directors of two publicly-held companies was required to be disclosed in proxy statements distributed by the issuers under Section 14(a) of the Exchange Act and Rule 14a-9.

Citing the language of Items 7(f) of Schedule 14A relating to transactions with the issuer the Court said that, if proven, the defendant's failure to disclose their interest in the kickbacks would be a violation of that item and consequently of Section 14(a).

The Court further held that the officers' and directors' sales of lettered stock immediately after acquiring the shares in a private placement clearly would violate Section 16(b) of the Exchange Act, and accordingly the failure to disclose such transactions would violate Item 7(e)(4) of Schedule 14A relating to indebtedness of officers and directors to the issuer including indebtedness arising under Section 16(b).

C. SEC Civil Actions

1. SEC v. Kalvex, Inc., 425 F.Supp. 310 (SDNY 1975)

The court held that a failure to disclose a kickback scheme involving corporate officers standing for election as directors in proxy solicitation materials violated Section 13(a), and 14(a) of the Exchange Act and Rules 13a-1, 13a-13, 14a-3 and 14a-9 promulgated thereunder.

a. Section 14(a)

(1) The Court found that the undisclosed kickback scheme was material and required disclosure under Item 7 of Sechedule 14A in view of the purpose of Section 14(a) "to ensure that full and fair disclosure would be made to stockholders whose proxies are being solicited so that an informed and meaningful consideration of the alternatives can be made". [citing Sargent v. Genesco, 492 F.2d 750, 769 (5th Cir. 1974).

(2) "One does not elect as a director an individual who is using the corporation he represents for personal gain."

b. Section 13(a)

(1) The Court held that by virtue of the failure to disclose the defendant's scheme, Kalvex's annual and quarterly reports were materially false and misleading in that they (i) did not accurately present the accounts of the company in its financial statements and (ii) falsely stated the income and expenses of the company and (iii) failed to disclose that the defendant had caused the making of the false entries which enabled him to receive improper disbursements.

2. SEC v. American Realty Trust and Thomas Broyhill, Civil Action No. 77-1839 (E.D.Va. 1977) 429 F.Supp. 1148 *rev'd on appeal*, 586 F.2d 1001 (1978)

The Commission alleged that American Realty Trust ("ART") and its president, Thomas Broyhill ("Broyhill") failed to disclose material information in a prospectus issued in connection with the sale of debentures, in two annual Reports on Form 10-K and in proxy materials and violated Sections 17(a) of the Securities Act and Sections 10(b), 13(a) and 14(a) of the Exchange Act and Rules 10b-5, 13a-1, 14a-3 and 14a-9 thereunder.

The Commission's Complaint alleged, among other things, that ART and Broyhill failed to disclose an agreement to indemnify the partners of a joint venture, one of which was related to Broyhill which created a contingent liability of up to $10 million for ART. The District Court held that the failure to disclose the agreement to indemnify the partners of Arlington Ridge Road was a material omission from the proxy statement. However, the District Court also found that a $368,000 advance to the partnership, and the president's daughter's interest in a company engaged in a significant transaction with the issuer were not material.

In reversing the District Court's decision the Court of Appeals held, among other things, that all of the above matters were material omissions from the proxy statement:

". . .we think the omission was a material one, for there is a great temptation to leniency on the part of a father when he knows that losses imposed by a strict enforcement of the rights of ART would fall upon his daughter."

3. SEC v. Washington County Utility District, et al., 676 F.2d 218 (6th Cir. 1982)

In this civil injunctive action the Commission alleged that a public utility district, and its manager, Commissioners, underwriter and bond counsel violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act and Rule 10b-5 thereunder, in connection with seven bond offerings by failing to disclose in the offering materials "kickbacks and other payments received by the district's manager from the underwriter. In reversing the lower court's decision, and finding the utility district's manager liable under both Section 10(b) and 17(a) as an aider and abettor for failing to disclose the "kickbacks" from the underwriter, the Court of Appeals addressed the materiality of the information to investors:

"The information omitted here was material in at least two respects. First, an investor, had he known of the payments, could have reasonably concluded that investment in the District's bonds was unwise because the kickbacks increased the cost of the offering. Second, an investor could have concluded that the District's bonds were a poor investment because the quality of the District's management was suspect. Such a conclusion is reasonable given the general manager's apparent willingness to advance his own interests at the expense of the District's interest." p. 225

D. Private Actions

1. Maldonado v. Flynn, 597 F.2d 789 (2d Cir. 1979)

In a shareholders' derivative suit on behalf of Zapata Corporation ("Zapata"), it was alleged that the defendants violated Section

14(a) and Rule 14a-9 in that the proxy statements were false and misleading in that they failed to ". . .advise the stockholders that on July 2, 1974, members of the board, possessed of inside information to the effect that an imminent tender offer would sharply increase the market value of Zapata's shares, had amended a stock option plan by accelerating the option exercise date, thus enabling Zapata's six senior officers to enlarge their profit substantially and reducing by several hundred thousand dollars the benefit which Zapata would otherwise have derived from the exercise of the options under the plan as it stood before amendment. In addition, the statement did not point out that under the original terms of the stock option plan Zapata shares could be purchased by the officers only for cash, so that amendment of the plan was necessary to obtain authorization for the loans."

