegal both conspiracies to restrain trade and activity which has a monopolizing effect. The language of the statute is intentionally broad and thus provides a high degree of adaptability to new situations. The legislative history of the Act does not indicate any real debate on the application of the statute to international trade, as interstate and international commerce appear to have been considered completely intertwined in this far-reaching legislation.[4]

As stated by Senator Hoar whose revision seems to have become the accepted law:

> The great thing that this bill does except affording a remedy, is to extend the common law principles, which protected fair competition in trade in old times in England, to international and interstate commerce in the U.S.[5]

Thus the Sherman Act does not specifically declare illegal the actual act of bribery, rather it focuses on the purpose and effect of the conspiratorial behavior which restrains trade or leads to monopolization.[6]

To the extent that bribery and similar techniques further conspiratorial behavior which restrains trade or has the effect of restraining trade, the entire pattern of anticompetitive behavior may be subject to prosecution.[7]

As stated by Mr. Baker:

---

[2] Donald I. Baker, Payments to Foreign Governmental Officials, 5 CCH Trade Regulation Reports, 50, 238, at p. 55,439 (1975) (hereinafter cited as Baker).

[3] 15 U.S.C. § 1 (1970). *See* Claudy, *Sherman Anti-Trust Law: Applicability to Foreign Commerce*, 37 CORNELL L.Q. 821 (1952).

[4] W. FUGATE, FOREIGN COMMERCE AND THE ANTITRUST LAWS (2nd ed. 1973), (hereinafter cited as Fugate).

[5] 21 CONG. REC. 3152 (1890). Also cited in Fugate.

[6] Baker, *supra* note 2.

[7] *Id.*

> While bribery has not been explicitly at issue up to now in cases involving international trade, some private inducements to foreign governments to engage in anticompetitive activity have been the subject of litigation. There is no logical reason why bribery of foreign officials may not be involved in future international activities which are the subject of antitrust litigation.[8]

Background — Foreign Commerce and U.S. Antitrust Laws

In order to understand the general background for the discussion of the application of the antitrust laws to foreign commerce, it must be remembered that the Sherman Act is the primary U.S. antitrust law. The Sherman Act derives its authority from the Commerce Clause of the U.S. Constitution. Clause 3, section 8 of Article I provides that Congress shall have the power "to regulate commerce with foreign Nations, and among the several States . . . " It was under this authority that, in 1890, the Congress enacted the Sherman Antitrust Act:

> Every contract, combination in the form of trust or otherwise, or conspiracy, in restraint of trade or commerce among the several states, or with *foreign nations*, is hereby declared illegal . . .(emphasis added)

Section 2 makes it a crime to:

> . . . monopolize, or attempt to monopolize any part of the trade or commerce among the states, or with foreign nations . . .[9]

Thus, the Sherman Act is applicable to basically two types of international situations. The first is where imports into the United States are unreasonably restrained (section 1) or monopolized (section 2), thereby injuring U.S. consumers who must buy on a less competitive basis.[10] The second is where export trade opportunities are restrained or monopolized, thereby denying other U.S. businesses the opportunity to compete abroad on their merits.[11] By its very nature, foreign commerce may involve activity abroad,

---

[8] *Id.* Also a recent case filed in the U. S. District Court for the Northern District of California on January 16, 1976, U.S.A. v. Bechtel Corp., Civil Case No. 6-76-99, deals with a form of bribery-blackmail. The case involves the Arab boycott of Israel and the government's complaint alleges that the defendants have conspired and entered into a combination which includes refusing to deal with blacklisted persons. This has the effect, among others, of excluding blacklisted persons from supplying parts, systems and materials and suppressing competition in an unreasonable restraint of interstate and foreign commerce in violation of Section 1, of the Sherman Act.

[9] 15 U.S.C. § 1 (1970).

[10] Baker, *supra* note 2, at 55,439.

[11] *Id.*

as well as activity in this country. Foreign commerce can encompass acts of American citizens in foreign countries as well as in the United States,[12] and acts of aliens in this country as well as in their own and other countries. The Act applies to these people only if their activities have an anticompetitive *effect* on U.S. trade or commerce — an effect which restrains U.S. imports, exports or interstate commerce.[13]

A case which illustrates an antitrust violation with respect to U.S. imports is the Justice Department's suit against the quinine cartel, *U.S. v. Nedarlandsche Combinatie Voor Chemische Industrie.*[14] The charges included counts under both sections 1 and 2 of the Sherman Act. The indictment alleged that 15 corporations, 12 European and three domestic, had engaged in a conspiracy to control and regulate the supply of cinchono bark, from which quinine is produced, and of quinine and quinidine, drugs used for many medical purposes including treatment for malaria and heart disorders.

The alleged price-fixing was of two kinds. The first involved a secret bid-rigging agreement between the European producers of quinine whereby only a Dutch firm, Nedchem and its affiliates, would bid on the purchase of part of the U.S. Government's quinine stockpile, but would share the purchase with the other producers who would refrain from the bidding and thus be assured of a low price. The second aspect was an alleged agreement to fix the prices of quinine in the United States. The domestic importers were joined as defendants in the suit.[15]

An example of a violation of the Sherman Act affecting U.S. exports is *Hazeltine Research Inc. v. Zenith Radio Corp.*[16] In that case, Zenith Radio Corporation, which had been successfully engaged in the business of manufacturing radio and television sets for sale in the United States and foreign countries, had obtained and used patents pursuant to licensing agreements with Hazeltine

---

[12] *Id.*

[13] United States v. Aluminum Co. of America, 148 F2d 416 (2d Cir. 1945). *See,* Cook, *The Application of the Criminal Law of a Country to Acts Committed by Foreigners Outside the Jurisdiction,* 40 W. VA. L. REV. 303 (1934); and Hyde, *Harvard Research in International Law, Jurisdiction with Respect to Crime,* 29 AM. J. INT'L. L. 480 (Supp. 1935); also, *International Antitrust Law Symposium Part I,* 8 J. INT'L. L. & ECON. 1-112 (1973).

[14] United States v. N. V. Nederlandsche, 1974-2 Trade Cas. 75434 (S.D.N.Y. 1974).

[15] *Id.*

[16] Hazeltine Research, Inc. v. Zenith Radio Corp., 239 F. Supp. 51, (N.D. Ill., 1965).

Research, Inc. Hazeltine Research is a wholly-owned subsidiary of the Hazeltine Corporation, a diversified company that had among its assets numerous foreign patents, including the foreign counterparts of Hazeltine Research's domestic patents.

Prior to 1959, Zenith had obtained the right to use all of Hazeltine Research's domestic patents under a so-called standard package license. In that year, however, with the expiration of Zenith's license imminent, Zenith declined to accept Hazeltine Research's offer to renew, asserting that it no longer needed a license. Hazeltine Research brought a suit for patent infringement. Zenith's answer alleged that the patent asserted was invalid, that Research's claim was unenforceable because of the patent misuse, and that Research had unclean hands because of its conspiracy with foreign patent pools. Zenith later filed a counterclaim against Hazeltine Research alleging violations of the Sherman Act by the misuse of Hazeltine Research patents as well as by a conspiracy among Hazeltine Research, Hazeltine Corporation, and patent pools in Canada, England, and Australia. Zenith contended that these three patent pools had refused to license the patents (including Hazeltine Corporation patents) placed within their exclusive licensing authority to Zenith and others seeking to export American made radios and televisions into those foreign markets.[17]

Hazeltine Corporation defended on the ground that:

> . . . conspiracies by American companies with companies abroad are governed solely by foreign law and are not violative of the Sherman Act . . .[18]

The District Court brushed this defense aside, saying that it was well established:

> . . . that a conspiracy to restrain the domestic or foreign commerce of the United States to which any American company is a party violates the Sherman Act irrespective of the fact that the conduct complained of occurs in whole or in part in foreign countries.[19]

The District Court found that Hazeltine Corporation had placed its foreign patents corresponding to its U. S. patents in patent pools in the United Kingdom, Canada and Australia, and had thus conspired with Hazeltine Research to restrain the trade or commerce of the United States in violation of section 1 of the

[17] *Id.*

[18] *Id.* at 78.

[19] *Id.* at 78.

