UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

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| SECURITIES AND EXCHANGE COMMISSION<br>500 North Capitol Street<br>Washington, D.C. 20549,<br><br>Plaintiff,<br><br>v.<br><br>INTERNATIONAL SYSTEMS & CONTROLS CORPORATION,<br>J. THOMAS KENNEALLY,<br>HERMAN M. FRIETSCH,<br>RAYMOND G. HOFKER,<br>ALBERT W. ANGULO, and<br>HARLAN M. STEIN,<br><br>Defendants. | Civil Action No. 79-<br><br>COMPLAINT FOR INJUNCTION, APPOINTMENT OF RECEIVER AND OTHER EQUITABLE RELIEF |

Plaintiff Securities and Exchange Commission ("Commission") for its Complaint alleges upon information and belief, except as to paragraphs 2, 3 and 4 which are alleged upon knowledge, that:

1. Defendants International Systems & Controls Corporation ("ISC"), J. Thomas Kenneally, Herman M. Frietsch, Raymond G. Hofker, Albert W. Angulo, and Harlan M. Stein (collectively referred to hereinafter as "Defendants"), and others, directly and indirectly, have engaged, are engaged, and it appears to the Commission that unless restrained and enjoined, are about to engage in, acts, practices and courses of business which constitute and will constitute violations of Section 17(a) of the Securities Act of 1933 ("Securities Act") [15 U.S.C. 77q(a)], Sections 10(b), 13(a), 13(b)(2) and 14(a) of the Securities Exchange Act of 1934 ("Exchange Act") [15 U.S.C. 78j(b), 78m(a), 78m(b) and 78n(a)] and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13b-2, 14a-3 and 14a-9 [17 C.F.R. 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13, 240.13b-2, 240.14a-3 and 240.14a-9] thereunder.

2. Plaintiff Commission, pursuant to authority granted to it by Sections 10(b), 13(a), 13(b), 14(a) and 23 of the



Exchange Act [15 U.S.C. 78j(b), 78m(a) and 78n(a)], has promulgated Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13b-2, 14a-3 and 14a-9 [17 C.F.R. 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13, 240.13b-2, 210.14a-3 and 240.14a-9].

3. Plaintiff Commission brings this action pursuant to Section 20(b) of the Securities Act [15 U.S.C. 77t(b)] and Sections 21(d) and 21(e) of the Exchange Act [15 U.S.C. 78(u)d and 78(u)e] to restrain and enjoin each of the Defendants from engaging in the acts, practices, and courses of business alleged herein.

## JURISDICTION AND VENUE

4. The Court has jurisdiction of this action pursuant to Section 22(a) of the Securities Act [15 U.S.C. 77v(a)] and Section 27 of the Exchange Act [15 U.S.C. 78aa].

5. Defendants, directly and indirectly, have made use of the means and instrumentalities of transportation and communication in interstate commerce, and the mails, in connection with the acts, practices, and courses of business alleged herein. Certain of the acts constituting violations of the Securities Act and the Exchange Act occurred within the District of Columbia.

## THE DEFENDANTS

6. ISC, a Delaware corporation with its principal place of business in Houston, Texas, at all times herein relevant was engaged in providing services and products for the development of energy, agricultural and forestry resources, and the processing, storage, and handling of natural resource and agricultural products. The common stock of ISC is registered with the Commission pursuant to Section 12(b) [15 U.S.C. 78l(b)] of the Exchange Act and traded on the London and Amsterdam stock exchanges. ISC's common stock was also traded on the Pacific and American Stock Exchanges. Since November 1978, when the Commission suspended trading in ISC's common stock for a ten day period, the stock has not

traded on the Pacific or American Stock Exchange. The AMEX is in the process of de-listing ISC's stock. ISC's common stock continues to trade in the over-the-counter market.

7. Kenneally, who resides in Houston, Texas, was Chairman of the Board of Directors of ISC until March, 1979, and was Chief Executive Officer of ISC until January, 1979. Kenneally is still a director of ISC. He owns and/or controls approximately 42% of the voting stock of ISC. Prior to resigning his positions as Chairman of ISC's Board of Directors and as its Chief Executive Officer, Kenneally was aware that the Commission intended to commence this action against him.

8. Prietsch, who resides in Houston, Texas, was at all times relevant to this action a Senior Vice-President of ISC.

9. Hofker, who resides in Houston, Texas, was at all times relevant to this action a Vice-President and the General Counsel of ISC. In March, 1979, Hofker resigned his position with ISC. Prior to his resignation, Hofker was aware that the Commission intended to commence this action against him.

10. Angulo, who resides in Houston, Texas, was at all times relevant to this action the Treasurer of ISC. In spring 1979, Angulo became Executive Vice-President of ISC's former subsidiary Black Sivalls & Bryson, Inc. Prior to Angulo's moving to the aforesaid position he was aware that the Commission intended to commence this action against him. In June 1979, the stock and certain assets of Black Sivalls & Bryson, Inc. and certain of its subsidiaries were sold to another publicly owned corporation. Angulo is special assistant to the president of the successor entity.

11. Stein, who resides in Houston, Texas, was at all times relevant to this action the President of ISC's Engineering Group.

NATURE OF ACTION

12. During the period from approximately 1970 to the date hereof, ISC has filed with the Commission and disseminated and made available



to its shareholders and the investing public, press releases, preliminary and definitive proxy soliciting materials, and annual and periodic reports. During the period from approximately 1970 to the date hereof, defendants ISC, Kenneally, Prietsch, Hofker, Angulo and Stein, and others, directly and indirectly, in connection with the purchase or sale or offer for sale of securities of ISC, in public filings with the Commission, in proxy soliciting materials and in press releases, and by use of the means and instrumentalities of transportation and communication in interstate commerce, and the mails, have employed and are employing devices, schemes, and artifices to defraud, have made and are making untrue statements of material facts, and have omitted and are omitting to state material facts necessary to make the statements made not misleading, or required to be stated in such proxy soliciting materials and periodic reports, and have engaged and are engaging in acts, practices and courses of business which have operated and are operating as a fraud and deceit upon the shareholders of ISC and other persons.

13. As a part of the aforesaid violative conduct by the defendants, as referred to in paragraph 12 above, material facts either were not disclosed, were falsely and misleadingly disclosed or were omitted by the defendants with respect to the following matters:

Improper Payments

ISC and its subsidiaries paid more than $23,000,000 in material, questionable and illicit foreign payments to foreign persons and entities in connection with the securement of contracts. These payments were disguised on the book and records of ISC and concealed from customers including foreign governments and government-owned entities. ISC failed to disclose that it was dependent upon its foreign payments practices for the securing of business and the obtaining of payments in addition to the originally contracted

amounts and that material risks to its earnings and revenues were occasioned by such practices. It filed false and misleading statements with the United States Export-Import Bank concerning its foreign payments.

Earnings and Assets

ISC falsely and misleadingly recorded and publicly reported, as "unbilled receivables" cost overruns on fixed price contracts, claims for escalation and kickback arrangements with suppliers. Additionally, uncollectible contract costs which indicated losses on fixed price contracts were improperly rolled into other unrelated contracts, liabilities and other obligations were not reported in, or were misleadingly reported in the financial statements.

Inadequate Internal Controls

ISC failed to make and keep adequate books, records and accounts which, in reasonable detail, accurately and fairly reflect transactions involving ISC's assets. ISC failed to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions were recorded properly and as necessary to permit preparation of accurate financial statements.

Misuse of Corporate Assets by Persons Associated with ISC and Others

ISC failed to disclose that more than $1,000,000 were expended for the purchase, decoration and maintenance of an Irish estate primarily used as a family summer residence for defendant Kenneally. Additionally, ISC made false and misleading disclosures concerning the Deferred Compensation Corporation, which since 1965 was entirely funded by ISC to the extent of more than $2,000,000 and which was dominated and controlled by defendant Kenneally and two of his associates, one of whom was a director of ISC, and they were the principal beneficiaries.

QUESTIONABLE AND ILLICIT FOREIGN PAYMENTS

14.(a) During the period from approximately 1970 to the date hereof, in connection with the securement of contracts and the securement of compensation for its services relating to those contracts, ISC, directly or through one or more of its subsidiaries, paid approximately $23 million to senior government officials, associates of senior government officials, persons it believed to be government officials and associates of government officials, and members of ruling families, in seven Middle Eastern, African and South American countries. ISC made other payments of similar nature in these and other countries.

(b) The payments referred to in paragraph 14(a) above, as well as approximately $10 million of outstanding commitments for payments of similar purport and object, were made in connection with approximately $750 million of business obtained by ISC during the period 1970 to date.

Saudi Arabia

15. Commencing in its fiscal year 1975, ISC's wholly-owned subsidiary, Sanderson & Porter, Inc. ("S&P"), a New Jersey corporation, engaged in fulfilling two contracts in Saudi Arabia for the design, engineering, and construction supervision of a water desalination and power generation complex. The contracts provide that if improper payments were made, the contracts were subject to being cancelled. A third contract was secured in 1976.

16. During the period 1975-1976, ISC/S&P made payments of approximately $3.5 million of an approximately $5.4 million commitment to a Saudi government official in connection with projects for which the Saudi government-owned Saudi Arabian Saline Water Conversion Corporation ("SWCC") ultimately let contracts to ISC totaling approximately $106 million. These payments were paid directly to Adnam Samman, a then Vice-Governor of SWCC and indirectly to that same official by payments to his designated

agent who was his father-in-law, and to designated accounts at banks located in Switzerland and Lebanon. Subsequently, Samman left the SWCC.

17. In certain instances, contracts for consultancy services were entered into between ISC/S&P and ARA International Overseas Establishment, ("ARA"), an entity designated by the said Vice-Governor to act as the conduit of the money he was to receive. The principal of ARA was the vice-governor's father-in-law. The majority of the services to be performed by this entity under the contract were not performed, yet funds were paid to the said vice-governor directly or were deposited to the numbered Swiss accounts designated by him.

18. ISC also agreed to pay $10,000 per month to a Saudi company with which the vice-governor was associated.

19. The payments referred to in paragraphs 16 and 17 above were recorded in the financial records of ISC as "consulting fees". The payments were authorized by Hofker and Frietsch. The other individual defendants knew or should have known of the activities alleged in paragraphs 15 through 18 above. Defendants failed and/or failed to cause ISC to adequately disclose those activities in its public filings with the Commission and in other materials disseminated to the investing public.

Iran

20. ISC's sales in Iran have, in recent years, represented approximately 20% of its total sales. ISC's recent sales in Iran were approximately $60 million per year.

21. (a) ISC's wholly-owned subsidiary, Stadler-Hurter Ltd. ("SHL"), is a Canadian engineering firm which provides feasibility studies, process technology, design services, project supervision and management services for the forestry industry, with particular expertise in pulp and paper production.

(b) Stadler-Hurter Zurich A.G. ("SHZ") was, until ISC's fiscal year 1978, an ISC Zurich-based subsidiary. (See paragraph 32 below regarding ISC's sale of SHZ in ISC's fiscal year 1978).

22. During all times relevant hereto, ISC's then wholly-owned subsidiary, Black, Sivalls & Bryson, Inc. ("BS&B"), was a Delaware corporation engaged in the design and manufacturing processing and handling of gases and liquids.

23. Between 1970 and 1976, approximately $633,000 was paid through BS&B, by check and wire transfer, to various foreign accounts of ITECH, a foreign entity. The payments were for purported "services" by the foreign entity in connection with the procurement of Iranian government contracts.

24. The principals of the foreign entity advised BS&B officials that a portion of the funds paid to the entity were passed to Iranian government officials.

25. ISC has no detailed information, vouchers or expense statements, or other forms of documentation, documenting the nature of the "services" for which it paid the aforesaid $633,000.

26. The payments referred to in paragraphs 24 and 25 above were recorded in the financial records of ISC as "agent's fees" or "agent's commissions."

27. In connection with an approximately $250 million contract and an approximately $350 million contract in Iran for forest products complexes ISC, through SHL and SHZ, from ISC's fiscal year 1974 to the present, paid approximately $11.3 million of an approximately $22.3 million commitment to several groups of "agents" or "consultants". Payments were made to various designated foreign bank accounts. Other similar payments or commitments to pay were made in connection with ISC's attempts to obtain other contracts in Iran.

28. Certain of the payments and commitments to pay described in paragraph 27 went to a member of Iran's former ruling family, Prince Abdorreza, to obtain his influence in getting certain of the contracts awarded to ISC.

29. Certain of the payments and commitments to pay described in paragraph 27 were made to persons who worked primarily for the Iranian government. The payments were made to obtain their influence in getting certain of the contracts awarded to ISC and in obtaining additional compensation in excess of the original contractual amounts for ISC for certain of the contracts.

30. Certain of the payments and commitments to pay described in paragraph 27 were made by ISC through SHZ in the form of "bearer" notes.

31. Approximately $4.8 million of the payments described in paragraph 27 were made by ISC through SHZ to a group of "agents or consultants" which included the managing director of SHZ, Max Zeier, a Swiss national.

32. In ISC's fiscal year ended June 30, 1978, ISC sold SHZ to a group of individuals. Included within that group was the aforesaid managing director, Zeier, and A.M. Hurter formerly the president of SHL. This related-party transaction was not disclosed in ISC's Annual Report on Form 10-K for the year 1978. During the period 1974 to date, ISC has also failed to disclose that Zeier was the principal of an entity known as Emeg, S.A., a Swiss entity, and that during the said period ISC paid approximately $2 million to Emeg in connection with securing contracts.

33. The payments referred to in paragraphs 27 through 32 above were recorded in the financial records of ISC as "commissions" or "consulting fees." ISC has no detailed information, vouchers or expense statements, or other forms of documentation, documenting the exact nature of the activities of the persons to whom it made the payments.

34. (a) Between 1974 and 1977, SHL received approximately $400,000 in rebates from a Canadian freight forwarder, Kuehne & Nagel International, Ltd., in connection with a contract between SHL and an Iranian state corporation. The freight forwarder agreed to this arrangement in order to obtain the freight forwarding subcontract. The aforesaid transaction was not accurately recorded in ISC's financial records.

(b) The rebates referred to in paragraph 34(a) above initially were deposited to an off-book account of SHZ, maintained at the Union Bank of Switzerland. The rebate funds thereafter were transferred to Seltec Engenharia, S.A.("Seltec"), a subsidiary of ISC's wholly-owned subsidiary Sanderson and Porter, Inc., a New Jersey corporation.

(c) As early as 1973, ISC entered into agreements with suppliers in connection with contracts in Iran whereby the suppliers agreed to inflate their invoices and thereafter kickback to SHL the inflated amounts. The amount that the invoices were inflated, as far as plaintiff has been able to determine at this time, was approximately $3.5 million. At least one supplier agreed to kickback approximately $525,000.

35. The payments referred to in paragraphs 23 and 27 through 34 above were authorized by Frietsch, Angulo and Stein. The other individual defendants knew or should have known of the activities and the arrangements described in paragraphs 21 through 34 above. Defendants failed and/or failed to cause ISC to adequately disclose those activities and arrangements in its public filings with the Commission and in other materials disseminated to the investing public.

Algeria

36. ISC's wholly-owned subsidiary, J.F. Pritchard & Co. ("JFP"), is a Kansas City based Delaware corporation specializing in providing feasibility studies, process technology, plant engineering and construction supervision services to the petrochemical industry with particular emphasis on gas and liquified natural gas.

JFP has several subsidiaries, including Pritchard International Corporation ("PIC").

37. ISC's wholly-owned subsidiary Pritchard-Rhodes, Limited ("PRL"), is a London based United Kingdom corporation with operations similar to JFP.

38. Verkor N.V. ("Verkor"), an ISC wholly-owned Belgian subsidiary, is an engineering firm with capabilities similar to those of JFP.

39. Since 1971, PRL has had three contracts with Sonatrach which is an Algerian state-owned entity. The contracts were for design, engineering and construction of liquified natural gas ("LNG") facilities. All of the contracts originally were fixed-price contracts and were to be financed through sources in the United Kingdom. The contracts were as follows:

(a) A 1971 contract under which PRL replaced a French contractor and was to complete a gas treatment plant in the Sahara (the "GTP" contract);

(b) A 1971 contract, known as the "Skikda 4" or "Skikda 40" contract, under which PRL was to construct "line IV" of production facilities located at Sonatrach's Skikda complex.