a. In holding that a cause of action under Section 14(a) and Rule 14a-9 thereunder existed, the Court stated:

> "The alleged misleading statements and nondisclosures involve matters of direct and deep concern to shareholders in the exercise of their right to vote, which the Exchange Act expects to be fully disclosed in proxy solicitations for election of officers and directors. Indeed, the compensation of directors and key officers and transactions between them and their corporation are matters explicitly covered by SEC disclosure regulations.
>
> Since self-dealing presents opportunity for abuse of corporate position of trust, the circumstances surrounding corporate transactions in which directors have a personal interest are directly relevant to a determination of whether they are qualified to exercise stewardship of the company.
>
> For this reason Rule 14a-9 specifically sets out minimum standards for disclosure and, going beyond the Rule, it has been

recognized that shareholders are entitled to truthful presentation of factual information "impugning the honesty, loyalty of competency of directors" in their dealings with the corporation to which they owe a fiduciary duty."

2. Goldberg v. Meridor, 567 F.2d 209 (2d Cir. 1977) cert. denied, 434 U.S. 1069 (1978).

The Court held that a failure to disclose all material facts underlying a transaction between a wholly owned subsidiary and its parent which may have resulted in a pecuniary benefit to its management, or misleading disclosures concerning such transactions, would be in violation of Rule 10b-5 under the Exchange Act.

PART C

ACCOUNTING PROVISIONS UNDER THE FOREIGN CORRUPT PRACTICES ACT

I. INTRODUCTION

A. The accounting provisions, which were added as Section 13(b)(2) of the Securities Exchange Act, require issuers:

1. "To make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer"; and

2. "To devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that * * *" certain statutory objectives are met.

B. Most of the Commission's enforcement actions under the Foreign Corrupt Practices Act (FCPA) have involved the accounting provisions.

II. THE GENESIS OF THE ACCOUNTING PROVISIONS

A. The accounting provisions of the Act had their genesis in 1973 with disclosures that corporate funds had been used for illegal domestic political contributions.

1. Subsequent Commission investigations and enforcement actions revealed instances in which questionable or illegal payments -- both foreign and domestic -- had not been disclosed to the investing public.

2. The Commission also developed a voluntary disclosure program as a supplement to its enforcement program.

a. The voluntary program was announced in several public statements, including the testimony of Commissioner Philip A. Loomis on July 17, 1975, before the Subcommittee on

International Economic Policy of the House Committee on International Relations and the testimony of former Commission Chairman Roderick M. Hills before the Subcommittee on Priorities and Economy in Government on January 14, 1976.

b. Companies participating in this program were encouraged to conduct careful investigations of their operations under the auspices of persons who were not involved in questionable activities, and to discuss the question of appropriate disclosure with the Commission's staff.

c. After the program was announced, more than 450 companies disclosed information relating to questionable activities in filings with the Commission.

3. The Commission's Report on Questionable and Illegal Corporate Payments and Practices.

a. On May 12, 1976, the Commission submitted a Report on Questionable and Illegal Corporate Payments and Practices to the Senate Committee on Banking, Housing and Urban Affairs.

(1) The Report described the Commission's activities with respect to questionable payments and practices during the previous three years.

(2) It analyzed various factors that might affect a determination as to whether such payments and practices are "material", and as a result, required to be disclosed to investors.

(3) It also recommended enactment of the accounting provisions of the FCPA.

b. In detailing the Commission's findings, the Commission's Report concluded,

"The almost universal characteristic of the cases reviewed . . . has been the apparent frustration of our system of corporate accountability which has been designed to assure that there is proper accounting of the use of corporate funds and that documents filed with the Commission and circulated to shareholders do not omit or misrepresent material facts."

c. The "most devastating disclosure" resulting from the Commission's inquiry was the fact that, and the extent to which, some companies falsified entries in their own books and records.

d. The Report also found a number of other practices associated with the making of questionable or illegal payments, including the "accumulation of funds outside the normal channels of financial accountability, placed at the discretion of one or a very small number of corporate executives not required to account for expenditures from the fund", the use of "non-functional subsidiaries and secret bank accounts" and the use of various methods of "laundering" or other means of disguising the source of funds used for such payments or the purposes for which they were disbursed.

e. The Commission concluded that these practices "cast doubt on the integrity and reliability of the corporate books and records which are the very foundation of the disclosure system established by the federal securities laws."

f. Thus, the deterrence of bribery was intended to be just one of the results that would flow from improved recordkeeping and systems of internal accounting controls; the principal purpose was to provide greater assurance that corporate records will be made and kept in a manner that permits companies to fulfill their disclosure obligations under the federal securities laws.

III. THE COMMISSION'S RULEMAKING PROCEEDING

A. The Commission promulgated two rules in February, 1979, as Regulation 13B.

1. Rule 13b2-1 prohibits the falsification of corporate books and records.