Sherman Act, and was liable for injury caused to Zenith's foreign business by the operation of the pools.[20]

The Supreme Court concurred as to the injury to Zenith's exports from the Canadian pool and held that it was illegal for American firms to cooperate in a patent pool which had the intended effect of limiting American exports of electronic products to Canada by nonparticipants in the patent pool.[21]

Basically, this is the essence of U.S. antitrust enforcement in international trade and, as such, is not particularly difficult to grasp. However, when applied to problems like bribery of foreign officials, the international antitrust area is complicated by important collateral considerations which must be taken into account in determining whether or not subject matter jurisdiction may be properly exercised.[22]

Although Congress intended that the Sherman Act should have a broad applicability to foreign commerce, the maintenance of comity between nations under principles of international law place certain practical constraints on the reach of this and other antitrust laws. If each nation were to apply its national laws to their full extent regardless of the impact on the vital concerns of other nations, severe international collisions and friction would be generated. Thus the application of our antitrust laws in the context of international commerce may be balanced by considerations of foreign policy and international law.

In his testimony, Mr. Baker discussed four constraints of particular importance which must be analyzed in nearly every international antitrust problem. These are:

(1) The doctrine of sovereign immunity;
(2) The doctrine of act of state;
(3) The doctrine of foreign governmental compulsion; and,
(4) Considerations of comity.[23]

The Doctrine of Sovereign Immunity

Briefly, the doctrine of sovereign immunity provides that, unless he gives his consent, a sovereign (or his agents) is immune from suit in foreign courts.[24] In the United States, however,

---

[20] *Supra* note 16, at 77-78.

[21] Zenith Corp. v. Hazeltine Research, Inc., 395 U.S. 100, 132; 23 L. Ed. 2d 129; 89 S. Ct. 1562 (1969).

[22] *See* Baker, *supra* note 2, at 55, 440.

[23] *Id.*

[24] L'Invincible, 14 U.S. (1 Wheat.) 238 (1816); The Schooner Exchange v. McFaddan, 11 U.S. (7 Cranch) 116 (1812). *See* Note, *The American Law of Sov-*

the doctrine is more restricted and excludes from immunity any sovereign acts of a commercial nature.[25]

An example where the assertion of sovereign immunity has been affirmed in an antitrust case was in the 1952 grand jury investigation of the petroleum industry.[26] In that case, the Anglo-Iranian Oil Company moved to quash a subpoena directed to it on the ground that it had been ordered by the British Government not to produce documents not located in the United States and not related to business transacted in the United States.[27] The Court found that the British Government, with a capital investment of about 35 percent and ownership of more than 50 percent of the voting stock, controlled the company. Therefore, the company was considered to be an instrument of the British Government and accordingly, the court quashed the subpoena. The basis of the decision was that the company was a subdivision of the British Government and was entitled to the immunity of a sovereign from a suit without its consent.[28] The Court distinguished an earlier case, *United States v. Deutsches Kalisyndikat Gesellschaft*,[29] where the doctrine was not extended to a French corporation[30] which was organized to administer potash mines in Alsace-Lor-

---

ereign Immunity Since the Tate Letter, 4 VA. J. INT'L L. 75 (1964); Note, *Sovereign Immunity for Commercial Instrumentalities of Foreign Governments*, 58 YALE L. J. 176 (1948). *See*, also W. Fugate, *supra* note 4, at 33, 34, 39.

[25] Bank of United States v. Planters' Bank of Georgia, 22 U.S. (9 Wheat.) 904, 906 (1824). The principle that immunity is limited only to the "governmental acts of a foreign state" was enunciated by Chief Justice Marshall in 1824:

> . . . when a government becomes a partner in any trading company, it divests itself, so far as concerns the transactions of that company, of its sovereign character, and takes that of a private citizen.

[26] *In re* Investigation of World Arrangements with Relation to Production, Transportation, Refining, and Distribution of Petroleum, 13 F.R.D. 280 (D.D.C. 1952).

[27] *Id.* at 289.

[28] *Id.* at 291.

[29] 31 F2d 199 (S.D.N.Y. 1929).

[30] Eleven-fifteenths of the stock of the corporation, Societe Commerciale des Potasses d'Alsace, was owned by the French government. The court, in refusing to extend the doctrine of sovereign immunity, stated that a corporation is an entity distinct from its stockholders, that there were private shareholders and that the corporation's by-laws provided that it could be sued. The court also stated:

> A foreign sovereign cannot authorize his agents to violate the law in a foreign jurisdiction, or to perform any sovereign or governmental functions within the domain of another sovereign, without his consent. He, therefore, cannot claim as a matter of comity or otherwise that the act of the alleged agent in such a case is the act of the sovereign, and that a suit against the agent is in fact a suit against the sovereign. *Id.* at 203.

raine. In that case, the French Government was involved in a commercial venture by operating the company, whereas the operation of the Anglo-Iranian Company in supplying oil for the British military was held to be a governmental function.[31]

The courts have generally deferred to State Department policy in this area, and that Department has compiled a set of standards for such cases.[32]

Generally, in applying the doctrine of sovereign immunity, the courts will follow a restrictive or strict construction and only extenuating circumstances of a national security or political nature will result in the recognition of immunity from the process of U. S. courts with respect to sovereign diplomatic and political activities even if these activities have anticompetitive consequences.[33]

The Doctrine of Act of State

The act of state doctrine holds that U. S. courts may not review the political acts of a sovereign within that sovereign's territory, even where the sovereign is not itself a party to litigation and even where such acts would, but for the applicability of the doctrine, be Sherman Act violations.[34] This doctrine was formalized in *American Banana Co. v. United Fruit Co.*[35] In that case, the American Banana Company alleged that the United Fruit Company, a New Jersey corporation engaged in the banana trade,

---

[31] A distinguished commentator, Wilbur L. Fugate, noting that the two corporations were both organized for commercial enterprises believes that the two cases appear to be in conflict and that a commercial company engaged in commerce in the United States should be subject to our laws, including the antitrust laws. Fugate, *supra* note 4, at 113. *See also*, E. W. Kintner and K. D. Hodlgartien, *Application of United States Antitrust Laws to Foreign Trade and Commerce — 1 Variations on American Banana Since 1909*, 15 B. C. IND. & COM. L. REV. 343-67 (1973); Earl Kintner and Katherine Drew Hallgarten, *Act of State Doctrine*, 3 DENVER J. INT'L L. & POLICY 133-40 (1973); Comment, *International Law: The Act of State Doctrine as a Limitation upon the Extraterritorial Application of the United States Antitrust Laws*, 21 J. PUBLIC L. 151 (1972).

[32] Fugate, *supra* note 4, at 113. The DOS policy is as follows:

> . . . The Department feels that the widespread and increasing practice on the part of governments of engaging in commercial activities makes necessary a practice which will enable persons doing business with them to have their rights determined in the courts. For these reasons it will hereafter be the Department's policy to follow the restrictive theory of sovereign immunity . . .

[33] *See* Baker, *supra* note 2, at 55,440.

[34] *Id.*

[35] American Banana Co. v. United Fruit Co., 213 U.S. 347, 29 S. Ct. 511, 53 L. Ed. 826 (1909).

had monopolized and restrained trade in violation of the Sherman Act to the injury of the plaintiff.[36]

Speaking for the Supreme Court in the *American Banana* case, Justice Holmes held that the complaint did not state a cause of action under the Sherman Act since the acts alleged were conducted outside the territorial jurisdiction of the United States and were legal under the laws of the jurisdiction within which they were performed. Also, the Court said that it considered the acts in question acts of a foreign government.[37]

Many courts have distinguished the *American Banana* case on the grounds that the Court did not see the acts abroad as substantially affecting U. S. commerce.[38] These courts view only those acts and contracts abroad where U. S. foreign commerce is involved or affected as falling within their jurisdiction. The Second Circuit, in a 1956 case, characterized U. S. power over foreign commerce this way:

> While Congress has no power to regulate commerce in the Dominion of Canada, it does have power to regulate commerce with foreign nations or among the several states. This power is now generally interpreted to extend to all commerce, even intrastate and entirely foreign commerce, which has a substantial effect on commerce between the states or between the United States and foreign countries . . . Particularly is this true when a conspiracy is alleged with acts in furtherance of

---

[36] The complaint further alleged that after plaintiff, American Banana, had purchased a banana plantation in Panama, which was then part of the United States of Colombia, and had begun construction of a railroad to transport the produce to export markets, it was notified by the defendant, United Fruit, that American must either combine with United Fruit or stop construction. The plaintiff complained that when it refused, the defendant influenced the Governor of Panama to recommend that Costa Rica be allowed to administer the land over which the railroad was to run and that later Costa Rican soldiers and officials seized a part of the plantation and stopped construction of the railroad. Then, in an *ex parte* proceeding, a third party obtained judgment from a Costa Rican court declaring the plantation to be his and he then sold it to the defendant. Another charge was that United Fruit, to prevent competition, had secured long term contracts with most of the producers of fruit in the region by compelling them to meet its terms and thus injuring the plaintiff's export capacity.