(c) A July 1973 contract, known as the "Skikda 5/6" or "Skikda 50/60" contract, under which PRL would be responsible for construction of "lines V and VI" of the Skikda facility.

(d) The contract value of these contracts was approximately $150 million.

40. In February 1975, JFP received a contract from Sonatrach for a "gas treatment module" to be installed at Hassi R'Mel (the "Hassi R'Mel" or "Cycling" contract). The contract value of the Hassi R'Mel project was approximately $170 million. This contract was financed through the U.S. Export-Import Bank. Portions of the original contract were on a fixed price basis.



41.(a) In 1975, approximately $400,000 was paid through JFP to a former senior Algerian military officer, Rhasid Zeghar for purported "consulting services" which consisted of meeting with ISC representatives over a four day period. The payment was made to a Swiss account.

(b) ISC does not have detailed information, vouchers, expense statements, or other forms of documentation, documenting the exact nature of the services provided by the former senior Algerian military officer.

(c) The $400,000 payment was included by JFP as "costs" attributable to the Hassi R'Mel project.

42. Defendant Frietsch, acting on behalf of ISC, including PRL and JFP, initially retained the former senior Algerian military officer.

43. As more fully described below, during the period from approximately 1971 to May 1976:

(a) Approximately $2.4 million was paid through PRL to Munib Masri and his "Arab Development Company" ("ADC") in connection with the GTP and Skikda projects.

(b) In connection with the Hassi R'Mel contract, approximately $1.1 million was paid through JFP to Masri through Ed Engineering and Development Holdings Establishment ("EDCO"). EDCO was the "mother company of" ADC.

44. By the end of June, 1971, PRL had entered into agreements with Masri for his services as a "sales representative" for several countries including Algeria. The agreements were subsequently extended to JFP.

45. Masri initially was to be paid 2% of the value of the GTP and Skikda 40 projects. For the period of August 5, 1971 through August 28, 1972, Masri received payments and fees on Skikda and GTP of approximately $860,000.

46.(a) In or about August 1972, the president director-general of Sonatrach advised ISC and PRL that they risked loss of their relationship with Sonatrach unless they conducted their business dealings in accordance with the strictest rules of morality and honest business relationships.

(b) The Sonatrach official was assured that the nature and purpose of Masri's services in connection with the GTP and Skikda contracts had been misunderstood by the Algerian official. He was further assured that Masri would have no connection with ISC/PRL's operations in Algeria.

(c) Defendant Kenneally was made aware of the facts set forth in paragraphs 46(a) and 46(b) above and, in turn, advised the Sonatrach official of ISC's awareness of the situation and assured that official that ISC would be responsive to his concerns. Defendant Kenneally arranged for Defendant Frietsch to meet with the Sonatrach official in September 1972.

(d) At the September 1972, meeting, the Sonatrach official informed Defendant Frietsch that Sonatrach was opposed to the use of "intermediaries" and that failure to comply with the undertaking not to utilize "intermediaries" in Algeria would result in ISC's exclusion from further business activity in that country. Defendant Frietsch assured the Sonatrach official that activities of the type about which he expressed disapproval had not and would not be engaged in by ISC or its subsidiaries.

(e) Neither Defendant Kenneally nor Defendant Frietsch informed the Sonatrach official that payments had been and were continuing to be made to Masri in connection with the GTP and Skikda contracts.

47. Subsequent to the September 1972 meeting, Masri continued to receive payments in connection with the GTP and Skikda 40 contracts. Masri also received payments in connection with the Skikda 50/60 contract entered into in 1973.



48. Certain of the payments to Masri in connection with the Skikda 40 and 50/60 projects were included on PRL's cost reports as "financing insurance" costs.

49. (a) As described in paragraph 40 above, the Hassi R'Mel contract was executed in February 1975. Section 19.7. of that contract provides:

> This contract was concluded without the assistance or the use, direct or indirect, of any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). No fees, nor any remuneration, commission, discount or other payment, has been paid, is or shall be due to any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). The parties agree to deal directly between themselves concerning any matter directly or indirectly connected with the Contract. The parties shall not permit, in their relations or in the relations of one of them with any government or administration, the intervention of any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). The Contractor undertakes to compensate the Owner if the Contractor shall have contravened one of the provisions of the present paragraph.

(b) A provision substantially similar to the aforesaid Section 19.7 was contained in the contract for Skikda 50/60.

(c) Neither ISC nor its subsidiaries, PRL or JFP, informed Sonatrach (i) that payments to Masri, and Zeghar (see paragraph 41 above) were included on Hassi R'Mel cost reports; and (ii) that payments to Masri were included on the cost reports for Skikda 50/60.

50. Certain provisions of Algerian law proscribe not only payments to government officials, but also the use of intermediaries or agents in the bidding for or negotiation of Algerian government contracts.

51.(a) In mid-1976, PRL and JFP were asked by Sonatrach to provide affidavits as to the use of third-parties in their dealings with Sonatrach. Such affidavits were executed by Defendant Hofker.

(b) Defendant Hofker's affidavits represented that for the period preceding the execution of the various contracts, and during the contract and post-contractual periods, neither ISC nor its subsidiaries, PRL or JFP, nor persons associated

with them had received or paid to any broker, representative, employee, agent, official or other person or corporate body domiciled in Algeria or abroad, any fees, commissions, bonuses, gratuities, donations or other payments or considerations, in connection with the Hassi R'Mel, GTP and Skikda projects. The affidavits acknowledged that the statements made therein constituted one of the fundamental bases of the contracts with Sonatrach; that the inaccuracy of the affidavits would constitute the provocation of faulty consent of Sonatrach; and that wilful false statements are subject to Algerian and United Kingdom penal laws.

(c) ISC and certain ISC officials decided not to inform Sonatrach of the payments to Masri and the former senior Algerian military officer. ISC officials were concerned that Sonatrach would terminate ISC's work in Algeria if the payments to these two persons were disclosed.

(d) Project cost reports which reflected the payments to Masri and the former senior Algerian military officer were adjusted prior to their review by Sonatrach representatives to remove these payments.

52. ISC obtained U.S. Export-Import Bank financing in connection with the Hassi R'Mel project. ISC was required to provide to the Export-Import Bank certificates as to certain payments of commission fees or otherwise in connection with the sale or obtaining of the contract of sale for financed equipment, materials and services.

53. ISC's filings with the U.S. Export-Import Bank fail to disclose the payments to the persons referred to in paragraphs 16, 17, 18, 23, 25, 29-32, 41-45, 48, 51 or the payments referred to in paragraphs 55-59, 64, 70, 71, 72, 74, and 77 below.

54. Verkor has been engaged in the design, engineering, procurement and construction of liquified natural gas facilities in the Algerian Sahara.

55. Between 1975 and 1977, Verkor paid $85,000 to a Swiss account for the benefit of a Belgian national, Hubert Renault, and a consulting firm with which he was affiliated, Sodac, in connection with an Algerian government contract.

56. Renault has claimed an additional $475,000 from Verkor, which amount represents approximately 2% of the value of the Algerian contracts obtained by Verkor.

57. A contract between the Renault and Verkor provided that Verkor shall pay to Renault "the sum of 2% of the value of whatever contract(s) may be finalized, payable in the form of secret commissions to one or more third parties."

58. The contract between Renault and Verkor also contained the following provision: "Each of the parties agrees to safeguard the confidential nature of the present agreement because of the mutual risks run in Algeria due to the effectiveness of Article 7 [concerning the secret commissions referenced in paragraph 57 above] of the present agreement."

59. ISC has no detailed information, vouchers or expense statements, or other forms of documentation, documenting the exact nature of the activities or the disposition of funds by Renault.

60. Paragraphs 49 and 50 are realleged and incorporated herein by reference.

61. With regard to Verkor, ISC submitted an affidavit to Sonatrach attesting to adherence to Algerian law and stating that no agents were used in obtaining the contract. The affidavit did not reveal the existence or provisions of the contract with Renault.

62. None of ISC's filings with the Commission or its public statements during the relevant periods disclosed the facts alleged in paragraphs 36 through 61 above. The individual defendants knew or should have known of the payments, arrangements, filings,

activities, and representations referred to in paragraphs 36 through 61. Defendants failed and/or failed to cause ISC to adequately disclose those payments, arrangements, filings, activities and representations in its public filings with the Commission and in other materials disseminated to the investing public.

Ivory Coast

63. ISC's wholly-owned subsidiary Lang Engineering, Corporation ("Lang") is an agricultural engineering firm incorporated in Delaware. Through Lang and related subsidiaries, ISC was engaged in 1972 to provide design, engineering, procurement, project management, construction and start-up services in conjunction with the establishment and implementation of a $50 million contract for construction of a sugar production and processing complex ("sugar complex") in the Ivory Coast.

64. Between 1972 and 1975, Lang paid approximately $1,073,711 and provided a new Lincoln Continental to Gilchrest Olympio, son of a former President of an African nation. The monies paid to Olympio were deposited to a Swiss account which he designated.

65. During that time, Olympio served as managing director of a British firm of consulting engineers, Lonhro Ltd., retained by the Ivorian government to assist it in determining the qualifications of the various firms competing for the referenced project and to assess the sufficiency of their bids.

66. The British consulting firm was in a position to influence the selection of ISC for the sugar complex contract. The British consulting firm also was responsible for overseeing the construction of the project.

67. During this period, Olympio provided Lang with confidential information and assisted it in meeting certain of its obligations and performance standards.



68. The payments referred to in paragraph 64 above were recorded in ISC's financial records as "intervention expenses." ISC has no detailed information, vouchers, expense statements or other documentation, documenting the exact nature of the activities of, or the disposition of funds, by Olympio.

69. During the period 1972-1973, Lang paid approximately $310,470 by checks to Societa Ivorienne de Developments et Financement ("SIDF"), a corporate entity which Lang engaged. One half of the stock of SIDF was owned by the Ivorian Ambassador to the United States, Timothee Ahoua. The Ivorian Minister of Finance also had an interest in SIDF.

70. The payments referred to in paragraph 69 above were recorded in ISC's financial records as "intervention expenses." The individual defendants knew or should have known of the facts alleged in paragraphs 63 through 69 above. Defendants failed and/or failed to cause ISC to adequately disclose those activities in its public filings with the Commission and in other materials disseminated to the investing public.

Nicaragua

71. ISC, through Lang and related subsidiaries, was engaged in 1971 to design, engineer, supply, and erect a $5.2 million grain storage facility in Nicaragua.

72. Between 1971 and 1975, Lang paid approximately $288,538 to two Nicaraguan agents in connection with the project. Approximately $25,000 was paid to A. Somoza y. Compania Ltda., a company owned by General Somoza, the president of Nicaragua, and his wife; the remainder was paid to Comdecosa, a company composed of employees of other entities controlled by the Somozas.

73. Additionally, approximately $127,000 was paid to one of these two agents.

74. The aforesaid payments were not accurately recorded in ISC's financial records. The individual defendants knew or

should have known of the matters referred to in paragraphs 71 through 73 above. Defendants failed to disclose and/or failed to cause ISC to adequately disclose those activities in its public filings with the Commission and in other materials disseminated to the investing public.

Chile

75. ISC Development Corporation, a wholly-owned subsidiary of ISC, incorporated in Delaware, is engaged in providing financial services. It solicits joint ventures or other equity participations in projects of ISC clients, holds ISC's interests in such projects, and provides financial management services to ISC subsidiaries, affiliates, and clients. ISC do Brazil Ltda. is a wholly-owned subsidiary of ISC Development Corporation.

76. Subsequent to receiving notification in 1975, that the Chilean Junta de Gobierno ("Junta") had reacted negatively to ISC's proposal to construct a $375 million LNG production project in the Straits of Magellan, ISC dispatched Alfred M. Lerner (see paragraphs 155 and 158 below) to Chile. Among others, Lerner met with Daniel Fuenzalida M., Chief Economic Advisor to General Leigh, a member of the ruling Junta, and General Leigh himself. Lerner encouraged Fuenzalida and Pedro Yoma to organize a Chilean company known as Chilco S.A. to represent ISC in Chile. Another individual involved with Chilco was the Chilean Consul General in Houston, Benjamin Rencoret. ISC viewed Fuenzalida as the "key member" of its group. To avoid possible conflict another individual was made president of Chilco. Chilco was to be paid one half of one percent of the value of any contracts which ISC secured in Chile. ISC expected Fuenzalida to present to, and gain acceptance for its proposals from, the Junta.

77. During the period when ISC was attempting to obtain the LNG project contract, ISC paid Chilco approximately $30,000.



78. The payments referred to in paragraph 77 were recorded on ISC's accounting records as a "commission". The individual Defendants knew or should have known of the matters referred to in paragraphs 75 through 77 above. Defendants failed and/or failed to cause ISC to adequately disclose those matters in its public filings with the Commission and in other materials disseminated to the investing public.

Certain Other Payments

79. During 1975, S&P paid $50,000 for Munib Masri's assistance in securing the aid of the Arab Development Corporation in connection with the arranging for a bank letter of credit. Masri was, at that time, also a director of the bank issuing the letter of credit.

80. The payment referred to in paragraph 79 above was reflected on ISC's accounting records as a "commission."

81. During 1976, SHL, as part of its agreement with an Iraqi state agency, was required to certify certain contract claims of other contractors. In this regard, upon instruction of an agent of the Iraqi government, it denied the claim of a certain Italian contractor.

82. Thereafter, the Italian contractor sought reimbursement from an insurance fund of the Italian government and asked S-H to validate its claim for that purpose. SHL agreed to assist the contractor for a fee of $700,000.

83. Upon payment of the aforesaid fee, $80,000 was rebated to the individual who negotiated the transaction with SHL as stated in paragraph 82 above. That individual was an employee or agent of the Italian contractor.

84. ISC has no detailed information, vouchers, expense statements, or other forms of documentation, documenting the exact nature of the activities or services for which the said individual was paid the said $80,000.

85. The individual defendants knew or should have known of the facts and activities alleged in paragraphs 79 through 84 above. Defendants failed and/or failed to cause ISC to adequately disclose those activities in its public filings with the Commission and in other materials disseminated to the investing public.

ISC's Current Report on Form 8-K for March 1978 and ISC's Annual Report on Form 10-K for 1978

86. Prior to April 1979, ISC did not disclose in its Annual or Quarterly Reports filed with the Commission or in its proxy soliciting materials filed with the Commission and disseminated to its shareholders the facts as stated in paragraphs 13 through 85 above and paragraphs 88 through 166.

87. On or about April 4, 1978, ISC filed with the Commission a Current Report on Form 8-K for the month of March, 1978 ("March 8-K") [See 17 C.F.R. 249.308]. On or about December 22, 1978, ISC filed with the Commission its Annual Report for its fiscal year 1978 on Form 10-K (the "1978 Form 8-K"). The March 8-K and the 1978 10-K are public documents. ISC caused the 1978 Form 10-K to be mailed and otherwise distributed to its shareholders and the investing public. Defendants ISC and Kenneally caused to be filed and filed with the Commission and distributed to ISC's shareholders and the investing public proxy soliciting materials for the years Defendant Kenneally stood for reelection as a director.

88.(a) The March 8-K does not fully or accurately report the findings or conclusions of the Special Counsel (see below). Neither the March 8-K nor the 1978 Form 10-K discloses the risks which ISC faces from operating or in continuing to operate its business in the above described manner nor the fact that a substantial part of ISC's overseas business was dependent on payments which were made to government officials or associates of government officials, persons believed to be government officials or associated with government officials or members of the ruling families of those countries, in connection with the securement of contracts.

(b) ISC's shareholders have not been informed, and are not informed by the March 8-K or the 1978 Form 10-K, that ISC's precarious financial condition and its ability to collect its "unbilled receivables" and its "escalation" claims is further jeopardized by its aforesaid foreign questionable and illicit payments and the rebate and kick back arrangement it entered into with its suppliers.

(c) The March 8-K and the 1978 Form 10-K fail to describe the risks involved in ISC's ceasing to engage in the types of foreign activities described in paragraphs 13 through 85 above.

(d) The March 8-K and the 1978 Form 10-K fail to state that the cessation of the aforesaid foreign activities could result in the company's demise.

89.(a) In 1976, ISC engaged Special Counsel to conduct an investigation into, among other things, questionable foreign payments, the use of foreign nationals in connection with its sales activities, and payments to those foreign nationals.

