M E M O R A N D U M

Jan 7, 1977

TO:	The Commission
FROM:	The Division of Enforcement
SUBJECT:	Voluntary Program
RECOMMENDATION:	That the Commission authorize the Division of Enforcement and the Division of Corporation Finance to advise future participants in the voluntary disclosure program that the Division will normally record or take possession of detailed information developed in the participants' internal investigations.
OTHER DIVISIONS CONSULTED:	Division of Corporation Finance
ACTION REQUESTED BY:	N/A
NOVEL, UNIQUE OR COMPLEX ISSUES:	None

To date over 225 corporations have made disclosures of questionable or illegal payments and practices. Many of these corporations have now completed their internal investigations. An essential element of the voluntary disclosure program has been that companies must agree to grant the Division of Enforcement access to the report of investigation and the underlying documentation. The Division of Enforcement realizes that it is unlikely that a comprehensive review can be made of each internal investigation with the inherent limitations of budget and manpower although every effort will be made to do so. Therefore, the Division of Enforcement has compiled certain guidelines it will attempt to adhere to in determining which internal investigations it will review. These guidelines are not to be considered definitive as flexibility in this program is essential.

Thus, in general, we will take access:

(1) When the payments were large and frequent and it would appear top management was involved.

(2) When the industry appears to have a greater propensity to make questionable payments. The pharmaceutical industry and the petroleum industry, for example, would deserve close scrutiny.

(3) When a payment was made by a company involved in a joint venture with another public company. We would take access to determine not only the adequacy of this inquiry but also whether or not the other public company has made disclosure.

(4) When the investigation has disclosed illegal rebates. We may discover that the recipients of the illegal rebates have not made disclosure. We have, furthermore, seen indications that the rebates are not finding their way back to the corporations, but are being possibly converted by management.

(5) When the investigation has indicated illegal domestic payments including bribes and illegal political contributions.

(6) When the investigation or disclosure appears to be of limited scope. We will check on the adequacy of the investigation.

(7) When the company indicates it will continue to make questionable payments.

(8) Of a random sampling of investigations in order to determine the adequacy of the investigations.

Access

Up to this time, except for a very few instances, we have reviewed internal investigations at the companies' headquarters.[1] We have advised the company that after such an examination, we would determine whether further investigation was necessary, and if so, we might go back to the company with a request to take possession of certain documentary materials.

As a result of the procedure followed to date, some members of the bar apparently are assuming that the staff will not record information or take possession of any materials unless we are proceeding toward a formal investigation or something close to that. Some apparently assume that the staff is somehow precluded from ever taking possession of reports and underlying details. An exercept from the attached letter from the attorneys for R.J. Reynolds illustrates this misconception.[2]

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[1] All companies in the voluntary disclosure program have been told that participation in the voluntary disclosure program does not result in the staff being precluded from recommending enforcement action.

[2] The staff, after a review of the underlying report, requested a copy of that report from Reyonds.

> Our agreement was clear that we would not be asked or compelled to turn that report over to you since it would be subject to the Freedom of Information Act (the "F.O.I.A."). As you know, we have had similar understandings with respect to reports prepared for other clients as part of the voluntary program, and such an agreement is a basic element in the entire voluntary disclosure program in which some 200 companies have taken part. The reason, of course, is that once a report is delivered to the Staff, it may become, in effect, a public document like the non-voluntary Gulf and Exxon reports because of the F.O.I.A., and there is every reason to believe that apparent payees will be identified to the very great detriment of Reynolds' business. If it were not for the fact that the voluntary program is structured to avoid this result, there would be little motive to participate in the program, since the major sanction of the non-voluntary program has been the obligation to publish the detailed report.

The staff has advised R.J. Reynolds that it is likely the staff will recommend enforcement action to the Commission.[3] Counsel concedes that they understood that the staff has never relinquished that right. It is therefore difficult to understand why Reynolds considers the staff's request to be "a fundamental change in the ground rules."

In order to clarify the staff's position, we propose to advise future participants in its program that in cases where we deem it necessary for enforcement purposes, including the obtaining of possibly important intelligence information, we may, even on our initial visit, record, or take possession of, detailed information developed in the company's investigation. In order that the Division exercise proper supervision over the volunteer program, sufficient information must be obtained in order to ascertain the adequacy of the internal investigations. Also we must have sufficient documentation for the Commission and Congressional oversight committees to judge the effectiveness of the program. Moreover under no circumstances can we participate in an arrangement, directly or indirectly, which has as its purpose a circumvention of the Freedom of Information Act. Of course participants in the program preserve all rights they may have under the Freedom of Information Act.