[37] 213 U.S. 347 (1909).

[38] *See, e.g.*, United States v. American Tobacco Co., 221 U.S. 106 (1910); United States v. Pacific and Artic Railway and Navigation Comp., Pacific Coast Steamship Comp., Alaska Steamship Comp., and Canadian Pacific Railway Comp., 228 U.S. 87 (1913); Thomsen v. Cayser, 243 U.S. 66 (1916); United States v. Sisal Sales Corp., 274 U.S. 268 (1927). *Cf.* Steele v. Bulova Watch Co., 344 U.S. 280 (1952); Branch v. Federal Trade Comm'n, 141 F2d 31 (7th Cir. 1944).

that conspiracy taking place in both the United States and foreign countries.[39]

Another case which distinguished the *Banana* case was *United States v. Sisal Sales Corp.*[40] That case involved an alleged conspiracy to restrain trade and to monopolize the trade in sisal, a Mexican plant used for making twine.[41] In distinguishing their decision to find jurisdiction, the Court said of the *Banana* case:

> Here we have a contract, combination and conspiracy entered into by parties within the United States and made effective by acts done therein. The fundamental object was control of both importation and sale of sisal and complete monopoly of both internal and external trade and commerce therein.[42]

The Court went on to say that the basic object of the plan was the monopolization of sisal in both internal and external trade and that the violation occurred, at least in part, within the territory of the United States.[43]

The Doctrine of Foreign Governmental Compulsion

The doctrine of foreign governmental compulsion states that a private corporation should not be held liable for certain violations of law which it may commit because it is compelled to do so under risk of penalty by a foreign sovereign.[44] Thus, if a foreign government compels a person to act in a specified manner which would violate our antitrust laws, such compulsion is a complete defense to an antitrust action based on the act compelled.

The application of this principle can be seen in a 1970 private

---

[39] Vanity Fair Mills, Inc. v. T. Eaton Co., Ltd., 234 F2d 633 *cert. denied*, 352 U.S. 871 (1956), 77 Sup. Ct. 96, Also cited in Fugate, *supra* note 4, at 42.

[40] 274 U.S. 268, 47 S.Ct. 592, 71 L.Ed. 1036 (1927).

[41] The complaint alleged that the defendants, three U.S. banking corporations, two Delaware corporations, and a Mexican corporation, had conspired to eliminate, and in fact did eliminate, the competition in the importation of sisal. The Government complained that the defendants, by persuading the Government of Mexico to pass discriminatory legislation, had enabled the Mexican corporation to become the sole purchaser of sisal from the producers, and one of the Delaware corporations to become the sole importer into the United States. As a result, the Government claimed that there was no longer any competition in the trade and that high prices were indiscriminately set. The Supreme Court reversed the lower court which had dismissed for failure to state a cause of action and held that the defendants had clearly engaged in a plan to destroy competition. *Id.* at 274.

[42] 274 U.S. at 276.

[43] *Id.*

[44] *See* Baker *supra* note 2, at 55,445.

antitrust suit, *Interamerican Refining Corp. v. Texaco Maracaibo, Inc.*[45] In that case, the plaintiff alleged that there had been a boycott designed to deny it Venezuelan crude oil required for its operations. The plaintiff was a processor of low grade Venezuelan crude oil, but was unable to obtain any for processing in its refinery in New Jersey because of the defendants' refusal to deal. One of the defendants, Amoco, claimed it was unable to obtain oil from its suppliers because the Venezuelan government had forbidden any sales that would reach the plaintiff, directly or indirectly. All suppliers refused to sell without the explicit permission of the Venezuelan government.

The District Court for the District of Delaware awarded a summary judgment to the defendants on the ground that they were compelled by Venezuelan regulatory authorites to boycott Interamerican, and thus had a complete defense to the matter. The court stated that sovereignty includes the right to regulate commerce within the nations:

> When a nation compels a trade practice, firms there have no choice but to obey. Acts of business become effectively acts of the sovereign. The Sherman Act does not confer jurisdiction on United States courts over acts of foreign sovereigns. By its terms, it forbids only anticompetitive practices of persons and corporations.[46]

When the plaintiff sought the court's inquiry and determination as to the validity of the act of compulsion under Venezuelan law, the court declared that it could not undertake such an inquiry because the act of state doctrine commands that the conduct of foreign policy resides exclusively in the sovereign. The court went on to state that:

> . . . anticompetitive practices compelled by foreign nations are not restraints of commerce, as commerce is understood in the Sherman Act, because refusal to comply would put an end to commerce.[47]

Issues of Comity

Issues of comity involve "situations in which two states have concurrent jurisdiction and are likely to prescribe and enforce rules of law requiring inconsistent conduct upon the same individ-

---

[45] 308 F. Supp. 1291 (D. Del. 1970).

[46] *Id.* at 1298.

[47] *Id.* Fugate, *supra* note 4, at 80, notes that while the acts here complained of were outside of Venezuela, that country nonetheless had complete control of the oil which it exported.

ual."[48] Whether to exercise or to refrain from the exercise of jurisdiction is a question that must be considered in good faith by the courts of each state with a view to the principles of international law. Some of these considerations are:

(1) The vital national interest of each of the states;

(2) The extent and the nature of the hardship that inconsistent enforcement actions would impose upon the person; . . . and,

(3) The extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rule prescribed by that state.[49]

The generally accepted principle which was enunciated by Mr. Justice Holmes in the *American Banana*[50] case is that:

> . . . the character of an act as lawful or unlawful must be determined wholly by the law of the country where the act is done.[51]

In that case, Justice Holmes was not examining the question of the effects on U. S. trade but rather was viewing the validity under foreign law of acts by a U. S. citizen in a foreign country. He determined that the law of the foreign nation should govern.[52]

Today the prevailing view is that U. S. citizens in a foreign country are not required to conform to U. S. laws, including the Sherman Act, so long as their activities have no direct and substantial effect on U. S. trade. A vital notion in this area is the international law territorial principle and its corollary, the "objective" territorial principle.[53]

The territorial principle as applicable in the United States was first stated by Chief Justice Marshall in an 1812 case:

> The jurisdiction of the nation, within its own territory, is necessarily exclusive and absolute; it is susceptible to no limitation, not imposed by itself.[54]

---

[48] Baker, *supra* note 2, at 55,445.

[49] RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 40 (1965), *cited in* Baker, *supra* note 2, at 55,445.

[50] 213 U.S. 347 (1909).

[51] *Id.* at 356. *See also* Fugate, *supra* note 4, at 31.

[52] *See* Fugate, *supra* note 4, at 31; *See also*, RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 9, comment *f* (1971), and RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW § 20 (1965). *See also* Note, *Antitrust Law — A Foreign Plaintiff has Standing to Bring Suit, under the Sherman and Clayton Acts, Even Though the Injury Occurs in a Foreign Jurisdiction*, 10 TEXAS INT'L L. J. 579 (1975).

[53] *See* Fugate, *supra* note 4, at 34-35.

[54] The Schooner Exchange v. McFaddan, 11 U.S. (7 Cranch) 116 (1812), quoted in Fugate, *supra* note 4, at 34.

In its simplest form this means that a state, within its own territory, has exclusive power and authority. But if taken literally this principle means that all acts, including anticompetitive ones, must have a particular situs within one country for any one nation to have jurisdiction.[55] This, however, does not account for a series of related acts which may make up a crime where such acts occur in two or more states. A contract may be made in one state and performed in another. A conspiracy may be planned in one state and carried out elsewhere.[56] A bribe may be transacted in one state and affect commerce in another. Thus the "objective" territorial principle states that someone in one country, who willfully initiates an action to take effect in another, is answerable at the place where the wrong is committed.[57] This principle was applied in a domestic antitrust case, *Strassheim, Sheriff of Cook County v. Daily*[58] which involved the bribing of a public official of Michigan and the obtaining of public money from Michigan under false pretenses; acts which were carried out outside the state of Michigan. Mr. Justice Holmes in that case stated:

> Acts done outside a jurisdiction but intended to produce and producing detrimental effects within it, justify a state in punishing the cause of the harm as if he had been present at the effect, if this state should succeed in getting him within its power.[59]

The Restatement of Conflict of Laws states:

> If consequences of an act done in one state occur in another state, each state in which any event in the series of act and consequences occurs may exercise legislative jurisdiction to create rights or other interests as a result thereof.[60]

Comment *a* to that section adds that if two or more states have concurrent jurisdiction, a state may impose liability upon any person whose (illegal) activity produces consequences within that state.[61] Comment *e* of a later section[62] says that if any part of a crime is committed in one state, the state can provide a penalty

[55] *See* Fugate, *supra* note 4, at 34.