(b) The March 8-K states that "in view of the widespread publicity and disclosures relating to domestic and foreign questionable payments and practices involving other corporations, management of the company commenced a program of inquiry into its existing policies, procedures and practices with respect to these subjects."

(c) Both the 1978 Form 10-K and the March 8-K fail to state that "management's inquiry" was, in fact, instituted after the Commission initiated an inquiry to ISC regarding certain of its activities abroad.

90. In or about December 1977, the Special Counsel transmitted its Draft Report to a Special Committee of ISC's Board of Directors. The members of the Special Committee were directors Austin Wilson and Robert F. Medina. Medina became Chairman of ISC's Board of Directors after Defendant Kenneally resigned that post.

91.(a) The March 8-K states that in December 1977, Special Counsel submitted to ISC a draft report ("Report") which the Special Committee deemed tentative and incomplete. The 1978 Form 10-K makes reference to the Report as a major interim report of which disclosure was made in the March 8-K.

(b) The March 8-K fails (i) to state that Special Counsel and ISC's outside auditors were not permitted to examine into certain matters in the course of their investigation and audit; (ii) to disclose the reasons why, five months after the Report was submitted to ISC, a Special Committee of its Board of Directors had chosen to treat as and keep the Report "tentative" and had "not had an opportunity to review [it] in detail with Special Counsel" in order to finalize and complete the Report.

(c) The 1978 Form 10-K fails to state that, one year after the Special Counsel's Report was received, no significant effort had been made, if any were necessary, to complete and finalize the investigation, and report the results in full to ISC's shareholders and the public.

92. The March 8-K states that the Special Counsel's Report "contains no conclusions ... that unrecorded transactions of a questionable nature occurred" but does not state the facts set forth in paragraph 13 through 85 above. Neither the March 8-K, nor any of ISC's filings during the period 1971 to date, discloses the activities alleged in paragraphs 13 through 85 above or the knowledge of the individual defendants thereof or their participation therein.

93.(a) The March 8-K states that "the company's operations involve projects and proposals in developing countries where business practices are different from those in the United States and in other industrialized nations." The March 8-K states that the Special Counsel's Report "refers to $7,628,654 in commitments (of which $5,788,454 has been paid) in which a significant portion was paid to or for officials of foreign government agencies."



(b) The March 8-K fails to disclose the amounts alleged in paragraphs 13, 14, 16, 23, 27, 31-34, 41, 43, 45, 55, 56, 69, 72, 73, 77, 79 and 83 above. The March 8-K fails to state that none of the countries where ISC or its subsidiaries did business permitted, by local law, bribery or the use of undisclosed "intermediaries" to secure business from the foreign country or an entity owned or controlled by the foreign country.

94. The March 8-K fails to state the names of the foreign countries and the persons to whom the questionable payments were, or to whom ISC believed they were, being made. The March 8-K fails to relate the amounts of foreign payments to the contracts with which they were associated or the effect of the facts alleged in paragraphs 13 through 85 above on ISC's ability to secure further business in those countries or its ability to collect monies it was and is claiming from the foreign entities and nations.

95. The March 8-K does not state in its discussion of "taxes", which countries permit deductions by ISC's subsidiaries for the types of payments referred to herein or in the March 8-K.

96. The March 8-K does not state that ISC was in arrears, at various times, in payments of its legal fees to Special Counsel and that ISC was experiencing a cash flow problem and attempted to pay its legal fees with notes which were rejected by the Special Counsel.

97. The March 8-K states that Special Counsel "directly questions the credibility of certain individuals including a senior employee (who is not a corporate officer)." The March 8-K fails to disclose the identity of the individuals whose "credibility" was questioned.

98. The March 8-K states in part: "continuing inquiry may lead ultimately to the conclusion that certain of the payments ... are neither illegal nor improper." The March 8-K fails to state that no specific evidence was, or to this date has been, developed to suggest that ISC's Special Counsel was substantially incorrect

99. The March 8-K also suggests that certain ISC officers and directors "may have had actual or constructive knowledge" of the various foreign payments but fails to identify those persons.

100. In fact, ISC's senior management knew and approved of the payments at the time or shortly after they occurred.

101. The March 8-K contains, among others, the following material factual omissions:

(a) the identity of the foreign countries involved;

(b) the persons and positions of the government officials receiving the payments;

(c) the subsidiaries which made the payments and the projects in connection with which they were made; and,

(d) the persons and positions of the senior ISC officials involved in these practices.

102. All of the facts and the omitted facts set forth in paragraphs 13 through 85, 88, 91(b), 92-95, 97, 98, and 100 above were known to ISC by December 1978, when it filed its 1978 Form 10-K with the Commission.

103. Since 1976, to the extent that ISC periodically has made generic, generalized disclosure in its annual and periodic reports and proxy materials of matters uncovered by the said Special Counsel, it couched such disclosures in a way designed to indicate that the Special Counsel's findings and conclusions were "tentative", had not been finalized, and, therefore, ISC was not in a position to make concrete, detailed disclosure of matters referred to in the Special Counsel's Report. ISC's reports failed to disclose the knowledge of both ISC and the individual defendants of, and the participation of the individual defendants in, the activities alleged in paragraphs 13 through 85 above.

104. ISC's said annual and periodic reports and its proxy soliciting materials fail to state that its continued viability depends on its ability to recover escalation claims made against, among



others, the governments of Iran, Saudi Arabia and Algeria.

105. The 1978 Form 10-K states that in 1976, ISC's Board of Directors "through a special committee of outside directors" expanded the scope of an internal inquiry then being conducted to include "the possibility of illegal, improper or questionable payments" and that "a permanent Board Audit and Practices Committee (formerly the Special Audit Committee, responsible for conducting the special review) composed of two outside directors" had been established. The 1978 Form 10-K failed to disclose that the aforesaid "outside directors" were Austin C. Wilson and Robert F. Medina, whose respective law firm and management consulting firms received, during the period covered by the Special Counsel's investigation which they were overseeing, fees of $430,000 and $604,000 respectively. In March 1979, Medina became ISC's Chairman of the Board. The 1978 Form 10-K also fails to disclose that in mid-1978, W.L. Ross, II, replaced Wilson as a member of the Board Audit Committee. As discussed in detail below at paragraphs 154 through 156, ISC has not disclosed that Mr. Ross has been one of the three major beneficiaries of the Deferred Compensation Corporation.

106. ISC's 1978 Form 10-K states that in connection with the Commission's investigation of the company's foreign payments and other matters ISC "has cooperated with the Staff in its investigation and has furnished records and other documents as requested by the staff." Statements similar in substance have been made by ISC in other documents filed with the Commission and disseminated to the public.

107. The disclosure referred to in paragraph 106 above omitted to state that during the course of the Commission's investigation ISC refused to produce certain documents "as requested by the staff" and omitted to state that certain defendants declined to testify to the Commission's staff during the course of the Commission's investigation.

ISC'S BANK LINE OF CREDIT

108. During the course of its 1976 fiscal year, ISC negotiated a $40 million Multicurrency Revolving Credit Agreement ("Agreement") with a consortium of banks. Pursuant to its Agreement with the banks, ISC was required to maintain a certain percentage of its borrowings under the line of credit as compensating balances, to maintain a specified net worth and to meet specified working capital requirements.

109. During the course of its 1977 fiscal year, ISC was not in compliance with "major covenants" of the Agreement. Such non-compliance included the non-payment of interest as well as the failure to meet certain other financial covenants. ISC's bank lenders agreed to renegotiate certain provisions of the line of credit. Such renegotiation resulted in the application of virtually all of ISC's assets, including available cash, as collateral under the line of credit Agreement.

110. The renegotiated Agreement grants ISC's bank lenders "procedures and rights" as to the "control over and use of net proceeds from the sale, liquidation or collection of certain collateralized assets."

111. In its filings with the Commission, ISC failed to fully disclose the nature and effect of these amendments to its revolving credit Agreement, the "procedures and rights" referred to in paragraph 110 above, or the effect thereof on its operations and its ability to continue operations.

ISC'S FINANCIAL REPORTS AND INTERNAL CONTROLS

112. ISC filed with the Commission and disseminated to the public its Annual Reports on From 10-Ks for its fiscal years ("FY") ending 1970 through the present. Those Form 10-K's contained financial reports for each of its fiscal years. ISC also filed interim quarterly reports during the said period. ISC originally



reported a growth in earnings and revenue for FY 1973 through FY 1976. Earnings increased from $2.9 million on revenues of $178 million in FY 1973 to earnings of $8.4 million on revenues of $339 million for FY 1976. However, beginning with its fiscal year 1977, ISC began to report substantial and increasing losses. For FY 1977, ISC originally reported losses of $9.9 million of revenues of $282 million, increasing to losses of $43 million on revenues of $276 million in its latest Form 10-K, that for FY 1978. In its 1978 Form 10-K, ISC's financial statements also reported its stockholders' equity as a deficit $5.3 million. These financial reports were false and misleading in that in the earlier years ISC overstated profits, assets and shareholders equity while in the later years and continuing to the present time ISC has understated losses and overstated assets and shareholder's equity through the use of false and misleading methods of financial reporting. The ISC financial reports were and continue to be false and misleading and ISC has made false and misleading disclosures for, among other things, the following:

(a) cost overruns on ISC's contract were improperly reflected as "unbilled receivables" without any reasonable assurance that ISC customers would reimburse such costs;

(b) improper and questionable payments were included in "unbilled receivables" as legitimate reimbursable contract costs;

(c) liabilities and obligations were not properly recorded and accounted for;

(d) additional cost reimbursement sought on a fixed-price contract was mispresented as an "escalation payment";

(e) profits were prematurely recognized;

(f) funds received through kickback arrangements were improperly accounted for;

(g) costs which were not collectible under the contract to which they were attributable were improperly rolled into other contracts and carried as assets; and

(h) sham "escalation" claims were and are still being carried as receivables.

113. ISC used the percentage-of-completion method of accounting for the GTP project. ISC's 1978 Form 10-K, as does its 1977 and 1976 Form 10-K's, states that "the percentage-of completion method requires that the entire amount of any ultimately projected individual contract losses be recognized when known."

114. In late 1974, PRL completed the GTP project. The GTP project had been undertaken on a fixed price basis notwithstanding ISC's and PRL's awareness that contracts with sub-contractors were not on a fixed price basis. ISC and PRL understood that they faced losses if the subcontractors increased the price of labor, services or material they were providing to them. PRL experienced purported cost overruns on the GTP project of approximately $3 million. ISC did not record on its books and records a provision for losses on the GTP contract as a result of the GTP cost overruns. ISC transferred the GTP cost overruns to the Hassi R'Mel cost reports (see paragraphs 40 and following above) and continued to carry the GTP cost overruns on its books and records as "unbilled receivables." The amounts of "unbilled receivables" for the completed GTP contract were reflected on ISC's books and records as increasing from $2.9 million at June 30, 1976 to $3.5 million at June 30, 1978.

115. ISC's 1978 Form 10-K financial statements reflect approximately $30.8 million in accounts and "unbilled receivables", a $6 million provision for settlement of certain claims and other unresolved contract matters, and show a deficit stockholders' equity of approximately $5.3 million. Of the $30.8 million in "unbilled receivables", approximately $14.6 million arises from projects in Algeria.

116. In May 1975, negotiations were begun with Sonatrach regarding increased costs purportedly was experienced on the Skikda projects ("the Skikda negotiations").

117. During the Skikda negotiations, ISC/PRL attempted to present a claim for reimbursement of the approximately $3 million



GTP cost overruns. Sonatrach officials repeatedly excluded the GTP costs from consideration on the grounds that the award of the $170 million Hassi R'Mel project, referred to in paragraph 40 above, was made without competitive bids or price negotiations. Sonatrach stated to ISC it would not pay anything additional on GTP.

118. The Skikda negotiations resulted in a December 1975, "Protocol" which provided among other things that:

(a) ISC was required to establish separate project bank accounts for each project and prepare opening balances for each project account based upon a reconciliation of all transactions having occurred to the effective dates of the conversions of the contracts.

(b) Sonatrach had the right to examine PRL's cost reports for the Skikda projects.

119. In or about August 1976, Sonatrach decided to replace JFP as construction contractor on the Hassi R'Mel project. ISC transferred the GTP loss, which it had transferred into the Hassi R'Mel project, back to PRL and continued to show the loss on its financial statement as an asset classified as "unbilled receivables."

120. In or about late 1976, the opening balances for the Skikda projects were prepared in accordance with the Protocol. Due to the lack of adequate and accurate books and records, it appeared that approximately 2.8 million British ["Br."] pounds advanced by Sonatrach for the Skikda projects had been diverted by ISC for other purposes. Therefore, ISC's opening balance for Skikda was reflected as a deficit opening balance ("the Skikda opening balance deficit").

121. During 1976 and 1977, PRL and Sonatrach conducted their relationship on the basis that there was in fact an opening balance deficit. In 1977, in connection with their audit examination of ISC's financial statements, ISC's auditors found PRL's records

inadequate for audit purposes. The auditors "reconstructed" the Skikda cost reports. In so doing, the auditors found that the accumulated costs in the PRL version were understated by 3.5 million Br. pounds when compared to project costs recorded in PRL's financial records. The auditors informed ISC that they (a) found that PRL has no analyses suitable for presentation of a formal claim on GTP to Sonatrach; (b) knew of no agreement by Sonatrach to pay additional sums on GTP; (c) learned that Sonatrach has repeatedly refused to discuss the matter of paying additional sums on GTP; (d) learned that Sonatrach had repeatedly refused to discuss the matter of paying additional monies with respect to the GTP loss; and (e) concluded that there is no contractual basis for including GTP in the final accounting of Skikda 40 project. ISC made no adjustment to or provision for the GTP loss in its financial statements to reflect the findings of its auditors. Instead, it continued to treat the GTP loss as an asset classified as "unbilled receivables".

122. In or about December, 1976, the following changes occurred in connection with the Skikda projects:

(a) Sonatrach determined to replace PRL on the Skikda 50/60 project and reimburse PRL for the actual costs properly changeable to Sonatrach. The reimbursement was to be made on the basis of a final financial statement. Such a statement was never prepared.

(b) Sonatrach required that the funds attributable to the Skikda opening balance deficit, which was then believed to exist, were to be restored to the project accounts.

123. In 1977, PRL made an informal proposal to Sonatrach for the continued funding of Skikda 40 in which PRL requested Sonatrach to allow PRL to credit the GTP loss against the opening balance deficit. Sonatrach did not accept PRL's proposal. PRL sought to net its previously rejected claim for reimbursement of the GTP loss against the opening balance deficit. PRL could not



then have restored the Skikda opening balance deficit and continued its operations.

124. For its fiscal year 1977, ISC's Form 10-K financial statements reflect assets of approximately $40.5 million classified as "unbilled receivables" with no provision for losses. ISC included in that $40.5 million of assets $6.1 million of "unbilled receivables" for Hassi R'Mel.

125. By October 1978, the Hassi R'Mel "unbilled receivables" were still being carried on JFP's books and records as an asset but had been increased to $7.9 million. On October 20, 1978, ISC sold substantially all the assets of JFP, including the aforesaid "unbilled receivables" then being carried for Hassi R'Mel. In connection with that sale of JFP a Purchase Agreement was executed by ISC.

126. Section 3.3 of the Purchase Agreement provided for the allocation of the purchase price with an acknowledgment by both parties that each of the assets had been bargained for individually. Exhibit D to the Purchase Agreement showed a net "unbilled receivable" for Hassi R'Mel in the amount of $2,971,470.

127. The aforesaid $7.9 million Hassi R'Mel "unbilled receivable" was reduced in valuation at the time of sale of JFP because ISC, JFP, and the Buyer, believed that ultimate recovery would approximate no more than thirty-five percent of the original claimed amount.

128. ISC's Forms 10-K for the years 1974 through 1978 are materially false and misleading in that they fail to adequately disclose the matters set forth in paragraphs 113-127 above.

129. ISC's 1978 Form 10-K, and its earlier filings with the Commission, have been materially false and misleading in that they have failed to disclose the inadequate condition of the books and records and internal controls of ISC's subsidiaries as more fully described below.