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[3] As the Commission will recall, R.J. Reynolds has recently disclosed that the corporation and certain of its officers are responsible for illegal political contributions and illegal rebates in excess of 20 million dollars. Some of these rebates were misappropriated by officers of other public companies.

Views of the Division of Corporate Finance

The Division of Corporation Finance agrees with the Division of Enforcement that internal guidelines for taking access are desirable. Moreover, we are in complete accord as to the right of the Division of Enforcement to record information or take possession of materials where enforcement action is under consideration as in the R. J. Reynolds situation. Throughout the last year and a half we and the Division of Enforcement have made it clear to all companies participating in the voluntary disclosure program that the granting of access to the Division of Enforcement was an essential element of the program and that the information obtained from taking access could form the basis of an enforcement action. Both Divisions have also made it clear that staff members might record or copy information without first being required to obtain a subpoena in those situations where enforcement action involving the issuer is being considered. We believe that the argument advanced by counsel for R. J. Reynolds, that there has been "a fundamental change in the groundrules" is totally frivolous.

The Division is concerned, however, that the broad guidelines suggested by the Division of Enforcement would permit it to record or take possession of detailed information, including names of recipients of payments and names of countries where payments were made, whenever access is taken, rather than limiting this activity to situations where enforcement action is under consideration. In our opinion this would constitute a change in the perception registrants may have of the voluntary program. It is not our impression that is has been conveyed to registrants and their representatives at the large number of meetings which have been conducted jointly by the Divisions, that the Division of Enforcement would take possession of detailed information each time they took access.

While we have no objection to such a change in the operation of the voluntary program, we believe that it would be appropriate to clarify publicly what is involved in taking access. Although the Commission has stated in the Proxmire Report and Congressional testimony, that the granting of access is a necessary element in a company's participation in the voluntary program, it has never defined that term or indicated what is involves. We therefore recommend that the Commission issue a public release which clarifies the meaning of access. We believe that this is a proper approach, in the interest of fairness, and that it will also serve to quell arguments of the type advanced by R. J. Reynolds.

We also suggest that the Commission consider the implications of this approach. A major inducement for companies' participation in the voluntary disclosure program has been the fact that certain details including the names of recipients of improper payments, and the names of the countries where payments were made, generally have remained nonpublic. Also, we have always made it clear to participants that materials in the staff's possession could be reachable under the Freedom of Information Act, and as a result most companies have avoided including information as to names and places in their

submissions.[1] Additionally, many registrants have either requested confidential treatment, submitted letters arguing that their materials were entitled to particular exemptions under the F.O.I.A., or in at least two cases, requested that supplemental materials be returned to registrants.[2]

While we do not object to Enforcement's proposal to take possession of this type of information more frequently in the future, we think that it is likely to have an impact on future participation in the voluntary program. We believe that fewer companies may choose to participate under these conditions. At the same time, the adoption of rules relating to "payments" similar to our legislative proposals in this area, would lessen the need for a voluntary disclosure program. Drafts of such rules have been prepared by the staff and will be presented to the Commission in the near future. We suggest that the voluntary program may soon reach a point of diminishing returns and that the time for terminating it may be approaching.

Recommendations

The Division of Corporation Finance recommends that, in connection with the recommendation of the Division of Enforcement, the Commission (1) authorize the staff to issue a release which clarifies the meaning of access, and (2) consider whether the time for terminating the voluntary program is approaching.

[1] Our policy of informing companies of the potential impact of the F.O.I.A. has never been, directly or indirectly, for the purpose of circumventing that Act. Because of the high level of issuer concern over recent changes in the rules relating to confidential treatment under the '34 Act, necessitated by amendments to the F.O.I.A., under which specific claims of exemption from the F.O.I.A. must be founded upon the provisions of that Act, we have advised issuers routinely of the F.O.I.A.'s requirements.

[2] While these requests were pending, we received an F.O.I.A. request from a Wall Street Journal reporter for "all records in the Commission's possession relating to illegal or questionable payments made by corporations under the Commission's jurisdiction in the United States or abroad." We have informed these registrants that we are unable to return their submissions and will allow them the opportunity to assert their F.O.I.A. exemption arguments.

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