[56] *Id.*

[57] *See* Chief Justice Taft's discussion in Ford v. United States, 273 U.S. 593, at 622, 47 S.Ct. 531, 71 L.E. 793 (1926). *See also*, Fugate, *supra* note 4, at 37.

[58] 221 U.S. 280 (1910).

[59] *Id.* at 285. *See also* Fugate, *supra* note 4, at 37.

[60] RESTATEMENT OF CONFLICT OF LAWS § 65 (1934). *See* Fugate, *supra* note 4, at 37.

[61] *See* Fugate, *supra* note 4, at 37.

[62] *Id. See*, RESTATEMENT OF CONFLICT OF LAWS, § 428 comment *e* (1934).

for the whole crime, not just the event within the state. The Restatement (Second) of the Foreign Relations Law of the United States, section 18 (1965) states that a nation has jurisdiction[63] to prescribe a rule of law attaching legal consequences to conduct outside its territory that has an effect within its territory if:

> (b)(i) The conduct and its effect constitute elements of activity to which the rule applies; (ii) the effect within the territory is substantial; (iii) it occurs as a direct and foreseeable result of the conduct outside the territory; and (iv) the rule is not inconsistent with the principals of justice generally recognized by states that have reasonably developed legal systems.[64]

Therefore, as stated by Mr. Baker, it would seem that "payments to foreign governmental officials could be the subject of an antitrust suit where they were part of a scheme to restrain or monopolize U. S. imports or exports if a suit was not otherwise constrained by these four and other related considerations."[65]

Bribery and U. S. Antitrust Laws

Bribery has been an issue in a few domestic antitrust cases.[66] The most notable case to date is *Rangen Inc. v. Sterling Nelson & Sons, Inc.*[67] In that case, a manufacturer of fish food, Sterling Nelson and Sons, Incorporated, asserted that a competitor, Rangen, Incorporated, had bribed an official of the State of Idaho to prefer Rangen's products. Four claims were alleged in the

---

[63] Fugate, *supra* note 4, at 38.

[64] *Id.* *See*, RESTATEMENT SECOND OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965).

[65] Baker, *supra* note 2, at 55,445.

[66] More often, bribery questions come up under other Federal statutes including:

> (a) Section 162 (c) of the Internal Revenue Code, 26 U.S.C. § 162 (c) (1)(2), which deals with bribes paid to foreign officials and states that no deduction shall be allowed under section (a) dealing with ordinary and necessary expenses incurred in carrying on a trade or business for such bribes or payments;
>
> (b) The federal bribery statute, 18 U.S.C. § 201 (1970), which deals with bribes paid to domestic U.S. officials. *See*, Baker, *supra* note 2, at 55,445; and *A. L. Farnsworth*, 32 T C M. 903 (1973) where the I.R.S. failed to sustain its burden of proving that the taxpayer had understated earnings because of bribes to Mexican officials. In another case, United States v. Rexach, et al., 482 F2d 10 (1st Cir. 1973), an American contractor who, over a 25 year period, had given $10 million in kickbacks to Trujillo, the dictator of the Dominican Republic, it was conceded that the payments would be deductible if made before the date of the 1958 Amendment providing for section 162(c).

[67] 351 F.2d 851 (9th Cir. 1965).

plaintiff's complaint. The first was based upon section 2(c) of the Clayton Act, as amended by the Robinson-Pattman Act,[68] which makes it unlawful for any person engaged in commerce, in the course of such commerce, to pay or receive anything of value as a commission (brokerage or other compensation) allowance or discount except for services rendered in connection with the sale or purchase of goods. The second and third claims were based upon sections 1 and 2 of the Sherman Act.[69] The fourth claim was based upon the Idaho Code[70] which was the State's counterpart to section 2(c) of the Clayton Act.[71]

At the trial, evidence was presented which showed that the plaintiff and defendant were in competition with each other and six other companies for the production and sale of fish food in the western states. At various times during the 4 years prior to 1962, the plaintiff had contacted the Chief of Fisheries from Idaho's Department of Fish and Game in an effort to sell its product to the State. The State, however, did not purchase any fish food from that company and, with only insignificant exceptions, the defendant was the sole supplier of fish food to the State of Idaho for consumption at fish hatcheries during those years.

For a period of 7 years, the defendant had paid a total of $24,047.80 to a superintendent of the State's fish hatchery, who was charged with the authority to inspect fish food for nutritional value. The court found that these payments were made pursuant to an understanding between the superintendent and the defendant that the former would use his best efforts to obtain for the defendant the fish food business for the State of Idaho.

After a trial, the District Court, sitting without a jury, entered judgment for the plaintiff awarding treble damages and attorney fees. The conclusions of law of the trial court indicate that the damages were awarded on the first claim, involving section 2(c) of the Clayton Act. An appeal was taken and the Appellate Court felt the trial court had sufficient evidence to find that the payments were indeed commercial bribes. As to the question of whether the facts of the case pertained to section 2(c) of the Clayton Act,[72] the defendants presented two lines of

[68] 49 Stat. 1526 (1936), 15 U.S.C. § 13(c) (1964).

[69] 26 Stat. 209 (1890), *as amended*, 15 U.S.C. § 1 and 2 (1964).

[70] Idaho Revised Code § 48-202(c) (1948).

[71] As to that claim, the plaintiff invoked diversity jurisdiction of 28 U.S.C. § 1332 (1964).

[72] Section 2(c) reads:

arguments. The first was that section 2(c) should not apply to the case at bar because that section is directed solely against price discrimination through rebates disguised as brokerage, not against commercial bribery unassociated with price discrimination.

The court found nothing in the express language of the Act nor in the statutory context of section 2 which required that subsection (c) be limited to instances of price discrimination. In fact in a previous case, *Federal Trade Commission v. Henry Broch & Co.*,[73] the Supreme Court noted with regard to the legislative history that there was Congressional interest to proscribe other practices other than just price discrimination including the bribing of a seller's broker by the buyer.[74]

Second, the defendants relied upon a Supreme Court decision, *United States v. Boston & Massachusetts Railroad*,[75] as establishing that ordinary bribery is not a basis for recovery under the antitrust laws. That case was an action under section 10 of the Clayton Act.[76] The gist of the indictment was that railroad officers had accepted bribes from the purchaser of some of the railroad's railway cars as compensation for making a sale without competitive bidding. The Court, in rejecting the government's contention that the bribes and related agreements gave the officers a "substantial interest" in the purchasing company in violation of the Act, said:

> But it is doubtful that this indictment, as illuminated by the bill of particulars, alleges anything more in substance than a bribe. Bribery might well be in the family of offenses covered under a conflict of interest statute. But it is more remote from an antitrust frame of reference.[77]

(c) Payment or acceptance of commission, brokerage or other compensation.

It shall be unlawful for any person engaged in commerce, in the course of such commerce, to pay or grant, or to receive or accept, anything of value as a commission, brokerage, or other compensation, or any allowance or discount in lieu thereof, except for services rendered in connection with the sale or purchase of goods, wares, or merchandise, either to the other party to such transaction or to an agent, representative, or other intermediary therein where such intermediary is acting in fact or in behalf, or is subject to the direct or indirect control of any party to such transaction other than the person by whom such compensation is so granted or paid.

[73] 363 U.S. 166 (1960).

[74] *Id.* note 55 at 169.

[75] 380 U.S. 157 (1965).

[76] 38 Stat. 734 (1914); 15 U.S.C. § 20 (1973).

[77] 380 U.S., at 162.

The *Rangen* court, however, noted that the Supreme Court's observation was not a definitive ruling and that there could be circumstances where commercial bribery would be violative of the antitrust laws.[78]

The court concluded that section 2(c) was not directed solely against price discrimination through rebates described as brokerage and, given fulfillment of the express requirements of subsection 2(c), held that that subsection also encompasses cases of commercial bribery.[79]

Donald I. Baker's Hypothetical Situations

In his testimony before the House Subcommittee on International Economic Policy,[80] Mr. Baker posed a series of hypothetical situations. He divided these situations into five categories:

(1) Payment for favorable considerations in general;

(2) Payment for specific preferences in foreign government procurement;

(3) Payment of foreign government "fees" or required "contributions";

(4) Payment to control foreign sources of raw material; and,

(5) Payment to procure foreign government action.