130. Arthur Andersen & Co. ("AA"), became ISC's auditors beginning with the fiscal year 1977 audit and was informed by a Sonatrach official in 1977, that, among other things, Sonatrach:

(a) intended to make a complete review of the contract costs on Skikda 40 upon completion of the project;

(b) would definitely dispute certain cost items;

(c) would look into ISC's cross funding between two contracts;

(d) intended to claim a credit for the advances made to PRL which were not used within a reasonable time limit for the purpose of the contracts; and

(e) that the amounts Sonatrach might claim from PRL could be very high in light of some of the transactions made by PRL including transfer of 2,800,000 Br. pounds to ISC to cover the GTP loss.

131. AA informed ISC of the result of its audit investigation. In its 1977 memorandum to PRL and ISC on internal control:

(a) AA stated that with regard to PRL's interpretation as to cost reimbursement from Sonatrach "[t]here is little doubt that the company's view of the intent of the parties to the contracts is not set out in the available contractual documentation." AA noted that substantial losses would be incurred if PRL's interpretation of the Skikda contracts and the intent of the parties were incorrect.

(b) AA noted that its audit investigation revealed (i) 864,000 Br. pounds of recorded revenue and reimbursable costs relating to overhead incurred in excess of the contractual amount; (ii) approximately 3.7 million Br. pounds of Skikda 40 costs incurred but not paid prior to a June 30, 1977, contract amendment stating that such liabilities should be treated as advances to be considered further at final settlement of the contract; (iii) approximately 1.3 million Br. pounds relating to certain heat exchangers in excess of the purchase price agreed to by Sonatrach; (iv) potential total penalties of up to 8.8 million Br. pounds; and (v) for the completed GTP project "[w]e know of no agreement by Sonatrach to pay further sums to PRL for the work on GTP."

132. The foregoing represented amounts as to which AA informed ISC and PRL there was uncertainty that Sonatrach would pay or would allow PRL to claim in a final accounting.

133. The auditors also informed ISC and PRL that their "reconstruction" of PRL's cost reports indicated that the cost reports were not suitable for audit purposes. The auditors reported that:

> Company management had been negotiating with Sonatrach on the basis of inadequate information. This poor standard of care and control could have had, and may yet have, considerable financial implications.

Nevertheless, ISC made no provision for doubtful "unbilled receivables".

134. In addition to the matters as stated above in paragraphs 130 through 133, subsequent to AA's engagement as ISC's auditors, AA ascertained and ISC was aware or should have been aware:

(a) that the company's "beliefs" of what costs Sonatrach would reimburse for Skikda 40 were not supported by the contract and its amendments;

(b) that substantial liabilities on Skikda 40 were not being recorded on the belief that PRL should not have to bear the costs;

(c) that there were substantial penalties on the Skikda projects which, although the company was prima facie in breach of certain of the completion dates and performance clauses, were not being properly recorded on the company's books and records;

(d) that the company had not prepared a financial statement for settlement of the terminated Skikda 50/60 contract and that the company's recorded gross profit on the projects exceeded that allowed for in the contractual documents by 744,000 Br. pounds;

(e) that contracts with Sonatrach were not accounted for separately as required by those contracts;

(f) that for a substantial period the systems for reporting contract costs were not operating effectively;

(g) that documentary evidence for certain transactions was incomplete;

(h) that the auditors could find no contractual or other support for including GTP in the Skikda 40 settlement.

135. In September, 1978, ISC was advised by its auditors that:

(a) they were unable to obtain confirmation of receivables from Sonatrach including, for June 30, 1978, accounts receivable of approximately 1.9 million Br. pounds;

(b) PRL had a liability to Sonatrach for advances under contracts of approximately 6.3 million Br. pounds;

(c) they were "unable to perform satisfactory alternative audit procedures to verify the balances due to or from Sonatrach;"

(d) Certain of the auditors' reviews could not be satisfactorily accomplished because the auditors found that the company's accounting procedures and system of internal control during the year were inadequate to provide for proper recording and allocation of costs and expenses and to assure proper custodianship of assets.

136. AA also informed ISC that they found that PRL's books violated the English Companies Act. The auditors advised ISC that:

(a) PRL does not consider whether costs that it transfers into "unbilled receivables" are, in fact, items for which it will be able to obtain reimbursement from Sonatrach;

(b) as of June 30, 1978 there is an asset in PRL's balance sheet of approximately 11.3 million [Br. pounds] for unbilled receivables and a liability for contract advances of 6.3 million [Br. pounds]; that no breakdown of these numbers is available; that they represent costs incurred on projects plus gross profit recognised less billings to date; and that the effect is that the balance sheet shows a net asset of 4 million [Br. pounds] for which the company is unable to provide any reasonable analysis;



(c) the company has also failed to perform any exercise to assess whether the costs that the "unbilled receivable" figure represents are chargeable to Sonatrach and that as long as the "unbilled receivables" and the contract advances are contained in the financial statements in this way, without a critical review by the company to establish whether the net asset is collectible, the directors cannot, as required under Section 12(3)(6) of the English Companies Act ensure that the balance sheet and profit and loss account give a true and fair view.

137. The auditors also informed ISC that AA's London office was of the opinion that the Foreign Corrupt Practices Act (Section 13(b)(2) of the Securities Exchange Act of 1934) was being violated as: (i) PRL had failed to maintain proper books of account; and (ii) a sufficient system of internal control had not been maintained.

138. On or about December 21, 1978, ISC's auditors informed it that PRL's accounting procedures were inadequate to provide for the proper recording and allocation of costs and expenses and to assure proper stewardship of PRL's assets. It was then the opinion of ISC's auditors that:

> the financial statements of Pritchard Rhodes Limited as of 30th June, 1978, do not present fairly its financial position as of 30th June, 1978 or the results of its operations for the year ended, in conformity with generally accepted accounting principles.

139. ISC, aided and abetted by Defendants Kenneally and Frietsch, in public filings made with the Commission and disseminated to its shareholders and the investing public made false and misleading statements and failed to adequately and accurately disclose, the matters described in paragraphs 112 through 138 above.

KILQUADE

140. In 1970, Kenneally used approximately $160,000 of ISC funds to purchase a large house and approximately 85 acres of farm land in Kilquade, near Dublin, Ireland ("Kilquade"). Kenneally took title to Kilquade in his own name.

141.(a) By June 30, 1974, improvements costing approximately $548,000 had been made to the house and grounds.

(b) In addition, by that date, approximately $97,000 had been spent on antiques for Kilquade.

(c) The improvements and antiques were paid for with ISC funds.

(d) In subsequent years, significant additional expenditures of ISC funds were made for these purposes.

(e) More than $1 million of ISC monies were expended from 1970 through 1978 to purchase, decorate and maintain Kilquade.

142. Kenneally's wife and a Houston based interior decorator have been signatories on ISC bank accounts maintained for Kilquade.

143. Kilquade has been used almost exclusively as a summer residence for Kenneally and his family.

144. ISC corporate funds have been used to transport Kenneally and his family to and from Kilquade.

145. In public filings, including its 1978 Form 10-K, ISC described Kilquade as "approximately 15,000 square feet of office space, support facilities and visitor accommodations ...." ISC's said filings and annual report fail to disclose that the only "office space [and] support facilities" located at Kilquade are Kenneally's den/library and a desk, typewriter and telex machine in the basement which is used by Kenneally's personal secretary when she accompanies him to Kilquade.

146. Certain expenses, including operating expenses, for Kilquade have been paid through a London-based ISC subsidiary, ISC Europe. ISC Europe pays the Kilquade expenses, adds on three percent, and records them on its books as an asset due from ISC. ISC, in turn, reimburses ISC Europe for this expenditure and records the Kilquade expenses as "Consultancy Fees" in its selling, engineering and administration accounts.



147. ISC has paid other perquisites for Kenneally and for other officers and directors in amounts and for purposes not now known by the Commission.

148. ISC's public filings made with the Commission and disseminated to its shareholders and the investing public failed to adequately and accurately disclose, and defendants Kenneally and Frietsch failed to cause ISC to adequately and accurately disclose, the matters described in paragraphs 140 through 147 above.

THE DEFERRED COMPENSATION CORPORATION

149. ISC has established a "Deferred Compensation Corporation" ("DCC") and a "Deferred Compensation Trust" ("DCT") as part of a "Deferred Compensation Plan" (the "Plan") purportedly to provide "incentive" and retirement benefits for ISC officers, directors and key personnel.

150. The DCC has outstanding both common shares and $4 cumulative preferred shares with a $100 liquidation and redemption preference. Certain of the preferred shares have been distributed under the Plan while others were distributed outside the Plan in 1968, as a dividend on the DCC common shares. Since the 1968 dividend, the value of DDC has been in the preferred shares.

151. The DCC has never been audited.

152.(a) The assets of the DCC consist primarily of ISC common shares of which, at June 30, 1978, DCC owned 23%. DCC acquired these shares with bank loans, and loans and "contributions" made or caused to be made by ISC.

(b) As disclosed in ISC's 1978 Form 10-K, ISC held notes and accounts receivable from DCC in the aggregate amount of $803,763.

(c) From August, 1965, through June 30, 1977, ISC contributed $158,000 per year to the DCC through the DCT. DCT used the money it received from ISC for, among other purposes, to buy DCC preferred shares.

(d) ISC subsidiaries purchased ISC common stock from the DCC at DCC's cost - rather than the prevailing market at the time of the purchase - and then sold the stock to "key personnel" at a loss to the subsidiaries and ultimate loss to ISC.

153. Except for the 1968 preferred share dividend, DCC shares are "allocated" to the participants without any set criteria, procedures, or time for determining such allocations.

154. There are essentially only three beneficiaries of the DCC who, for very little investment, have received the benefits of ISC's funding of DCC: Kenneally, Alfred M. Lerner ("Lerner") and W.L. Ross, II ("Ross").

(a) Collectively, Kenneally, Ross and Lerner own 73% of the outstanding DCC common shares and 74% of the outstanding preferred shares, not including those presently being held by the DCT for possible future distribution under the Plan.

(b) All but 6% of the shares held by Kenneally, Lerner and Ross are vested shares received by them in the 1968 dividend referred to in paragraph 151 above.

155.(a) ISC's 1978 Form 10-K states that Kenneally owns 400 shares (45%) of DCC's common stock and was allocated 950 shares of DCC preferred stock. The 1978 Form 10-K states that maximum benefit to Kenneally from those shares under the Plan will be $19,085 for each of the years 1991 through 2000.

(b) ISC's 1978 Form 10-K does not disclose that Kenneally also owns 3000 shares of vested DCC preferred shares which he received in the 1968 dividend.

156.(a) Ross has been a director of ISC since 1964. During that time period he has not served ISC in any other capacity. Ross is one of the "outside directors" on ISC's Board Audit and Practices Committee (formerly the Special Audit Committee), referred to in paragraph 105 above. Ross is also chairman of the board of Ross, Stebbins, Inc., a member firm of the New York Stock Exchange.



(b) While ISC's 1978 Form 10-K states that Ross owns 100 shares (11%) of DCC's common shares, the 1978 Form 10-K fails to disclose that Ross also owns 2,550 shares of vested DCC preferred shares obtained in the 1968 dividend.

157.(a) Lerner, for a period prior to 1971, was a director of ISC's predecessor, HOMCO, and an officer of an ISC subsidiary. Subsequently, Lerner resigned as a director. That resignation was disclosed to ISC's shareholders. Thereafter, Lerner continued to be engaged by ISC as a "consultant" and directed ISC's activities in Chile and Brazil. Neither Lerner's continued employment by ISC nor his interest in the DCC have been disclosed by ISC.

(b) The 1978 Form 10-K does not disclose that Lerner owns 152 shares (17%) of DCC's common shares and 3000 shares of vested DCC preferred shares received in the 1968 dividend.

158. ISC's 1978 Form 10-K, and its filings for its fiscal years 1976 through 1978 including its proxy soliciting materials, state that in May, 1976, DCC acquired ISC common shares from Kenneally in a "privately negotiated transaction." The said filings did not state that the purchase from Kenneally was in an amount, at a time, and at a price determined by Kenneally. It was also not disclosed that when the above transaction occurred, ISC's problems in Algeria and its questionable "unbilled receivables" were known to Kenneally but not publicly disclosed.

159. ISC's public filings fail to disclose that Kenneally is and has been indebted to DCC while DCC has owed monies to ISC, an ISC subsidiary, and banks.

160. ISC's public filings fail to disclose that between April 30, 1973 and June 26, 1978, DCC paid out $211,477.79 to Lerner for options and future options for purchase of 200 shares of DCC common stock owned by Lerner. As of June 26, 1978, those shares had no value. An option to purchase DCC common stock was extended to Ross in December 1971, the last payment thereon due in March, 1979.

161. ISC has failed to disclose and defendants Kenneally and Frietsch failed to cause ISC to disclose the matters described in paragraphs 151 through 160 above in its filings with the Commission, or in its communications to its shareholders and the investing public.

BRAZILIAN SUBSIDIARIES

162. In its fiscal year 1978, ISC disposed of certain of its Brazilian subsidiaries to a company owned in whole or in part by Alfred M. Lerner (see paragraghs 154 and 157 above).

Public Filings and Offering Circular

163.(a) Upon conclusion of each of its fiscal years ended 1970, through June 30, 1978, ISC prepared and filed with the Commission an Annual Report on Form 10-K [See 17 C.F.R. 249.310]. During each of the aforesaid years, ISC filed with the Commission and disseminated to its shareholders and the investing public, definitive proxy soliciting materials. In 1979, ISC filed preliminary proxy soliciting materials with the Commission. In each of the aforesaid proxy soliciting materials, Kenneally was proposed for and stood for reelection as a director of ISC. Kenneally knew or should have know that the matters alleged in this Complaint were not disclosed in the said proxy soliciting materials.

(b) During each of its fiscal years referred to in paragraph 163(a), ISC prepared and filed with the Commission Quarterly Reports on Form 10-Q [See 17 C.F.R. 249.308(a)].

164. The reports referred to in paragraph 163 above were filed with the Commission by ISC pursuant to Section 13(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78m(a)]. ISC reasonably knew that the said reports would be publicly disseminated.

165. During its fiscal year 1977, ISC prepared and filed with the Commission and disseminated, or caused to be disseminated, to the investing public an Offering Circular in connection with an exchange offer made to the holders of ISC's common stock.



166. The reports referred to in paragraphs 162 through 164 and the Offering Circular referred to in paragraph 165 omitted the facts as set forth in paragraphs 13 through 162 above.

COUNT I

(Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 [17 C.F.R. 240.10b-5] thereunder.)

167. Paragraphs 1 through 166 above are realleged and incorporated herein by reference.

168. During the period from approximately January, 1970, to the date hereof, Defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, and each of them, and others, directly and indirectly, singly and in concert, and aiding and abetting each other, in connection with the purchase or sale of securities of ISC, and by use of the means and instrumentalities of transportation and communication in interstate commerce, the mails, and the facilities of a national securities exchange, have been and are now (i) employing devices, schemes, and artifices to defraud; (ii) making untrue statements of material facts, and omitting to state material facts necessary to make the statements made, in light of the circumstances under which they were made, not misleading; and, (iii) engaging in acts, practices, and courses of business which have operated and are operating as a fraud and deceit upon shareholders of ISC and other persons in violation of Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 [15 C.F.R. 240.10b-5] thereunder as more fully alleged in paragraphs 13 through 166 above.

169. By reason of the foregoing, defendants ISC, Kenneally, Frietsch, Hofker, Stein and Angulo, and each of them, and others, singly and in concert, and aiding and abetting each other, directly and indirectly, violated Section 10(b) of the Exchange Act [15 U.S.C. 78j(b)] and Rule 10b-5 [17 C.F.R. 240.10b-5] thereunder.

COUNT II

(Section 17(a) of the Securities Act [15 U.S.C. 77q(a)])

170. Paragraphs 1 through 166 above are realleged and incorporated herein by reference.

171. During the year 1977 to the date hereof, defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, and each of them, directly and indirectly, singly and in concert, and aiding and abetting each other, in the offer and sale of ISC securities, by use of means and instrumentalities of transportation and communications in interstate commerce and by the use of the mails, have been and are now (i) employing devices, schemes and artifices to defraud; (ii) making untrue statements of material facts, and omitting to state material facts necessary in order to make the statements made, in light of the circumstances under which they were made not misleading; and (iii) engaging in acts, practices and courses of business which have operated and are operating as a fraud and deceit upon shareholders of ISC and other persons in violation of Section 17(a) of the Securities Act [15 U.S.C. 78q(a)] as more fully alleged in paragraphs 14 through 166 above.