The first situation, which Baker believes to be the most common form of bribery, he terms " 'grease the wheel' payments for future considerations without the immediate prospect of advantage, offered in the hope that it will smooth future access to or cooperation from government officials."[81] In Baker's analysis,

[78] 351 F2d, at 857 (9th Cir. 1965). Where commercial bribery is associated with evils which a particular provision of the antitrust laws are designed to prevent, the fact that it was bribery rather than a mere defensive arrangement ought to preclude application of the statute.

[79] *Id.* at 858. The court also cited Fitch v. Kentucky-Tennessee Light and Power Co., 136 F.2nd 12 (6th Cir. 1943), where the plaintiff power company recovered damages under section 2(c) from its former president who had accepted bribes in connection with the power company's purchases of coal. The court there found that commercial bribery was within the intended proscription of section 2(c) despite the fact that the compensation was not passed on to the buyer. The court reviewed prior decisions which had construed section 2(c) as an absolute prohibition of brokerage payments except for services rendered and concluded that the threat to competition posed by such bribery, brought within the terms of section 2(c).

[80] Baker, *supra* note 2, at 55,445-55,448.

[81] Baker, *supra* note 2, at 55,445.

this type of payment would most likely not be an antitrust violation in and of itself, for it is not usually made with the intent to harm a U. S. competitor's export opportunities and as such would not be directly related to the flow of imports into or exports from U. S. markets.[82]

The second situation, payments for specific preferences in foreign government procurement, may very well effect U. S. commerce and thus could be seen as a violation of U. S. antitrust laws. As an example of this type of payment, Baker gives the following:

> . . . A U. S. firm, say, sells its product directly to a foreign government for its own use, bribing the responsible foreign procurement official to choose its product over that of a particular competitor. If the bribe is paid for the purpose of excluding the product of a non-U. S. competitor, there is no likely violation of U. S. law since there is no anticompetitive effect on U. S. foreign commerce.
>
> . . . If, to change the facts, a Delaware corporation is paying a bribe specifically to ensure that a foreign procurement officer buys its product to the exclusion of its principal competitor, a New Jersey corporation, there would be an impact on U. S. foreign commerce. It is not necessarily, however, a violation of U. S. antitrust law. Whether or not there is a violation of the Sherman Act might well depend, for example, on whether the procurement officer was acting in his official capacity on behalf of his government in accepting the payment or whether he was acting outside the scope of his authority. If the former, actual execution of the purchase might well be an act of state. The act of state doctrine thus might insulate the Delaware corporation from antitrust liability since holding it liable would imply a judgment about the conduct of the foreign government officer, within his or her own territory, and this is just what the act of state doctrine seeks to avoid.[83]

The situation described above is similar to the one presented in *Occidental Petroleum Co. v. Buttes Gas & Oil Co.*[84] In that case, a private antitrust suit was brought by the Occidental Petroleum Corporation and its wholly-owned subsidiary, Occidental of Umm al Qaywayn against Clayco Petroleum Corporation and Buttes Gas and Oil Company (Buttes). The complaint charged that the defendants conspired to restrain trade, to monopolize, and to attempt to monopolize the exploration, development and exploitation of petroleum reserves of the territorial waters of

[82] *Id.*, at 55,446.

[83] Baker, *supra* note 2, at 55,446.

[84] 331 F. Supp. 92 (1971).

the Trucial States. The plaintiff and defendant corporations were holders of offshore oil concessions granted by two adjacent sheikdoms in the Persian Gulf. The defendants were charged in the complaint with instigating an international dispute over the sovereign rights to a portion of the Gulf — allegedly covering the richest area of the plaintiffs' concession — with the result that the plaintiffs were prevented from enjoying the fruits of their concession. The complaint alleged that the defendants, after unsuccessfully submitting a plan to the British Political Agent in the Trucial States whereby Buttes would drill for oil in a portion of the Occidental — Umm al Qaywayn concession area, induced and procured the Ruler of Sharjah (one of the sheikdoms) to claim ownership of the oil-rich portion of plaintiffs' concession area.

The defendants, in a motion to dismiss the plaintiffs' suit, relied on the limitation of antitrust jurisdiction articulated in *Eastern R.R. Presidents Conference v. Noerr Motor Freight, Inc.*[85] and the rule of judicial abstention — the act of state doctrine. The Court noted that in *Noerr*, the Supreme Court unanimously decided that:

> The Sherman Act does not prohibit two or more persons from associating together in an attempt to persuade the legislature or the executive to take particular action with respect to a law that would produce a restraint on a monopoly.[86]

But the Court pointed out that the root of the *Noerr* decision was a desire to avoid a construction of the antitrust laws that might trespass upon the First Amendment right of petition[87] and that the constitutional freedom "to petition the government" carried limited if any applicability to the petitions of foreign governments.[88] The dispositive principle in the motion was the act of state doctrine and the Court dismissed the suit and acknowledged the Executive's primary competency in foreign affairs.[89]

To further complicate the analysis of the example above, Baker suggests that if the procurement officer accepts the bribe, without official sanction, the act of state doctrine would probably not apply.[90] He cites *Continental Ore Co. v. Union Carbide &*

[85] 365 U.S. 127 (1961).

[86] 331 F. Supp., at 107.

[87] *Id.* at 108.

[88] *Id.*

[89] *Id.*, at 108-109.

[90] Baker, *supra* note 2, at 55,446.

Carbon Co.[91] in support of his suggestion. In that case, the Canadian government appointed a Canadian corporation to act as that nation's exclusive agent to purchase and allocate to Canadian industry vanadium metal during World War II. Without being authorized to do so, the Canadian agent made purchases which discriminated against the plaintiff and aided the Canadian agent's U. S. parent in restraining and monopolizing the vanadium industry. Bribery per se was not involved in the case for the agent was a loyal subordinate to the company seeking preferential treatment.[92] The Supreme Court held the defendants liable for violating the Sherman Act, declining to find that the agent's conduct had been directed or ratified by the Canadian government.[93]

Baker notes that at least three special facts were present in the *Continental Ore* case which may not be present in instances of bribery of foreign government procurement officers.[94] He states that:

> First, *Continental Ore* involved a conspiracy not only between one private firm and a government officer but a conspiracy among other private firms as well. It is not clear that the requirement of Section 1 of the Sherman Act that the restraint of trade be the result of a conspiracy will be met by a simple relationship between a single private firm and a single bribed government official, even one acting outside the scope of his or her authority.[95]

Baker also notes that in a domestic antitrust inducement case, *Harman v. Valley National Bank of Arizona*[96], the Court of Appeals for the North Circuit reversed the District Court's dismissal of a Sherman Act complaint. The complaint alleged that the defendants, several leading Arizona banks, induced the then Attorney General of the State of Arizona to file actions against banks in the state which resulted in those banks being placed in receivership with the intent to restrain and monopolize commercial banking in the state. The court in its decision made clear that more than one private company was involved in the alleged bribe.[97]

---

[91] 370 U.S. 690, at 707 (1962).

[92] Baker, *supra* note 2, at 55,446.

[93] *Id.*

[94] *Id.*

[95] *Id.*

[96] 339 F.2nd 564 (9th Cir. 1964).

[97] *See* Baker, *supra* note 2, at 55,446.

Baker then continues his analysis of the two remaining special facts:

> A second, related factor is that in both *Continental Ore* and in *Harman* the alleged antitrust violation was a much more extensive scheme of conduct than merely inducing specific discriminatory behavior by a specific government official. There would likely be judicial reluctance to use the antitrust laws to deal with a simple bribery situation where the commercial impact of that bribe was relatively limited. These two factors would weigh against successful prosecution of a Section 1 action on the given facts.
> Third, the defendants in *Continental Ore* had virtually total control over the U. S. production of vanadium and over the vanadium sold in the United States. This degree of market power amply justified a finding that the defendants had monopolized the relevant vanadium market, North America, in violation of Section 2 of the Sherman Act. It would be most improbable that even an extended sequence of bribes and sales to a foreign government would involve sufficient domination of any product market relevant to U. S. commerce.[98]

The third hypothecal situation, payments of foreign government "fees" or required "contributions," Baker feels may not be a bribe at all. He states that these payments are more in the nature of an "assessment" or "license fee" which firms are required to make to a foreign government as a condition of doing business in that country.

> The test of whether it is a "bribe" to the foreign official or a "payment" to the foreign government can probably best be developed under Section 162(c) of the Internal Revenue Code. Where the payment is to the government, the principle of sovereign immunity would, in most situations, preclude U. S. antitrust enforcement against the foreign government.[99]

Thus, these "bribes" or "fees" are just a cost of doing business which must be absorbed by the U. S. corporation.

Baker's next hypothetical situation, payments to control foreign sources of raw materials, can best be illustrated when a private U. S. firm, conspiring to restrain trade in and monopolize a raw material which is an important U. S. import, uses bribes to further its anticompetitive purposes.[100] Both the *American Banana* and *Sisal* cases illustrate this situation. The analysis of those two cases shows that an attempt by a group of American firms to use

---

[98] *Id.* at 55,446-447.

[99] *Id.*

[100] *Id.*

bribes of foreign officials to tie up the main foreign source of an essential raw material used in the United States would in fact be a cause of action under U. S. antitrust law. Due consideration must be given, however, to the part a foreign sovereign is playing in the activities. The whole transaction may be deemed to be an act of state and exempt from the antitrust laws.

The last situation, payments to procure foreign government action, Baker believes to be the hardest case to analyze.[101] In this situation, Baker assumes that a group of U. S. corporations concentrated their price-fixing activities abroad at the production level. He further assumes that these corporations bribed the chief executive of the foreign government to issue a presidential proclamation ratifying all past private activities of the group or cartel and announcing that all future anticompetitive activities were explicitly sanctioned and directed by the government. Assume that this proclamation was valid under the foreign government's local law and that failure to comply with the proclamation would render those corporations liable to expropriation of assets if they failed to continue their price-fixing control of exports to the United States.[102] Baker, in analyzing this situation, states that:

> This example brings into play the remaining two jurisdictional considerations . . . namely, the doctrine of foreign governmental compulsion and considerations of comity. It would appear the Cartel could not satisfy both local and United States law. The respective laws are in direct conflict. At the risk of disappointing you, I prefer to leave my question unanswered, today. There are arguments to be made on both sides. Present case law is relatively uncertain. I am sure we would look very carefully at such a fact situation and not reject lightly the option of bringing suit — especially where the vital interests of U. S. consumers were involved.[103]

The requisite effect on U. S. commerce and the domination of a product market required by sections 1 and 2 respectively of the Sherman Act are clearly present. With respect to the governmental compulsion, the analysis may hinge on whether it was "actual" or a more self-styled version and if the latter, a U. S. court might not find the doctrine of foreign governmental compulsion applicable thus allowing a suit to proceed. With regard to issues of comity, the analysis may finally focus on the impact on the U. S. market and the vital interests of U. S. commerce.

---

[101] *Id.* at 55,448.

[102] *Id.*

[103] *Id.* at 55,448.

The problem presented by the above situation is a complex and perplexing one which has not yet been heard by an American court. Generally, where the doctrines of sovereign immunity, act of state or foreign governmental compulsion are present, U. S. courts will abstain from exercising jurisdiction. However, with issues of comity, the courts are allowed a greater degree of discretion and will engage in balancing the various interests and considerations present.

It is clear that the antitrust approach is based on fundamentally different premises than the securities law approach. The antitrust provisions are aimed at a direct legal intervention into the (illegal) transaction itself; the securities provisions are aimed at the disclosure of the material facts. The assumption of securities law in this area of illegal payments is that disclosure of a questionable transaction is enough to deter that transaction. Each body of law has its strengths and weaknesses. Antitrust law is direct but national in scope, examining situations which have an effect on U.S. commerce or trade. Securities law is broader in the sense that it applies to all U.S. corporations involved either domestically or internationally. Further, it may be easier to circumvent securities law in that it is based on voluntary disclosures by the corporation itself and has value only to the degree to which those disclosures are examined and understood by investors. With the above antitrust analysis in mind, an attempt will be made to give an overview of the securities law approach to the problem of illegal or questionable payments abroad.

THE SECURITIES AND EXCHANGE COMMISSION'S APPROACH

The Securities and Exchange Commission (SEC) is taking a different approach to the problem of payments by American firms to foreign governmental officials.[104] Rather than analyzing the

[104] In a speech at the Brookings Institution Seminar on International Trade and Finance, Commissioner John Evans described the SEC's current position on disclosure of improper payments. Evans said that generally the SEC alleges that failure to reveal off-the-record funds, creation of false corporate books and records, use of corporate funds for unlawful purposes, and use of consultant fees or commissions to bribe foreign government officials violate federal securities law. If illegality is uncovered, the SEC will seek relief through court orders prohibiting continuation of such activities and agreement that the company will appoint a committee of independent directors and attorneys to undertake an in-depth inquiry of past and present corporate conduct. The requirement of these in-house studies saves the SEC time and money.
Securities Regulation and Law Report, B.N.A. No. 346, 3/31/76, at A-15.

payments in terms of their effect on U. S. trade and commerce, their approach is directed to requiring firms to make a full and fair disclosure of material matters which investors need to know in order to make informed investment decisions.[105] The SEC was created by the Securities and Exchange Act of 1934,[106] to establish an agency for regulation of the securities markets of the country. Disclosure is and has been the central aim of the national policy in the field of securities regulation. This emphasis is derived from two basic considerations. The first relates to the function of the Federal Government in investment matters; the second relates to the belief that publicity tends to deter questionable practices and to elevate standards of business conduct. In other words, the government has assumed the responsibility to see that investors and speculators have access to enough information to enable them to make informed investment decisions.

The SEC's concern with illegal payments stems mainly from the 1934 Act's requirement that corporations which issue securities must file or disclose certain "material" information. The question of what is a material fact has been wrestled with repeatedly. The Supreme Court has stated that "material facts" are those which "a reasonable investor might have considered . . . important in the making of (an investment) decision."[107] The Second Circuit has recently added and expanded upon that definition:

> Materiality focuses on the weightiness of the misstated or omitted fact in a reasonable investor's decision to buy or sell. . . . Account must be taken of all the surrounding circumstances to determine whether the fact under consideration is of such significance that a reasonable investor would weigh it in his decision whether or not to invest.[108]

---

[105] *See Program of Federal Regulation of Securities, Federal Securities Laws and Corporate Management and Insurance Sheet*, Panel discussion in BUS. LAW., Vol. 31, No. 3, at 1659-1687, 1703-1708. *See also*, Milton V. Freeman, *The Legality of the SEC's Management Fraud Program*; Leonard S. Janofsky, *Liability of Management and Directors for Illegal Conduct*; *Protective Actions*; and Warren F. Grienenberger, *Emerging Disclosure Requirements: Environmental and Socially Significant Matters*, BUS. LAW., Vol. 31, Special Issue, March 1976, at 1295, 1313, and 1423 respectively.

[106] 15 U.S.C. § 78a-jj (1970).

[107] Affiliated Ute Citizens of Utah v. United States, 406 U.S. 128, at 153-154 (1972).

[108] Chris-Craft Industries, Inc. v. Piper Aircraft Corp., 480 F.2nd 341, at 362-363 (2nd Cir. 1972), *cert. denied*, 414 U.S. 910 (1973). The issue is again before the Supreme Court in TSC Industries, Inc. v. Northway, Inc. which was argued March 3, 1976.

Material facts then are not limited to information solely about a corporation's balance sheet. Even facts which have not yet occurred may be deemed material after balancing the indicated probability that the event will occur and the anticipated magnitude of the event in light of the totality of the company's activity. Thus, any information which can be seen as affecting the probable future of the company and which may affect the desire of investors to buy or sell or hold the securities of the company is a material fact.[109] Messrs. Sierck and Watson, in an article[110] on the role of the SEC in illegal and unethical business conduct, believe that unethical though legal corporate conduct might be subject to disclosure as a "material" fact.[111]

The position of various SEC Commissioners appears to be that illegal payments of corporate funds to obtain business are "material" facts. SEC Commissioner Irving M. Pollock recently went so far as to state unequivocally that "the bribery of a foreign official is a *per se* material fact."[112] SEC Chairman Ray Garrett, Jr., who has since resigned, stated in a January 16, 1975 address:

> It may affect earnings if the president is sent to jail. It may affect the quality of earnings if they are dependent to any significant extent on illegal expenditures. If a company can prosper at its present business only by successfully bribing the local fire inspector, or what have you, that information is material to even the most heartless and amoral investor.[113]

SEC Commissioner John Evans stated in an address on May 15, 1975, that knowledge of illegal payments is necessary if investors

---

[109] *See* SEC v. Texas Gulf Sulphur Co., 401 F.2d 833, at 849 (2nd Cir., 1968).