172. By reason of the foregoing, defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein and each of them, and others, singly and in concert, and aiding and abetting each other, directly and indirectly, violated Section 17(a) of the Securities Act [15 U.S.C. 77q(a)].

COUNT III

(Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)], and Rules 12b-20, 13a-1, 13a-11 and 13a-13, [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13] thereunder)

173. Paragraphs 1 through 166 are hereby realleged and incorporated herein by reference.

174. During the period 1970 to the date hereof, ISC filed with the Commission certain reports, including Annual Reports



on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, all of which were required by Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13 [17 C.F.R. 240.12b-20, 240.13a-1 and 240.13a-13] thereunder. The Forms 10-K, 10-Q and 8-K were false and misleading and omitted to state material facts necessary to make the statements made not misleading and omitted to state facts required to be stated herein.

175. Defendants Kenneally, Frietsch, Hofker, Angulo and Stein, singly and in concert, directly and indirectly, and aiding and abetting each other and ISC, failed to disclose, failed to cause ISC to disclose, or caused ISC, to misrepresent the events, activities and transactions described in paragraphs 14 through 166 above.

176. By reason of the foregoing, defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, singly and in concert, and aiding and abetting each other, directly and indirectly, violated Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20, 13a-1, 13a-11 and 13a-13, [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13] thereunder.

COUNT IV

(Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)] and Rules 14a-3 and 14a-9 [17 C.F.R. 240.14a-3 and 240.14a-9] thereunder).

177. Paragraphs 1 through 166 above are hereby realleged and incorporated herein by reference.

178. Defendant ISC solicited, and defendants Kenneally, Frietsch, Hofker, Angulo and Stein caused ISC to solicit proxies for the election of ISC directors by means of definitive proxy soliciting materials during the years 1970 through 1978, and in 1979 ISC filed and the said individual defendants caused ISC to file preliminary proxy soliciting materials, which did not contain information specified in Schedule 14A of the Commission's proxy rules and which proxy

soliciting materials were false and misleading and omitted to state material facts necessary to make the statements made not misleading, in that, among other things, said proxy soliciting materials failed to disclose the matters alleged in paragraphs 14 through 166 above.

179. By reason of the foregoing, defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein and each of them, and others, singly and in concert, and aiding and abetting each other, directly and indirectly, violated Section 14(a) of the Exchange Act [15 U.S.C. 78n(a)], and Rule 14a-3 and 14a-9 [17 C.F.R. 240.14a-3 and 240.14a-9] thereunder.

COUNT V

(Section 13(b)(2) ("Foreign Corrupt Practices Act of 1977") of the Exchange Act [15 U.S.C. 78m (b)(2)] and Rule 13b-2 (17 C.F.R. 240.13b-2)

180. Paragraphs 1 through 166 are hereby realleged and incorporated herein by reference.

181. During the period from at least December 19, 1977, (effective date of the "Foreign Corrupt Practices Act of 1977") and continuing to the date hereof, defendant ISC in connection with its operations is now failing to: (1) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of ISC; and (2) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that (a) transactions are executed in accordance with management's general or specific authorization, (b) transactions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and/or other criteria applicable to such statements, and to maintain accountability for assets, (c) access to assets is permitted only in accordance



with management's general or specific authorization, and (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

182. By reason of the foregoing, defendant ISC has violated, is violating and, unless restrained and enjoined, will continue to violate Section 13(b)(2) of the Exchange Act [15 U.S.C. 78m(b)(2)] and Rule 13b-2 [17 C.F.R. 240.13b-2] thereunder.

WHEREFORE, Plaintiff Commission respectfully prays and requests that this Court:

I

Determine, declare and issue findings of fact with respect to the violations, acts and practices alleged in this Complaint.

II

Issue an Injunction restraining and enjoining defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, and each of them, and their officers, directors, agents, servants, employees, successors, assigns, affiliates, and subsidiaries, and each of them, and those persons in active concert or participation with them, directly or indirectly, in connection with the purchase, sale or offer to purchase or sell the securities of ISC or any other issuer, by the use of any means or instrumentalities of transportation or communication in interstate commerce, or by the use of the mails, from making any false, misleading or untrue statement of fact, or omitting to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading, concerning, among other things:

1. any agreement, commitment, understanding, arrangement or transaction between ISC, or any of its subsidiaries or

any of their affiliates or subsidiaries, and any third persons, official or employee of any entity owned and/or controlled by a foreign government, consultant, government official, trade association, or any attorney, employee or agent thereof;

2. any transaction or payment between or by ISC, its subsidiaries or any of their affiliates or subsidiaries, and any third party without reliable documentation accurately reflecting the purpose of such transaction or payment, to whom such payment or with whom such transaction took place, or the existence of fictitious vouchers;

3. any agreement, understanding, arrangement, or transaction involving officers, directors, or employees of ISC, or any of its affiliates or subsidiaries, wherein payments are generated, disguised, and made to third persons;

4. the nature and extent of any expenditure of funds to agents, foreign trade associations, consultants, attorneys, or other such persons;

5. any action by ISC, its subsidiaries or affiliates, or any person or entity acting for or on behalf of any of them, in furtherance of a payment, offer, promise to pay, or authorization of a payment of the type specified in subparagraphs (1), (2), (3) and (4) above;

6. the employment and activities of any foreign national or foreign entity employed in connection with the securement of, application process relating to, or execution of a contract for proposals, feasibility studies, engineering, construction work, or related activities to be let either by a foreign government, a subdivision thereof, or a government-owned corporation with respect to a proposed or actual project;

7. the nature and extent of any fund of corporate monies or other assets established or maintained without being fully



and properly accounted for on the books and records of ISC, or the nature and extent of payment, disbursements, or transfers, if any, therefrom;

8. the extent to which transfers or disbursements of corporate funds, material in nature, amount, or effect, were or could be effected without the application of adequate accounting or auditing procedures and controls;

9. the means by which ISC obtains business, its performance under contracts it has obtained, its relations with its clients, the risks encountered in its business, and its financial condition;

10. the terms and conditions under which ISC has secured a line of credit from any bank, insurance company, or similar financial institution;

11. transactions in any pension or profit sharing plan maintained, established, or funded, directly or through loans, by ISC;

12. the personal use of any of the facilities of ISC by any officer or director, or any family member of an officer or director, of ISC, or any of its subsidiaries or affiliates, or any other benefit conferred, directly or indirectly, upon any such person;

13. the submission of any false affidavit or other false document to any foreign government, or any agency or wholly-owned entity thereof;

14. the nature and extent of any false of fictitious entries on the books and records of ISC, or any of its subsidiaries or affiliates, with respect to the matters referred to in subparagraphs (1) through (13) hereinabove; and

15. the extent to which any officer, director, or employee of ISC, its subsidiaries or affiliates, knew of or participated in the matters and activities required to be disclosed pursuant to subparagraphs (1) through (14) hereinabove.

III

Issue an Injunction restraining and enjoining defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, and each of them, and their officers, agents, servants, employees, successors, assigns, affiliates, and subsidiaries, and each of them, and those persons in active concert or participation with them, directly or indirectly, from filing, causing the filing, or aiding and abetting the filing, with the Commission any annual, current or quarterly or other periodic report required to be filed pursuant to Section 13(a) of the Exchange Act [15 U.S.C. 78m(a)] and Rules 12b-20, 13a-1, 13a-11, and 13a-13 [17 C.F.R. 240.12b-20, 240.13a-1, 240.13a-11 and 240.13a-13] thereunder, which contains any untrue statement of a material fact, or omits to state a material fact necessary, in order to make the statements made, in light of the circumstances under which they were made not misleading, or omits to state any fact required to be included therein.

IV

Issue an Injunction restraining and enjoining defendants ISC, Kenneally, Frietsch, Hofker, Angulo and Stein, and each of them, and their officers, directors, agents, servants, employees, successors, assigns, affiliates, and subsidiaries, and all persons in active concert or participation with them, and each of them, by use of the mails or by any means and instrumentalities of transportation or communication in inter-state commerce, or of any facility of a national securities exchange or otherwise, directly or indirectly, from:

a) soliciting any proxy of any security holder without concurrently or previously furnishing said person with a written proxy statement containing the information specified in Schedule 14A [17 C.F.R. 240.14a-101] of the Commission's proxy rules [17 C.F.R. 240.14a-1 through 240.14a-12];



b) filing, causing to be filed, or aiding and abetting the filing with the Commission of proxy soliciting materials, or soliciting any proxy of any security holder of a public corporation by means of any proxy statement, form of proxy, notice of meeting or other communication, whether written or oral, containing any statement which, at the time and in the light of the circumstances under which it is made, is false or misleading with respect to any material fact, or which omits to state any material fact necessary in order to make the statement therein not false or misleading, or necessary to correct any statement in any earlier communication with respect to the solicitation of any proxy for the same meeting or subject matter which has become false and misleading.

V

Issue an Injunction restraining and enjoining ISC, its officers, directors, agents, servants, employees, successors, assigns, affiliates, subsidiaries, and attorneys in fact, and all persons in active concert or participation with them, and each of them, from violating Section 13(b)(2) of the Exchange Act [15 U.S.C. 78m(b)(2)], by failing to:

1. make and keep books, records, and accounts which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of ISC, or its subsidiaries or affiliates;
2. devise and maintain a system of internal accounting controls for ISC, and its subsidiaries and affiliates, sufficient to provide reasonable assurances that: (a) transactions are executed in accordance with manage-ment's general or specific authorization; (b) trans-

actions are recorded as necessary to permit preparation of financial statements in conformity with generally accepted accounting principles and/or any other criteria applicable to such statements, and to maintain accountability for assets; (c) access to assets is permitted only in accordance with management's general or specific authorization; and (d) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

VI

Issue an Injunction restraining and enjoining ISC, its officers, directors, agents, employees, successors, assigns, affiliates and subsidiaries from making, or aiding and abetting the making of false or fictitious entries in the books and records of ISC or any of its affiliates or subsidiaries, or establishing and maintaining or aiding and abetting in the establishment or maintenance of any secret or unrecorded fund of corporate monies or assets, or making or aiding and abetting the making of any payments, disbursements or transfers therefrom.

VII

Issue a Mandatory Injunction requiring ISC to correct and amend its annual and periodic reports currently on file with the Commission for each of its fiscal years 1970 to date so that said reports comply in all respects, including those respects complained of herein, with the federal securities laws.

VIII

Issue an Injunction restraining and enjoining ISC, Kenneally, DCT and DCC from liquidating or otherwise disposing of the assets of or their interests in DCC without prior notice to the Commission and without a prior order of this Court authorizing such liquidation or disposition.



IX

Issue an Order directing defendants Kenneally and Freitsch, and those persons identified by the equity receiver referred to in paragraph X below as having utilized corporate funds for their personal use and benefit, to account for and disgorge all benefits which they wrongfully received.

X

Issue an Order appointing an equity receiver for ISC and its subsidiaries (referred to collectively hereinafter as "ISC") with directions and authority to accomplish the following, subject to a bond in an amount satisfactory to the Court, conditioned on the faithful performance of his duties as said receiver, and after having taken the oath required by law and being otherwise qualified:

A. To take custody, control and possession of all of the funds, property, premises and other assets of or in the possession or under the control of the defendant ISC, and/or assume all rights and powers which the defendant ISC may have to manage, control, operate, maintain, possess, receive and use income, earnings, rents, issues and profits under any agreements or contracts, wheresoever situated, with full power to sue for, collect, receive and take into possession all goods, chattels, rights, credits, monies, effects, lands, books and records of account and other papers and documents of ISC; to conserve, hold and manage all such assets, pending further order of this Court, in order to prevent irreparable loss, damage and injury to investors, to conserve and prevent the withdrawal and misapplication of funds entrusted to ISC; to obtain an accounting thereof; to determine, adjust and protect the interests of investors in ISC;

B. To make such payments and disbursements from the funds so taken into his custody, control and possession or thereafter received by him, and to incur such expenses as may be necessary and advisable in discharging his duties as receiver;

C. To engage and employ accountants and other experts to audit and investigate the books, records and accounts of ISC, and to evaluate the assets of ISC and to submit suitable reports of such audit and evaluation with the appointment of such accountants and experts and the nature of their compensation subject to the approval of the Court;

D. To resist and defend all suits, actions, claims and demands which may now be pending or which may be brought or asserted against ISC;

E. To undertake an independent inquiry and investigation into the financial condition of ISC;

F. To present to this Court, within such time period as set by the Court, his report reflecting the existence and value of the assets of ISC, the extent of its liabilities, both those claimed to exist by others and those which the receiver believes to be legal obligations of ISC and any further information which the receiver believes may assist this Court in disposing of this action. This report should also contain the receiver's opinion regarding the ability of ISC to meet its obligations as they come due.

G. To remove the individual defendants Kenneally, Frietsch, from control and management of ISC; and to prevent further evasions and violations of the securities laws by all the defendants named in this action.



XI

Issue an Order commanding and requiring ISC, its officers, directors, agents and employees, including specifically Kenneally, Frietsch, Angulo and Stein to deliver over to said receiver's possession, custody and control all funds, property, premises, and other assets, and all books and records of accounts, title documents, and other papers of ISC; and further order defendants ISC, Kenneally, Frietsch, Stein and Angulo, and ISC's officers, directors, agents, managers, attorneys and employees to refrain from interfering with said receiver taking such custody, control and possession, and from interfering in any manner, directly or indirectly with such custody, possession and control by said receiver; provided, however, that defendants ISC, Kenneally, Frietsch, Stein and Angulo, their accountants and attorneys shall be afforded reasonable access to such records and other documents of ISC.

XII

Issue an Order providing that said receiver, and any counsel whom the receiver may select, subject to the approval of the Court, shall be entitled to compensation from the assets now held by or in the possession or control of, or which may be received by the defendant ISC, in an amount or amounts commensurate with his duties and obligations in the circumstances.

XIII

Issue an Order staying and restraining, except by leave of Court or lawful proceedings under the Bankruptcy Act, during the pendency of any receivership ordered herein, all creditors and other persons seeking money, or other assets of defendant ISC and all others acting on behalf of any such creditor and other persons, including sheriffs, marshals and other officers and their deputies and their respective attorneys, servants, agents and employees from:

A. Commencing, prosecuting, continuing or enforcing any suit or proceeding;

B. Executing or issuing or causing the execution or issuance of any Court attachment, subpoena, replevin, execution or other process for the purpose of impounding or taking possession of or interfering with or creating or enforcing a lien upon any property owned by or in the possession of said defendant and affiliates, or the receiver prayed for herein, wheresoever situated; and

C. Doing any act or thing whatsoever to interfere with the possession of or management by the receiver appointed herein of the property and assets owned, controlled or in the possession of defendant ISC, or to in any way interfere with said receiver, or to interfere in any manner during the pendency of this proceeding with the exclusive jurisdiction of this Court over said defendant.

XIV

Issue an Order providing that the Court reserves the right to make and enter such further orders or decrees, upon application of said receiver or otherwise, that may be necessary for the guidance of said receiver in his administration of the receivership herein established.

XV

Issue an Order providing that this Court retain jurisdiction of this action in order to implement and carry out the terms of all orders and decrees that may be entered herein or to entertain any suitable application or motion by the Securities and Exchange Commission for additonal relief within the jurisdiction of this Court and to continue all stays previously issued.

XVI

Issue an Order authorizing representatives of the Securities and Exchange Commission and other state and federal law enforcement and regulatory agencies having jurisdiction over matters relating



to the conduct or business of the defendant ISC to have, subject to such reasonable conditions as the receiver may require, continuing access to the corporate books and records of ISC. Nothing in this or previous orders so issued shall be construed to impair the right of such law enforcement agencies to continue to perform their duly authorized investigative and prosecutorial duties.

XVII

Grant such other and further relief as the Court may determine to be just, equitable and necessary in connection with the enforcement of the federal securities laws and appropriate in the public interest for the protection of investors.