[110] Alexander W. Sierck and Keith S. Watson, *Post-Watergate Business Conduct: What Role for the SEC*, Bus. LAW., Vol. 31, No. 2, Jan. 1976, at 721.

[111] *Id.* at 722. Thus, under the banner of materiality, the SEC is now actively investigating and prosecuting corporations for failing to disclose political contributions and bribery payments both at home and abroad. The Commission's complaint in SEC v. Sanitas Service Corp. typifies its approach. There the SEC brought suit in the District Court for the District of Columbia against a corporation for failure to disclose that certain transactions were in fact "bribes" paid to obtain business for the company. The SEC's complaint suggested two reasons why it deemed this information to be material for investors: (1) In the event that tax treatment of the bribes as deductible expenses were disallowed, corporate earnings would be substantially reduced; and (2) the company's use of bribery to obtain business was illegal and would be terminated if discovered, thus also adversely affecting corporate earnings.

[112] Bus. WEEK, Feb. 23, 1976, at 22, col. 2.

[113] Sierck and Watson, *supra* note 110, at 723-24.

are to make prudent judgments.[114] Thus, the SEC has focused its attack on illegal payments to foreign officials primarily in reliance on the antifraud and reporting requirements of the 1934 Act.[115]

A recent illustration of the SEC's approach to the problem is in its handling of the General Tire and Rubber Company's proxy. The Commission sought "voluntary" compliance from General Tire in reporting any questionable payments either domestically or abroad. General Tire disclosed some information but the Commission charged that the material disclosed was not sufficiently detailed and refused to approve General Tire's proxy,

---

[114] Sierck and Watson, *supra* note 110, at 724. SEC Commissioner John Evans stated in an address May 15, 1975:

> (T)here seems little question that an investor might consider it important to know that the management of his company is misusing corporate funds to engage in conduct involving possible criminal activity. Such conduct, even if the monetary amounts involved are not large, reflects on the integrity of management, particularly in connection with proxy solicitations, and disclosure may well have a significant impact on investor views regarding management's qualifications. Furthermore, the weighing of expected economic rewards against economic risks is fundamental to any investment decision, and, while management has claimed that they are engaged in secret payoffs and other illegal activities in the shareholders' economic interest, such activities increase the risks of doing business without informing shareholders of such risks.

[115] Section 10(b) of the 1934 Act states:

> It shall be unlawful for any person . . . to use or employ in connection with the purchase or sale of any (registered) security . . . any manipulative or deceptive device.

Rule 10b-5 of the 1934 Act makes it illegal to:

> (1) employ any device, scheme, or artifice to defraud,
>
> (2) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person, in connection with the purchase or sale of any security.

Section 13(a) of the 1934 states that the Commission may prescribe any information as it deems necessary or appropriate for the proper protection of investors and to insure fair dealing in the security.

Section 14(e) of the 1934 Act makes it unlawful "to make any untrue statement of a material fact or omit to state any material fact" in connection with tender offers.

Section 18(a) of the 1934 Act makes it unlawful to file documents or reports with the SEC containing statements which are "false or misleading with respect to any material fact."

Section 21 of the 1934 Act provides discretionary powers for the SEC to conduct "such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate" any provision of the Act.

thereby preventing the company from holding its annual meeting.[116] The Commission subsequently filed a complaint[117] alleging violations of the antifraud, reporting and proxy provisions of the Securities Exchange Act of 1934.[118] General Tire, in the above case, has recently consented to the entry of a judgment of a permanent injunction in connection with illegal payments to foreign officials.[119] In addition to the entry of the permanent injunction, ancillary relief was ordered by the court. General Tire has been ordered to maintain accurate books and records and accurate supporting documentation for all transactions entered in its books and records, and to provide the Commission with access to such documentation in connection with these matters. General Tire has also been enjoined first, from using or aiding and abetting the use of corporate funds or funds of its affiliates or subsidiaries for illegal foreign payments and second, from establishing, maintaining or causing to be established any secret or unrecorded fund of corporate monies or other assets or from making or causing to be made any disbursement from such fund. In addition, the company has been ordered to establish a Special Review Committee consisting of five members of the Board with special counsel and to conduct an extensive investigation into the area of payments to foreign officials and to submit a report to the court and to file the report with the SEC as an exhibit to the current report on Form 8-K.[120]

In another recent case, *Securities and Exchange Commission v. Lockheed Aircraft Corp.*,[121] the Commission alleged that Lockheed violated the antifraud, proxy, and reporting requirements of the 1934 Act in connection with payments to officials of foreign governments.[122]

---

[116] *See On Foreign 'Bribes'*, VALUE LINE SELECTION AND OPINION, (N.Y.) XXXI No. 30, Part II, April 30, 1976, at 823.

[117] Securities & Exchange Commission v. General Tire and Rubber Co., (D.C. Dist. Ct.), filed 5/10/76, cited in Securities Regulations and Law Report, B.N.A., No. 352, May 12, 1976, at A-9.

[118] Allegations included the making of substantial improper and illegal payments totaling several million dollars of corporate funds to officials and employees of various governments. *See supra* note 117.

[119] *Supra* note 117.

[120] *Id.* at A-10.

[121] Filed in the District Court for District of Columbia on 4/13/76, cited in Securities Regulation and Law Reports, B.N.A., No. 349. 4/21/76 at A-3.

[122] *Id.* The complaint alleged:

(1) 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;

Without admitting or denying the allegations of the complaint, Lockheed has entered into a consent decree similar to the one ordered by the court in the *General Tire* case with the exception that Lockheed will have the opportunity, before filing the report of the Special Committee as an exhibit to the current report on Form 8-K, to apply to the court for a protective order concerning the public release of and deletion from the exhibit of those portions of the report that the Board deems to be harmful to the interests of the corporation and its shareholders and not "material under the federal securities law."[123]

Chairman Roderick M. Hills in an address[124] stated with regard to corporate disclosures of illegal payments that:

> When we pass the peak of the current filing season, by May, (1976) 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 practices 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.[125]

---

(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) That at least $25 million of the $200 million was used for making secret payments to government officials rather than for the stated purposes. These payments were designed to assist the corporations in obtaining and retaining contracts with foreign governments;

(4) 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.

[123] *Id.* at A-4.

[124] *Corporate Morality — Whose Business Is It?*, address by Roderick M. Hills, April 13, 1976, Los Angeles, Calif.

[125] *Id.* at 6.

In his final address[126] before he resigned as Commissioner, A. A. Sommer, Jr. raised questions about the SEC's role in the foreign payment area:

> All of us have been schooled in the notion that competition in price and quality among sellers is the surest road to the most efficient use of resources and maximum benefit to consumers. When business is bought by payments to gain official favor, this desirable competitive process is, somewhere in the world, subverted. And while we in this nation may not be the direct victims of this, nonetheless, such activity runs contrary to our heritage, our ideologies, our modes of thinking, and we therefore feel constrained to condemn it wherever it occurs and no matter what justification may be asserted. I think all of us would much prefer if all business, not just that done by American companies, were done in accordance with high ethics and strict adherence to the law. Regretably, in some countries, apparently, the abortion of the competitive process is not seen as the evil that it is in this country and practices, repugnant to us, but which are ancient in origin and woven into the very structure of society, are accepted ways of doing business. This cultural clash, this conflict of ideologies, is a part of a total reality we cannot ignore and it is one that I would suggest we have not yet begun to understand fully or deal with effectively. I reiterate, lest sight is lost of this: Notwithstanding the misgivings I may express with regard to the manner in which this entire matter has emerged, the way in which the Commission has interpreted its mandate, the manner in which the Commission has exercised its powers, nothing I say should be construed as a condonation or approval of anything that has been disclosed with regard to the questionable manner in which some American corporations have done business abroad — or at home for that matter.[127]

Commissioner Sommer then continued in a manner which seems to suggest he feels that the SEC should change its position with respect to the disclosure requirements:

> Conceptually, I think it is difficult to jibe these cases with the traditional standards of materiality which have been applied historically by the Commission. As I have mentioned, it was only with respect to environmental matters that the Commission adopted requirements *in its forms* requiring disclosure of suits brought by governmental agencies notwithstanding the amounts involved, and then only because of an apparent Congressional mandate. Nothing in the Commission's historic interpretation of its mandate has suggested that a corporation must disclose

[126] *A Parting Look at Foreign Payments,* address by A. A. Sommer, Jr., April 2, 1976, Columbus, Ohio.