Respectfully submitted,

Irwin M. Borowski
Marvin G. Pickholz
Benjamin Greenspoon
William H. Kuehnle
Edward L. Hahn
Sammy S. Knight
Arthur M. Schwartzstein

By: _____
Attorneys for Plaintiff
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Tel: (202) 755-1674
(202) 755-5015

Dated: July 9, 1979

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

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| SECURITIES AND EXCHANGE COMMISSION,<br>500 North Capitol Street<br>Washington, D. C. 20549<br>(202) 755-1674,<br><br>Plaintiff,<br><br>v.<br><br>INTERNATIONAL SYSTEMS & CONTROLS CORPORATION,<br>J. THOMAS KENNEALLY,<br>HERMAN M. FRIETSCH,<br>RAYMOND G. HOEKER,<br>ALBERT W. ANGULO, and<br>HARLAN M. STEIN,<br><br>Defendants | CIVIL ACTION<br>NO. 79-<br><br>MOTION FOR PRELIMINARY INJUNCTION AND OTHER EQUITABLE RELIEF PURSUANT TO RULE 65, F.R. CIV. P. |

Pursuant to Rule 65, of the Federal Rules of Civil Procedure, Plaintiff Securities and Exchange Commission ("Commission") hereby moves this Court for an order:

(1) Preliminarily enjoining the Defendant International Systems & Controls Corporation ("ISC"), during the pendency of this action, from further violations of Section 17(a) of the Securities Act of 1933 [15 U.S.C. 77q(a)], Sections 10(b), 13(a), 13(b)(2) and 14(a) of the Securities Exchange Act of 1934 [15 U.S.C. 78j(b), 78m(a), 78m(b) and 78n(a)] and Rules 10b-5, 12b-20, 13a-1, 13a-11, 13a-13, 13b-2, 14a-3, and 14a-9 [17 C.F.R. 240.10b-5, 240.12b-20, 240.13a-1, 240.13a-11, 240.13a-13, 240.13b-2, 240.14a-3 and 240.14a-9] thereunder;

(2) Appointing an agent of the Court:

A. to take custody and control of all assets of ISC; and to oversee the business activities of ISC to assure that these activities are being carried out for legitimate business purposes of ISC and not for the personal benefit of any control person, officer, director or employee of ISC or its subsidiaries or affiliates;



B. to review and inquire into the activities of ISC (i) to determine whether assets of ISC have been diverted to or for the benefit of any control person, officer, director or employee of ISC, and (ii) to determine whether ISC has entered into any significant transactions involving expenditures of substantial funds or assets which appear not to have been engaged in for legitimate business purposes or are not adequately explained on the books and records of ISC, and in this regard, to determine the true nature and circumstances of such transactions and the beneficiaries of any such transactions;

C. to recover any funds or assets or enforce any liability to ISC which may result from any of the activities described in paragraphs 2(a) and 2(b) above;

D. to oversee ISC's filings with the Commission and its public disclosures to assure that they comply with the Federal securities laws;

(3) Requiring ISC and its control persons, officers, directors or employees of ISC and any person in possession or control of assets or books and records of ISC to cooperate fully with the agent of the Court in carrying out his duties;

(4) Authorizing the agent of the Court to apply to this Court for such further orders or assistance as may be appropriate or necessary to carry out his duties;

(5) Directing the agent of the Court to report to the Court within 60 days on his findings and activities and to file such further reports as this Court may direct.

Respectfully submitted,

Sammy S. Yoigt
Attorney for Plaintiff
Securities and Exchange Commission
500 North Capitol Street, N.W.
Washington, DC 20549
Telephone: (202) 755-1674

Dated: Washington, DC
July 9, 1979

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

| | |
|---|---|
| SECURITIES AND EXCHANGE COMMISSION,<br>500 North Capitol Street<br>Washington, D.C. 20549,<br><br>Plaintiff,<br><br>v.<br><br>INTERNATIONAL SYSTEMS & CONTROLS CORPORATION,<br>J. THOMAS KENNEALLY,<br>HERMAN M. FRIETSCH,<br>RAYMOND G. HOFKER,<br>ALBERT W. ANGULO, and<br>HARLAN M. STEIN,<br><br>Defendants. | CIVIL ACTION<br>NO. 79- |

AFFIDAVIT OF ARTHUR M. SCHWARTZSTEIN IN SUPPORT OF SECURITIES AND EXCHANGE COMMISSION'S MOTION FOR A PRELIMINARY INJUNCTION AND OTHER EQUITABLE RELIEF

City of Washington )
) ss:
District of Columbia )

Arthur M. Schwartzstein, being duly sworn, says:

1. I am employed as an attorney in the Division of Enforcement of the United States Securities and Exchange Commission (the "Commission"), 500 North Capitol Street, Washington, D.C. 20549, and I make this affidavit in support of the Commission's Motion for Preliminary Injunction and Other Equitable Relief. Since approximately September 1978, I have been one of the Commission's staff assigned to investigate International Systems & Controls Corporation's ("ISC") questionable foreign payments; its financial disclosures; the status of its books and records; self-dealing by corporate officials; and the accuracy of its annual and periodic reports, and its proxy solicitation materials.

2. This affidavit is based upon my participation in the Commission's investigation described herein and on knowledge, information and belief based upon my review of transcripts of testimony of various witnesses; notes of meetings, correspondence and conversations with various persons, including counsel for the defendants herein; and documents, including documents of defendant ISC and its subsidiaries, its independent auditors, its attorneys and its special outside counsel; and other materials gathered pursuant to the Commission's private formal investigation.



THE DEFENDANTS

3. ISC, a Delaware corporation with its principal place of business in Houston, Texas, is engaged in providing services and products for the development of energy, agricultural and forestry resources, and the processing, storage, and handling of natural resource and agricultural products. The common stock of ISC is registered with the Commission pursuant to Section 12(b) of the Securities Exchange Act of 1934, as amended [15 U.S.C. 78l(b)] and was traded on the Pacific and American stock exchanges. Since November 1978, when the Commission suspended trading in ISC's stock for a period of ten days, the stock has not traded on the Pacific Stock Exchange or the American Stock Exchange. ISC's common stock currently is traded in the United States in the over-the-counter market.

4. J. Thomas Kenneally resides in Houston, Texas. Defendant Kenneally was Chairman of the Board of Directors and Chief Executive Officer of ISC until early 1979, when he resigned these positions. Prior to these resignations, defendant Kenneally was aware that the Commission intended to commence an action against him. Defendant Kenneally is still a director of ISC and owns and/or controls approximately 42% of ISC's common stock.

5. Herman M. Frietsch resides in Houston, Texas, and was at all times relevant to this action a Senior Vice-President of ISC.

6. Raymond G. Hofker resides in Houston, Texas, and was a Vice-President and the General Counsel of ISC until early 1979 when he resigned his postion with ISC. Prior to his resignation, defendant Hofker was aware that the Commission intended to commence an action against him.

7. Albert W. Angulo resides in Houston, Texas, and was the Treasurer of ISC. In early 1979, defendant Angulo resigned his position with ISC after becoming aware that the Commission intended to commence an action against him. He then became Executive Vice-President of Black, Sivalls & Bryson, Inc. ("BS&B"), an ISC subsidiary, until early June 1979 when certain of the assets of BS&B were sold to another public corporation. Defendant Angulo became and is a special assistant to the president of the new BS&B entity.

8. Harlan M. Stein resides in Houston, Texas, and was the President of ISC's Engineering Group until early 1979 when he resigned after becoming aware that the Commission intended to commence an action against him.

FACTS AND DOCUMENTS IN SUPPORT
OF THE COMMISSION'S MOTION

A. ISC'S REPORTED FINANCIAL CONDITION

9. ISC is required to and, since 1970, has filed with the Commission, Annual Reports on Form 10-K (see generally 17 C.F.R. 240.13a-1) for each of its fiscal years 1970 through 1978. From 1973 through 1976, ISC originally reported earnings increasing from $2.9 million on revenues of $178 million for its fiscal year ("FY") 1973 to earnings of $8.4 million on revenues of $339 million for FY 1976.

10. For FY 1977, ISC reported losses of $9.9 million on revenues of $276. In December 1978, ISC filed with the Commission its 1978 Form 10-K in which it reported losses of $43 million for FY 1978 and a stockholders equity deficit of $5.3 million. During FY 1978



ISC defaulted under a loan agreement with its major lenders. It remains in default and has pledged virtually all its assets, as collateral to its lenders. During that same period, ISC has attempted to sell, and has been selling, the stock and/or assets of certain of its subsidiaries, and has been applying the proceeds to pay its bank lenders. The most recent sale occurred on June 18, 1979. (See paragraph 123 below).

11. In addition to its Annual Reports on Form 10-K, ISC has filed Current and Periodic Reports with the Commission on Form 8-K and Form 10-Q. See generally 17 C.F.R. §240.13a-11 and 13a-13.

12. During the period 1970 through 1978, various of ISC's Annual, Periodic and Current Reports, its proxy soliciting materials, and press releases, which it caused to be disseminated to the public, did not adequately disclose that ISC made illicit and questionable foreign payments; that false and misleading bookkeeping entries were made to conceal the true nature and purpose of the payments; that certain of its so-called "escalation" claims and "unbilled receivables", are questionable in nature; that the course of conduct engaged in by ISC management exposed ISC's business in several foreign nations to a variety of risks, including the risk of having some if not all of its claims for "escalation" payments and "unbilled receivables" rejected; that its books and records expose ISC to violations of the Foreign Corrupt Practices Act [15 U.S.C. 78m(b)] and the English Companies Act; and that its assets were being used by certain of its officers and directors in self-dealing situations and for their personal use and enjoyment; and other facts relating to the integrity of its management.

13. As noted in paragraph 10 above, ISC reported in December 1978 that it had a stockholders equity deficit of $5.3 million.

However, if for the reasons discussed below ISC's claims for so-called "escalation" payments and the "unbilled receivables" -- which ISC reflects on its financial records at approximately $31 million -- are not paid, ISC's stockholders equity deficit would increase.

14. The manner in which ISC's present management has conducted the company's affairs, utilized ISC's assets for personal benefit and has improperly recorded the disposition of ISC's assets, warrants immediate injunctive relief and appointment of a court officer to monitor ISC's activities and investigate the matters set forth here and in the Commission's Complaint, and is necessary to safeguard and secure the interests of ISC's shareholders and their property.

## B. QUESTIONABLE AND ILLICIT PAYMENTS

15. As discussed in greater detail below, ISC's business activities in Iran, Algeria, Saudi Arabia and elsewhere, and the contracts ISC secured from Iranian, Algerian and Saudi Arabian Government agencies were closely tied to ISC's improper and illicit payments to foreign nationals, including foreign government officials and associates of government officials. ISC made certain of the payments to those persons either by depositing or causing to be deposited into designated numbered foreign bank accounts various sums of money, by giving such persons cash, or by issuing commercial paper and agreements payable to "bearer".

### 1. IRAN

16. The Industrial Development and Renovation Organization of Iran ("IDRO") was created by the Iranian Government in 1967 for the purpose of developing and renovating industries and mines in that country. IDRO's "shareholders" were various governmental agencies such as the Ministry of Finance and the Ministry of Economy. Exhibit 1. A subsidiary known as Technolog, Inc. ("Technolog"), which was 70% owned by IDRO, was established in 1968 to provide, among other things, Iran's business and industrial communities with guidelines for negotiating agreements and contracts with foreign firms. Technolog was recognized "as the official engineering and industrial consultancy to Government organizations and agencies in Iran * * *." Id. at 49. Organizationally, Technolog was "composed of five divisions: Management, Industrial, Construction Technology, Research and Agriculture." Id.

#### a. Early Relationships With Iranian Government Officials

17. ISC, through various of its subsidiaries, sought to secure contracts from Iranian Government agencies for consulting and construction work. Various other foreign entities likewise were competing for those assignments. In 1972-1973, ISC, through its wholly-owned subsidiary, Lang Engineering Corporation ("Lang"), sought the contract for construction of a $20 million grain terminal and facility at the Iranian port facility of Bandar Shahpour. */ The Iranian Ports and Shipping Organization, which was responsible for overseeing that project, contracted with Technolog for the overall study of the project and for assistance in preparation of tender documents. Exhibits 2 and 3. At that time, F. Sid Askari was managing director of Technolog. Exhibit 19 at 2.

18. Lang's representatives met with Askari who informed them that he wanted Lang to be the successful contract bidder on the Bandar Shahpour project. Exhibit 3 at 5.

19. Askari informed Lang's representatives that after he delivered to them the preliminary design for the grain facility,

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*/ Dollar amounts expressed in relation to ISC's involvement in Iran may be either United States or Canadian Dollars.

he wanted to discuss "business arrangements." Lang's representatives understood that Askari "will and does expect aremuneration [sic] as we are selected." Exhibit 3 (Fuller Memorandum of October 9, 1972 at 4). Askari made it clear that Lang should engage the services of one of two Iranian contractors which Askari would recommend. Id. Lang selected Tchacosh Co., Ltd. (Subsequently, another Iranian company, Avadje Company, replaced Tchacosh as ISC's local contractor). See Exhibit 6.

20. Thereafter, on February 23, 1973, Lang issued a $650,000 letter of credit to Askari, payable at the Swiss Credit Bank in Geneva. Exhibits 4, 5 and 6. The purpose of the letter of credit was to assure that Askari worked exclusively in Lang's behalf to secure for it the Bandar Shahpour contract. Exhibit 5. However, prior to the bids being accepted, Lang decided to withdraw from the bidding which precipitated a demand from Askari for a payment because of the "loss of opportunity." Defendant Angulo sent a memorandum (Exhibit 5) to defendant Frietsch, with copies to defendants Hofker and Stein, among others, describing the situation and Askari's demand. After consulting with defendants Angulo and Stein, defendant Frietsch authorized a payment to Askari. Thereafter, Askari was paid $250,000 from ISC funds. Exhibits 5, 7, 8, 9 and 10.

21. At the time ISC made the payment to Askari, ISC was interested in securing the contracts for two other projects -- "Gilan" and "Sari" -- and was aware that Askari was in a position to influence whether another ISC wholly-owned subsidiary, Stadler-Hurter Ltd. ("SHL"), received those contracts. Exhibits 8 and 10. As discussed below, ISC ultimately received the contracts for the Gilan (or "Rasht") project and the Sari (or "Mazandaran") project. Exhibits 10 and 11.



b. Financial Arrangements With Iranian Officials: The "Gilan" ("Rasht") and "Mazendaran" ("Sari") Projects

22. By January 1972, the president of SHL (see paragraph 21), A.M. Hurter, considered the Rasht project lost to the Japanese and was concerned that the Sari project also would be lost. Exhibit 11.

23. In late June 1972, SHL's president requested, by telex message (Exhibit 12), a meeting with Prince Abdorreza, a member of Iran's Royal Family, "to make proposals [to the Prince] regarding the pulp and paper projects." Exhibit 12.

24. SHL's president and Max Zeier, managing director of SHL's wholly-owned subsidiary, Stadler-Hurter Zurich, A.G. ("SHZ"), met with the Prince on July 9, 1972. At the Prince's request, SHL's agent, Shamsedin ["Shamse"] Golestaneh, met with him again on July 12, 1972. Exhibits 12 and 13 As Zeier reported, the "necessary commitments were made" and SHL was "optimistic as far as the Rasht project is concerned." Exhibit 13.

25. On August 4, 1972, less than one month after the meeting with the Prince, SHL gave one of the Princes's associates -- Hashim Naraghi -- an "irrevocable letter of undertaking" (Exhibit 15) to pay him 3% of the total contract price if either or both the Rasht or Sari contracts were awarded to SHL. Exhibits 14, 15. */

26. The letter of undertaking referred to in paragraph 25 above provided for payments to be made to a numbered bank account at the First National City Bank in Paris, France. Exhibit 15.

27. On August 11, 1972, SHL issued another letter of undertaking to a Lichtenstein corporation designated by Golestaneh (see

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*/ A handwritten note (Exhibit 16), prepared by Lang representatives in connection with a proposal for Naraghi's feed mill advised that ISC's representatives met with Naraghi and, "after he got down to brass tacks about the commission and who has to be paid off," Naraghi discussed the arrangements for generating funds to make the payoffs. According to the note, Naraghi stated that he had "a few to pay in Iran" and that he wanted "20% for himself" -- that was his way of "get[ting] dollars out". The note then advised that 35% "must" be added "to every item". Exhibit 16.

paragraph 24, above) known as Amirco Establissement ("Amirco"). Amirco was to receive payment based on 4% of the contract price of the Rasht project and on the Sari project if awarded to SHL. Exhibits 14 & 17.

28. By letter dated October 11, 1972 (Exhibit 17), Golestaneh instructed SHL's president, pursuant to the letter of undertaking, to pay $250,000 to the designated account of Parviz Sepahbodi at Manufacturers Hanover Trust Company in New York on the Rasht project and the same amount upon SHL receiving the Sari project. By letter dated October 14, 1972, SHL acknowledged Golestaneh's letter and agreed to make the payments to Sepahbodi's account as requested. Exhibit 18. At that time Sepahbodi worked in the Ministry of Economy under Minister Ansary. Exhibit 19 at 10. As noted in paragraph 16 above, the Minister of Economy was one of the "shareholders" of IDRO and presided over the "General (Shareholders) Meetings" of IDRO. Exhibit 1.

29. According to an October 9, 1972, memorandum (Exhibit 20) prepared by Zeier, the president of SHL, Zeier and Golestaneh met with Technolog's managing director, Askari, in September 1972. At that meeting, SHL's payment agreement with Askari was rearranged and a "provisional letter of undertaking" was given to Askari. Exhibit 20. On September 25, 1972, SHL's president and vice-president executed an irrevocable "Letter of Undertaking To Whom It May Concern" (Exhibit 21) stating, in part, that SHL would "pay a commission of 1/2% of the total contract sum [Rasht project] to the bearer of this letter." The letter states that there would be two payments of approximately $325,000 each to be paid to a designated numbered account at the Swiss Credit Bank in Geneva. Exhibit 21. On September 27, 1972, SHL's president and Askari executed a letter of intent with respect to the Rasht project. Exhibit 20 at 12. On September 30, 1972, SHL and Golestaneh



agreed that for the next 10 years, Golestaneh would receive a 10% commission on all supplies for the Rasht project. Exhibit 20 at 15.

30. On August 21, 1973, two contracts for the Rasht project, by then commonly called "Gilan," were signed. The first, a fixed price contract, was signed between IDRO and SHL with Technolog acting and signing as IDRO's consultants. This contract included, undisclosed to the Iranians, $8.2 million in "Sales representation Agency Fees" as "equipment costs." Exhibit 69. The second contract, covering reimbursable costs, was signed by IDRO and an SHL subsidiary — with Technolog again acting and signing as IDRO's consultants.

31. By September 17, 1973, with regard to the Sari project, IDRO formed a subsidiary known as the Iran Wood (Pulp) Paper Company ("Chuka") which was 60% owned by the Ministry of Economy (in which, as noted in paragraph 28 above, Sepahbodi was employed) and 40% owned by the Ministry of Agriculture and Natural Resources. Exhibit 22.

32. Members of Chuka's board of directors included: Askari, who, besides his position with Technolog, was the Vice-Chairman of the Board of Chuka; Dr. Max Mossadeghi, managing director of a related company also owned by the Ministry of Agriculture and Natural Resources; and, Mr. Massoumi, Senior Deputy Minister of the Ministry of Agriculture and Natural Resources and Chairman of the Board of Chuka. Exhibit 26.

33. On September 14, 1973, Zeier advised both Stein and SHL's president that Dr. Mossadeghi had requested that SHL fulfill its promise to pay him because the Gilan (Rasht) project had been awarded to SHL. Exhibit 23. Several days later, by memorandum (Exhibit 24) to Zeier copied to defendant Stein, SHL's president acknowledged a $100,000 commitment to Mossadeghi. Exhibit 28. (By April 1974, the Mossadeghi payment issue was satisfied: defendant Stein approved payments of $30,000 and $70,000 to Mossadeghi in

connection with, respectively, the Gilan (Rasht) and Sari (Mazandaran) contracts, and $30,000 was added to the Amirco invoice. Exhibits 25 and 26.]

34. In November 1973, defendant Frietsch made defendants Kenneally and Stein, and others, aware of the Shah's directive putting "government men on notice against bribery, influence-peddling and all outside interests that conflict with their public responsibilities." Exhibit 27. Frietsch noted:

> I think all of us should keep an active interest in how these government moves will affect how we do business in the future so that we neither take them so seriously as to hurt our position nor ignore them and compromise our advantages.

35. Nevertheless, at meetings in November 27 - December 1, 1973 with Golestaneh, Zeier learned that Askari would be in charge of negotiating the Sari project; that Askari's commission would be 1/2% of the contractual amount; that commissions to be paid to persons involved in the Sari project were to be 8 1/2%; and that "new people had to be incorporated [into the commissions] like Mr. Massoumi and Dr. Mossadeghi" [see paragraph 32 above] and two "close personal friends of the present Minister of Economy had also to be included." Exhibit 28. At Golestaneh's insistence a limited number of ISC officers were to be aware of these payments. Zeier told Golestaneh it would be inevitable to include defendants Kenneally, Frietsch, Angulo and Stein. Id.

36. On December 31, 1973, SHL issued a Promissory Note (Exhibit 29) in the amount of $325,000 (Canadian) payable "to the bearer," to be paid at the Bank of Montreal in Montreal, Canada. The promissory note was presented to Credit Suisse Bank in Geneva Switzerland, on April 23, 1974, and paid by the Bank of Montreal on May 13, 1974. Exhibit 29.

37. The knowledge of ISC's senior officials, and especially the approval by the individual defendants herein, of the payments



in connection with securing the Gilan contracts was further contemporaneously documented by these defendants. On April 16, 1974, defendant Angulo, in his capacity as ISC's Treasurer, confirmed to Golestaneh ISC's knowledge of the agreement between SHL and Naraghi and Amirco (see paragraphs 25 through 27 above) and, in particular, the promissory notes which SHL executed on April 16, 1974 "in the amounts of $2,474,000 and $3,299,720 respectively...." Exhibit 30. Among the defendants who received copies of defendant Angulo's acknowledgment were defendants Hofker, Frietsch and Stein. Id. Additionally, defendants Stein, Angulo and Freitsch were copied on a memorandum (Exhibit 31) dated April 26, 1974, and exchanged views thereon, further reflecting the payment agreements with Golestaneh. Id. On June 25, 1974 SHL executed two promissory notes for the identical sums referred to above. One note (Exhibit 32) for $3,299,720, required that amount, less $1,162,808 which was immediately tendered to Amirco, to be paid to Amirco's designated account at the Swiss Bank Corporation in Geneva, Switzerland. The second note (Exhibit 33), for $2,474,790, required that amount, less $872,115 which was immediately tendered, be paid to a numbered account at the Avenue Hoche office of the First National Bank of Chicago in Paris, France. Id.

38. By memorandum dated April 27, 1974, from Zeier to defendants Stein, Angulo and Frietsch, reflecting a meeting with Golestaneh in Geneva on April 26, 1974, Zeier stated that "the Prince keeps complaining about certain delays in our payments [in connection with the Gilan project]." Zeier further reported that an SHL draft letter of commitment on the Sari project had been rejected by Shamse Golestaneh for several reasons: a) The Prince wants a down-payment of 50% of the total commission;

b) The wording of the commitment chosen in the letter is too weak; c) He also requests a Letter of Awareness of ISC. Exhibit 31 (and see paragraph 37 below). The Zeier memorandum bears a handwritten notation with the initials "HMF" [defendant Herman M. Frietsch] and the date "5/7/74." The notation states, in part, that the payments should "come out of the cashflow of the job. This is universal. Anything else is a stickup. Even in Iran. We can go to the local top cops there too." Id.

39. At a meeting in Geneva in July 1974, defendant Stein and Zeier for SHL agreed with Golestaneh and Askari that Golestaneh would arrange for the Board of Directors responsible for the Sari project to be instructed to proceed with the project and that the Board would be instructed to designate Technolog to negotiate the contract and to invite SHL for contract negotiations. Exhibit 36 at 4. Golestaneh and Askari would arrange to avoid international bidding for the project; however, if this could not be done, Technolog would at least grant SHL a service contract for the Sari project. Again, the Iranians would receive payment for their activities - SHL would issue a provisional promissory note, then a firm promissory note and, finally, ISC would issue a "letter of awareness" as it had done in connection with the Gilan project. Id at 5.

40. In November, 1974, a competitor of SHL was attempting to split off a part of the Sari contract using its "connections" in the Ministry of Agriculture and Natural Resources, and had received favorable comments from Minister Rohani. Exhibit 110 at 1-2. On November 6, 1974, Golestaneh met with Rohani to try to convince him to support SHL's approach. Id at 3. However, the results of the meeting were "extremely unfortunate"; Rohani indicated that he had proof that SHL were paying large amounts of bribery to various persons, including Askari; that SHL was being watched by the Iranian secret service; and that "he had all tools



in hand to prove the unethical attitude of the Stadler Hurter group." Id at 1. The results of the meeting were immediately reported to the Prince by Golestaneh in the presence of defendant Stein and Zeier. Id. The Prince then had a "personal meeting" with Rohani after which it was "obvious" that the Prince had reached an agreement with Rohani, id. and official negotiations between SHL and Technolog were to be begun. Id. at 4-5. In reporting these meetings, Zeier noted certain relationships of SHL with "various Iranian authorities." Id. at 5. Zeier reported that Prince Abdorreza, would support SHL as long as he considered SHL to be doing a good job including "meet[ing] our financial obligations to the Prince punctually." Id. at 1. Zeier concluded:

> the fact that Minister Rohani got hold of certain highly confidential information, although part of them were not correct, is extremely dangerous and alarming. It must consequently be emphasized once more that any confidential payments made to Iranian personalities must be kept in a small circle. Although it is inevitable that some employees know that payments are made, it must be watched carefully that only top executives of ISC are aware of the recepients.

Id. at 6.

41. On December 9, 1974, Zeier issued a Letter of Undertaking (Exhibit 40) obligating SHL to pay to a designated numbered account at Swiss Credit Bank in Geneva, Switzerland, a sum equal to 2.8% of the fixed price contract in the event SHL was awarded the Sari contract by IDRO. Id. On December 16, 1974, defendant Stein issued another Letter of Undertaking obligating SHL to pay Golestaneh an additional $2 million to be deposited to a designated numbered account at the Swiss Bank Corporation in Geneva, Switzerland. Exhibit 41.

42. However by early December, 1974, Rohani had a better competitive bid from Metax, another foreign entity, for the project which he favored. Exhibit 42 at 4. The Prince was willing to support a bid by SHL in the amount of $115 million even though that bid was

approximately $10 million higher than the competitive price. Id at 2. Golestaneh, Zeier, Askari and defendant Stein were in frequent contact during early December 1974, discussing methods for securing the Sari contract. Askari requested a commitment letter, on SHL letterhead, agreeing to pay him and "his partner in the Ministry of Agriculture" 2.8% of the contract price, if SHL received the contract. Id. at 8. The letter was to be sent to Askari's "bank connections in Geneva." Id. On or about December 9, 1974, Golestaneh secured the Prince's approval of SHL as the Sari contractor. Id. at 9.

43. On December 21, 1974, SHL was awarded the Sari contract. Exhibit 43. On January 7, 1975, SHL issued a promissory note (Exhibit 43) to pay Amirco $7.7 million, at a designated numbered account at the Swiss Bank Corporation in Geneva, Switzerland, if the Sari contract price of $140 million was not reduced before final payment; if the contract price was reduced, the payment would be adjusted downward. Id.

44. By June 16, 1977, SHL had paid $5.8 million of its $8.2 million in commitments for "sales representation and support services" for the payments described above on Gilan and $5.5 million of its $14.1 million in its similar commitments on Mazandaran. Exhibits 111 and 112.

c. False Escalation Claim

45. In April, 1973, SHL had been asked to reduce its contract price on Gilan by $3 million because of the Japanese competition. Exhibit 113 at 1. By an addendum to the Gilan contract the total contract price had been reduced by $3 million. Exhibit 114. As defendant Stein reported to ISC's audit review committee in 1976, SHL set about trying to "determine ways and means of recouping the original $3MM as well as potential means of increasing the gross profit on the project." Exhibit 112 at 1. In meetings in July and August, 1974 SHL entered into agreements with Askari and Golestaneh that would allow SHL to recoup the $3 million as well as generate additional commission payments through the guise of a claim against the Iranian government for "escalation" of SHL's costs to complete Gilan. At the July meeting it was agreed that SHL should prepare a claim for escalation on Gilan to be submitted to Askari first on a "personal and private basis". Exhibit 36 at 2. Furthermore, Askari required that this not be done until the Sari negotiations had begun. Id. It was agreed that Askari would send a telex to defendant Stein acknowledging escalation. Id. at 2 and 6. Askari said that the escalation should be approximately $15 million. Id. at 2. Moreover, it was understood that "commissions" would have to be paid on any escalation received. Id. However, at the August meeting, defendant Stein and Zeier for SHL agreed with Golestaneh and Askari that the claim for "escalation" should be $9 million:

| | | |
|---|---|---|
| 3 | [million] $ | to cover the concession made during [the Gilan] contract negotiations, |
| 3.5 | [million] $ | to compensate for real escalation, |
| 1.5 | [million] $ | to be paid to Shamse [Golestaneh] for cancelling the commitment taken by the SH group to pay 10% on spare part supplies over the period of 10 years after commissioning the plants, |
| 0.5 | [million] $ | additional commission for Shamse [Golestaneh], |
| 0.5 | [million] $ | additional commission for Sid [Askari]. |

Exhibit 114

46. Shortly thereafter defendant Stein caused to be issued a Letter of Undertaking (Exhibit 37) dated December 15, 1974, which obligated SHL, in case it received the sum of $9 million from IDRO on its Gilan "escalation" claims, to pay a total of $1 million to two designated numbered accounts, one at the Swiss Bank Corporation in Geneva and the other at Credit Suisse in

Geneva, id., and an additional letter of undertaking to pay commissions if the contract price for Mazandaran was raised beyond that at which it had been finalized by IDRO. Exhibit 37.

47. However, SHL's plans to recover additional revenues from IDRO for Mazandaran and Gilan began to encounter difficulties. By March 7, 1975, Askari was asked by his immediate supervisor to resign as president of Technolog at the same time it was made known that the Shah himself had ordered an investigation into possible illegal payments on Gilan. Exhibit 39.

48. On October 27, 1975, the new president of Technolog sent a letter to SHL requesting it to submit affidavits as to its use of agents in Iran. Exhibit 44. SHL did not respond to those requests although repeated demands were made. Exhibits 45-51.

49. Golestaneh became concerned that ISC might no longer honor its commitments and advised defendant Frietsch on December 27, 1976 that if ISC and SHL did not fulfill their payments commitments

> I would be obligated to place Stadler Hurter's promissory notes as well as all and any other documents signed so far by ISC and Stadler Hurter Directors at the disposal of the government.
>
> I trust you realise the minimum effect of this measure would be that, all the ISC and Stadler Hurter's commitments to me would be calculated and deducted from your contracts signed with or proposals made to the government, as your undertakings to me have been provided for in your prices. To say nothing of the adverse effect that such proceedings would have upon your company's position and business records in Iran.

Exhibit 52.

50. In May, 1977, an agreement was entered into among SHL, by defendants Stein with Frietsch as witness, and Golestaneh for himself, Naraghi, Amirco, and Pakosa, S.A., a Luxembourg Company to which Golestaneh had directed certain commission payments. The agreement ratified various SHL promissory notes and provided that SHL would pay Amirco $2.5 million in commissions if SHL received



$9 million on its "escalation" claim on Gilan or a combination of escalation on Gilan and additional compensation on Mazandaran. Exhibit 34 at 10. The aforesaid "agreement" does not specify what "services" were rendered by the named parties. Id.

51. At the time the "agreement" was signed, May 2, 1977, SHL had been requested by the Iranians to provide affidavits as to its use of agents in Iran. (see paragraph 48 above). Moreover, by that time ISC had also received an inquiry from the Commission regarding ISC's activities abroad. The "agreement" was created after ISC had undertaken to engage Special Outside Counsel to conduct an investigation into its questionable foreign and domestic payments. Indeed, that investigation was commenced almost one year prior to the creation of the agreement -- i.e. on May 24, 1976. Exhibit 33. Thus, although the "agreement" states several times that the "beneficial owners [of the numbered foreign accounts to which ISC had transferred monies as described above] are not officials or employees of the Imperial Government of Iran, nor are they officers, directors or employees of Companies owned or controlled by the Imperial Government of Iran," it ignores the payments to various Iranian Government officials such as Dr. Mossadeghi, Mr. Massoumi, Mr. Askari and the others discussed above (and as supported by the exhibits hereto which were prepared contemporaneously with the actual payments).