[127] *Id.* at 3-4.

every charged violation of the law, *every* conviction that it suffered under domestic and foreign law or *every* violation of law or "proper" standards of conduct even if not the subject of a proceeding. Why then make this exception with regard to illegal political payments?[128]

CONCLUSION

Many U.S. multinational corporations must feel that the risks of possible liability under the antitrust laws and the disclosure requirements of the securities law are worth taking when viewed in light of the potential profits which illegal or questionable payments foster. Also these corporations often feel that bribery is a way of life in many foreign countries and a necessity if they are to compete successfully with other firms who are engaging in similar payments. The solution to the problem seems not to lie with dramatic revisions of current law. In fact, any tampering with the Sherman Act may lessen its flexibility and prove harmful to its adaptibility to changing economic situations. The Internal Revenue Service, in an attempt to discover which corporations may have engaged in questionable payments and then deducted them as business expenses, has recently sent to approximately 1,200 major corporations a set of 11 specific questions about possible illegal payments.[129] The IRS is hoping

---

[128] *Id.* at 11.

[129] The text of the 11 question follows:

1. Did the corporation, any corporate officer or employee or any third party acting on behalf of the corporation, make, directly or indirectly, any bribes, kickbacks or other payments, regardless of form, whether in money property, or services, to any employee, person, company or organization, or any representative of any person, company or organization, to obtain favorable treatment in securing business or to otherwise obtain special concessions, or to pay for favorable treatment for business secured or for special concessions already obtained?

2. Did the corporation, any corporate officer or employee or any third party acting on behalf of the corporation, make any bribes, kickbacks or other payments regardless of form whether in money, property or services, directly or indirectly, to or for the benefit of any government official or employee, domestic or foreign, whether on the national level or a lower level such as state, county or local (in the case of a foreign government also including any level inferior to the national level) and including regulatory agencies or governmentally controlled business, corporations, companies or societies, for the purpose of affecting his/her action of the government he/she represents to obtain favorable treatment in securing business or to obtain special concessions, or to pay for business secured or special concessions obtained in the past?

3. Were corporate funds donated, loaned or made available, directly or indirectly, to or for the use or benefit of, or for the purpose

for voluntary compliance but the questions appear to be so broad as to raise the problem of whether or not a corporation could in good faith supply all the specific data called for. There currently is no bottom figure for the amounts of payments for which disclosure is sought. The resulting burden of searching the records for payments no matter how small can be overwhelming. The Securities and Exchange Commission, in an attempt to shore up its provisions on disclosure, has proposed a bill designed to amend relevent provisions of the Securities and Exchange Act of 1934 to prohibit certain issuers of securities from

---

of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

4. Was corporate property of any kind donated, loaned, or made available, directly or indirectly, to or for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

5. Was any corporate officer or employee compensated, directly or indirectly, by the corporation, for time spent or expenses incurred in performing services for the benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

6. Did the corporation make any loans, donations or other disbursements, directly or indirectly, to corporate officers or employees or others for the purpose of making contributions, directly or indirectly, for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

7. Did the corporation make any loans, donations or other disbursements, directly or indirectly, to corporate officers or employees or others for the purpose of reimbursing such corporate officers, employees or others for contributions made directly or indirectly, for the use or benefit of, or for the purpose of opposing, any government or subdivision thereof, political party, candidate or committee, either domestic or foreign?

8. Does now or did any corporate officer or employee or any third party acting on behalf of the domestic corporation have signatory or other authority or control over disbursements from foreign bank accounts?

9. Does now or did the corporation maintain a bank account or any other account of any kind, either domestic or foreign, which account was not reflected or the corporate books, records, balance sheets or financial statements?

10. Does now or did the corporation or any other person or entity acting on behalf of the corporation maintain a domestic or foreign numbered account or an account in a name other than the name of the corporation?

11. Which other present or former corporate officers, directors, employees, or other persons acting on behalf of the corporation may have knowledge concerning any of the above areas?

See Text of I.R.S. Questions to Companies, The N.Y. Times, April 8, 1976, at 58, col. 1.

falsifying their records with regard to illegal and questionable payments and related situations.[130]

[130] The Commission proposes the following draft legislation for Congressional consideration:

A BILL

To amend the Securities Exchange Act of 1934 to prohibit certain issuers of securities from falsifying their books and records, and for related purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

That Section 13(b) of the Securities Exchange Act, 15 U.S.C. 78m(b), is amended by renumbering existing Section 13(b) as "Section 13(b)(1)", and by adding at the end of new Section 13(b)(1), the following subparagraphs:

"(b)(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall

"A) make and keep books, records and accounts, which accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and

"(B) devise and maintain an adequate system of internal accounting controls sufficient to provide reasonable assurances that

"(i) transactions are executed in accordance with management's general or specific authorization;

"(ii) transactions are recorded as necessary (1) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and (2) to maintain accountability for assets:

"(iii) access to assets is permitted only in accordance with management's authorization; and

"(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

"(b)(3) It shall be unlawful for any person, directly or indirectly, to falsify, or cause to be falsified, any book, record, account or document, made or required to be made for any accounting purpose, of any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to Section 15(d) of this title.

"(b)(4) It shall be unlawful for any person, directly or indirectly,

"(A) to make, or cause to be made, a materially false or misleading statement, or

"B) to omit to state, or cause another person to omit to state, any material fact necessary in order to make statements made, in the light of the circumstances under which they were made, not misleading to an accountant in connection with any examination or audit of an issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports pursuant to Section 15(d) of

Perhaps the most serious problem which has arisen out of questionable payments is the possible legislative action which foreign countries may deem necessary to enact. Many Third World nations which host multinational corporations are experiencing strong nationalistic trends and may view legislation restricting investment as a logical solution to the problems which have been created by multinationals. This response from host nations, whether taken on a unilateral or multilateral approach, would be particularly unfortunate. The number of U.S. corporations disclosing questionable payments is relatively small (about 100) when compared with the approximately 9,000 corporations which file information with the SEC.[131] Such an overreaction by host nations could result in laws which would chill, if not freeze, the investment climate for a long period.

The United Nations has taken a first step in examining questionable payments and has established a new agency, the U.N. Information and Research Center on Transnational Corporations, whose primary function will be to draft a code of conduct for multinational corporations.[132] U.S. corporations have been concerned lest this United Nations sponsored approach result in a two-tiered international code, U.S. corporations being held to the higher standard. Corporations also anticipate that the code would be directed solely at multinational corporate conduct to the exclusion of national government conduct. Finally, corporations fear that any broad code disclosure requirements could raise significant problems of confidentiality. For example, if disclosure were made to a domestic agency, would that agency be able to withstand a suit brought under the Freedom of Information Act seeking dissemination of that information? Would an agency be able to obtain a protective order to prevent disclosure of information requested in a subpeona? As the law is currently interpreted, it appears that an agency would be forced to submit to the requests for information. These are serious problems which must be resolved before any code will receive the enthusiastic support of U.S. corporations.

Many developing countries view the MNC as a source of

> this title, or in connection with any examination or audit of an issuer with respect to an offering registered or to be registered under the Securities Act of 1933."

[131] *See* REPORT OF THE SECURITIES AND EXCHANGE COMMISSION, *supra* note 139, at 54.

[132] *See* SECURITIES REGULATIONS AND LAW REPORTS, BNA., No. 339, January 28, 1976, at A-13.

modern technology and as a means of attaining an advanced economic posture rapidly. American businesses undoubtly feel that these countries would view a code as a means of hastening a redistribution of wealth from the developed to the developing nations.

The multinational corporation has been cast in many lights — from an extension of the national government into the economic arena to a malevolent organization acting independently of local law and eroding the moral character of the international community. A more sanguine and perhaps more accurate view is that the MNC is the vehicle which is wiping away centuries of conflict in the political, military, and geographical arena and will, in the long run, advance world peace, lowering ethnocentric barriers which have heretofore existed.

Finally, exposure of both those who offer illegal payments and those who accept them to the international community and their own countrymen may well bring these practices to an end.

RICHARD VERRI*

* J.D. candidate, Case Western Reserve University, 1973-75.