52. As negotiations on escalation continued into 1977, Dr. Motazed, on behalf of the Iranians, sought to examine SHL records to show its actual cost increases from those set forth in the contract's Detailed Project Report ("DPR"). In August 15, 1977, SHL prepared a draft letter to Motazed, breaking down the costs shown in the DPR. The draft letter shows that SHL had included as "equipment costs" in the DPR, $8.2 million in "Sales Representation; Agency fees" (emphasis added) and $3 mil-

lion for "overhead." Exhibit 115 (Schedule II). The draft letter explained that certain items included in the DPR as allocations for equipment and service were items such as "overhead, profit, sales representation and other miscellaneous costs incurred in projects of this type, but not specifically in the nature of equipment or services." Id. at 2 (emphasis added).

53. The August 15, 1977, draft letter was revised for presentation to Motazed. Schedule II was revised to show included in estimated equipment costs $10.5 million for "marketing, overhead, sales, and other costs." Exhibit 116 (Schedule II). The draft letter was revised to explain that these costs were "provisions for items such as overhead, profit and other miscellaneous costs incurred in projects of this type." Id at 3.

54. As negotiations continued, SHL continued to attempt resolution of the escalation claim based on indices. Exhibit 117. In response to requests by Motazed for further clarification of the DPR figures, Stein and Prietsch responded (id. at 2 emphasis added):

> You specifically requested that we clarify the derivation of the equipment cost component in the original Detailed Project Review (DPR) which ultimately became the underlying Stadler Hurter bid for the project. The foreign cost element in the DPR was $82,493,000. This total as shown in Schedule I was built up from $68,514,000 for costs related to equipment and $15,979,000 for costs related to services.
>
> It is standard industry practice that both of these total equipment and services amounts include sub-categories of the costs that are usually associated with the contractor's activities and obligations in supplying the equipment items and engineering outputs specified in the contract. Therefore, the total amounts include provisions for overhead and profit, marketing and promotional expenses, financing fees, contingencies, etc. as shown in Schedules II (for equipment) and IV (for Services).

In other words, the $8.2 million in illicit payments to obtain the contracts, which would have been revealed had the draft letter been sent (see paragraph 52 above), was concealed in the letters sent to the Iranians and explained as costs associated with supplying equipment and engineering outputs.



55. Had the Iranians be allowed to examine SHL's books and records, in addition to the true nature of SHL's escalation claim [i.e., SHL's attempt to recoup the $3 million contract concession on Gilan, to generate $2.5 million in revenues to pay "commissions," and to recover only $3.5 million for so-called "real escalation"], the Iranians might have discovered that SHL was receiving kickbacks from its suppliers and rebates from the freight forwarder on the contract. (See paragraphs 56-58 below).

d. Kickbacks

56. As early as November, 1973, as shown by a memorandum to defendant Stein (Exhibit 69), ISC was considering generating revenues for its payments obligations by having its Canadian suppliers falsely inflate their invoices. Thereafter SHL entered into such agreements with its Canadian suppliers and the inflated amounts were kicked-back to SHL. For example, SHL entered into an agreement with Candian Kenworth Limited on April 25, 1974, pursuant to which that supplier agreed to kickback as much as $523,750 to SHL, Exhibit 60. To secure the funds necessary to effectuate the rebate, that Canadian entity undertook to "markup [its] unit equipment price by 30% for billing purposes." Id. To date, the Commission has learned of contracts with SHL suppliers which provides for approximately $3.5 million of inflated billings to be invoiced to the Iranian goverment, representing approximately $3.5 million more as costs of supplying equipment than SHL incurred, or approximately the amount SHL was seeking to recover from the Iranian government for "real escalation." (See paragraph 45 above).

e. Rebates

57. Kuehne & Nagel International, Ltd. ("K&N") is a Canadian freight forwarding company. Exhibit 57. In May 1974, K&N agreed to pay rebates to SHL if it were awarded the freight forwarding contract for the Gilan project. Exhibits 57, 58, and 59 at 3, 4 and 16. This agreement was supplemented on July 19, 1974.

Exhibit 58 at 4. The agreement provided for a $200,000 payment to SHL upon receipt by K&N of the contract for the transportation work at the Gilan project. Exhibit 57. The rebates were to be paid at the rate of $16 or $17 [Can.] per ton of freight as described in the agreements. Exhibits 57, 59. See also Exhibit 58 at 5-7. The payments received from K&N were deposited in an offbook Stadler-Hurter Zurich account, No. 201200, at the Union Bank of Switzerland. Exhibit 58 at 2, 16-17. On September 10, 1974, $200,000 [Can.] was deposited into the Union Bank of Switzerland account. Exhibit 58 at 19. On September 17, 1974, $195,000 [Can.] was transfered to ISC. Id. On November 22, 1974, $5,000 [Can.] was transferred to SHL in Montreal. Id. On June 26, 1976, a second $200,000 was deposited in the Union Bank of Switzerland account and transferred the same day to ISC's Brazilian subsidiary, Seltec Engherias. Exhibit 58 at 1, 19.

f. The "Negotiations" Between Emeg S.A. and Stadler-Hurter Zurich ("SHZ")

58. On December 12, 1974, defendant Stein gave Zeier authority to sign letters of undertaking and promissory notes on behalf of SHL in connection with the Gilan and Mazandaran projects. Exhibit 118. On December 9, 1974, Zeier, on behalf of SHL, had given the Letter of Undertaking dated December 9, 1974, described in paragraph 41 to Emeg S.A., a Swiss company. On January 15, 1975, Zeier, acting for "Emeg in Liq.", gave a power of attorney to Ivo Mellini to sign, on behalf of Emeg, any and all documents for the account of Emeg in connection with the Iranian contracts. Exhibit 119. On April 26, 1976, Zeier, in his capacity as an officer of SHZ, was asked to review a letter to SHL from Emeg modifying the letter of undertaking. Exhibit 120. The letter was subsequently signed by Mellini. Exhibit 122. On September 15, 1976, defendant Stein instructed Zeier that:

> Further to our discussions held recently and, more specifically, as a result of my meetings in Iran pertaining to Mazandaran activity, I would like to begin immediate discussions with Emeg regarding the further reduction of their services and, in fact, the cessation of their activity on Mazandaran.

Exhibit 122.

Zeier then "negotiated" a termination agreement with Emeg "on behalf of Stadler-Hurter Limited," Exhibit 123, which was executed by SHL on April 6, 1977. Id. During February, 1978, ISC sold SHZ to certain persons, including Zeier. This sale was not disclosed in ISC's 1978 Form 10-K.

g. ISC's Inadequate 1978 Disclosure

59. ISC's 1978 Form 10-K does not disclose that its claim for "cost escalation," which is reported in its financial statements as $3.2 million in "unbilled receivables," included escalation on costs concealed from the Iranian government; bribes and other payments made to obtain contracts; similar payments to be made if the claim was realized; monies to compensate for SHL's cutting its bid to meet the competition; inflated supplier costs of which the excess was kickbacked to SHL; and costs above those SHL had to pay its freight forwarder. Furthermore, the 1978 Form 10-K does not report that SHL's business in Iran, including both the Gilan and Mazandaran projects, and its attempts to obtain additional revenues with regard thereto, were and are dependant upon its paying bribes and making other questionable and illicit payments which it has concealed from the Iranian government.

ALGERIA

60. ISC's reported growth in sales and revenues during the 1970's were in part related to its business activities in Algeria. ISC's financial statements in its 1978 Form 10-K reflect as assets approximately $14.6 million [Exhibit 56 at F-14 and F-16] of accounts

and "unbilled receivables". Its ability to realize payment of that $14 million is seriously impaired because of the nature of its activities and the questionable veracity of its sworn statements to Algerian officials. (See discussion below).

a. Contracts in Algeria

61. In 1971, ISC, through its subsidiaries, began entering into contracts with Sonatrach, the Algerian government agency responsible for hydrocarbon development. Exhibit 61. In 1971, Pritchard-Rhodes Limited ("PRL"), a wholly-owned subsidiary of ISC, entered into a fixed price contract of approximately $14 million, for completion of a gas treatment plant begun by another contractor. Id. This project was referred to as the GTP project. In 1971, PRL also entered into a second fixed price contract with Sonatrach for the design and construction of line IV of a gas liquification plant at Skikda (known as "Skikda 4" or "Skikda 40") with a fixed contract price of approximately $44 million. In 1973, PRL entered into a third contract for two additional lines for the liquification plant at Skikda ("Skikda 5 and 6" or "Skikda 50/60") with a fixed contract price of approximately $92 million. Id. Another wholly-owned ISC subsidiary, Pritchard International Corporation ("PIC"), entered into a project known as "Hassi R'Mel" in 1975, for a gas treatment module to be built in the Sahara. The Hassi R'Mel contract was valued by ISC at approximately $170 million, and a portion of this contract was cost reimbursable. */ Exhibit 62.

*/ ISC's 1975 Annual Report on Form 10-K reports PIC and PRL as wholly-owned subsidiaries of ISC's wholly-owned subsidiary, J.F. Pritchard & Company ("JFP"). ISC's 1976 Annual Report on Form 10-K reports that PRL had become a wholly-owned ISC subsidiary, no longer under JFP's umbrella. References hereafter to JFP include JFP and PIC but not PRL.



b. Undisclosed Agents and Illicit Payments in Contravention of Algerian Regulations and Contract Provisions

62. Despite warnings from Sonatrach's President Directeur General, Dr. Ahmed Ghozali, that ISC and PRL should not utilize the services of agents, intermediaries or influence-peddlers in connection with its dealings in Algeria -- or face possible loss of its business in Algeria (see paragraphs 63 et seq. below) -- ISC utilized such persons in its Algerian activities.

63. On June 23, 1971, PRL entered into an "Agreement for Sales Representation" (Exhibit 63) with the Arab Development Company ("ADC"). The agreement was executed for ADC by Munib R. Masri, as "Owner" of ADC. Exhibit 63 at 6. By August 28, 1972, Masri had been paid $240,000 as fees on GTP and $620,000 as fees on Skikda 4. Exhibit 64 at 7.

64. On August 3, 1972, Ahmed Ghozali, President Directeur General of Sonatrach, wrote to the president of PRL about rumors that PRL had been assured of getting the Skikda 5 & 6 contracts:

> In particular, these rumors give to understand [sic] that for the 5th and 6th liquefaction lines of Skikda, PRITCHARD-RHODES LIMITED has been assured of carrying off the construction contract and that its competitors have therefore been eliminated in advance.
>
> Such rumors seem to corroborate the reason for Mr. Mounib [SIC] Masri's actions, who claims to work on your behalf and who, we are told, behaves in such a way as to make one believe that he is in a position to use, to your company's advantage, the "personal relationships" which he has within Sonatrach.

Exhibit 65.

Mr. Ghozali further stated that Sonatrach

> would not hesitate to break off, purely and simply, any relations with your group if it proved to be impossible to work with PRITCHARD-RHODES LIMITED with straightforwardness and in accordance with the strictest moral rules of sound and honest business relations.

Id.

65. Both PRL and defendant Kenneally replied to Dr. Ghozali's letter and denied any impropriety (Exhibits 66 and 67). PRL stated that Masri was involved in GTP and Skikda solely to coordinate in the use of Lebanese construction labor. PRL further assured Dr. Ghozali that Masri "has not been concerned at all in the project of the 5th and 6th lines at Skikda" (Exhibit 66) and that

> to avoid any possible further conjecture or misunderstanding, we undertake to redefine Mr. Masri's responsibilities in such a manner that he would have no connection whatever with the operations of our company in Algeria, until you specifically instruct us to the contrary.

Id.

66. Defendant Kenneally's letter of August 29, 1972 stated that Dr. Ghozali's letter had been brought to the attention of the ISC Board of Directors and that defendant Kenneally had read the reply letter of PRL to Dr. Ghozali. Defendant Kenneally wrote that he wished "to assure you [Ghozali] that our entire organization is responsive to this situation." Defendant Kenneally informed Dr. Ghozali that "Mr. Herman Frietsch, Senior Vice President of ISC, will be attending the planned meeting on the 6th September, 1972" between Sonatrach and ISC "as a representative of the ISC Board of Directors." Exhibit 67.

67. ISC's memorandum (Exhibit 68) of the September 3, 1972, meeting between Sonatrach and ISC/PRL, in which defendant Freitsch represented ISC, reflects Dr. Ghozali's position:

> ... Sonatrach never works in any underhanded or indirect way, and the intervention of 'business-men' in the activities of Sonatrach is systematically barred, because such intervention is not in the interests of Sonatrach. He did not know whether any money had gone to intermediaries for Skikda 4 and GTP. He would be violently opposed to any such activity. Intermediaries sometimes succeeded in persuading bidders of their power and influence, and the result is that the entire competition is put on a false basis. Rumors have existed about Pritchard-Rhodes in this field; generally, in his view, where there was smoke there must be some fire. Perhaps the rumors were false, but if the rumors existed, there must have been some basis or explanation. He did not know of the relations between Pritchard-Rhodes and Munib Masri, but Mr. Masri's role was such as to sow seeds of doubt. He did not want to condemn Mr. Masri; the major error was for Pritchard-Rhodes to have utilized the help of Mr. Masri.... There was no need for the help of any intermediaries in Algeria; Sonatrach was there to help with any problems which might arise with other government administrations, such as customs.

Exhibit 68 at 2-3. (Emphasis in original).

68. Section 19.7 of the Hassi R'Mel contract which was entered into in February 1975 contained a provision prohibiting the use of intermediaries and the payment of fees:

> This Contract has been concluded without the assistance or the use, direct or indirect, of any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). No fee, nor any remuneration, commission, discount or other payment, has been paid, is or shall be due to any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). The parties agree to deal directly between themselves concerning any matter directly or indirectly connected with the Contract. The parties shall not permit, in their relations or in the relations of one of them with any government or administration, the intervention of any broker, intermediary, commission agent, business agent or the like (Algerian or non-Algerian). The Contractor undertakes to compensate the Owner if the Contractor shall have contravened one of the provisions of the present paragraph.

b. A provision substantially similar to the aforesaid Section 19.7 was contained in Article 19.8 of the contract for Skikda 5/6.

69. Nevertheless, PRL continued to make payments to ADC (i.e, to Masri), including payments on Skikda 5 and 6. Exhibit 70. Some of the payments were made to ADC by transfers of funds from ISC to Ed Engineering and Development Holdings Establishment ("EDCo") the "mother company" of ADC. The funds were deposited to a designated numbered account at the Landesbank in Lichtenstein pursuant to defendant Freitsch's confidential instructions. Exhibit 71.

70. By May 12, 1976, according to a PRL list on the Skikda projects, "commission" payments of 386,492 British pounds on Skikda 4 and 575,647 British pounds on Skikda 5/6 had been made to ADC. Exhibit 72. This information was supplied to defendants Frietsch and Hofker on that date. Exhibit 73.

71. In 1976, Sonatrach requested PRL's president, William L. Friend, to provide it with an affidavit in a prescribed form attesting that no third party had been involved in negotiating the Skikda 5/6 Contracts dated July 6, 1973, or the addendum dated February 10, 1976, for ISC or PRL. Exhibit 74. This request was made "as per the Algerian regulations in force on the date of signature of the above contract." Id.

72. Mr. Friend, then in charge of ISC's "Pritchard group" of companies, including PRL and JFP (Exhibit 75 at 11-13) refused defendant Frietsch's request that he execute the affidavits required by Sonatrach. Mr. Friend was concerned that the required language of the prescribed affidavit was broad enough to cover the payments to Masri and ADC and a former Algerian military officer, Khasid Zeghar (see Complaint paragraph 41). Exhibit 75 at 83-84.

73. Defendants Frietsch and Hofker discussed the matter with Mr. Friend and his concerns regarding execution of the affidavit. Exhibit 75 at 85-86. More significantly, ISC officials, including defendant Frietsch, were concerned that if disclosure of the payments was made, the Algerians, who had demanded that all relationships between ISC/PRL and governmental entities be direct and without resort to intermediaries, would terminate all of PRL's work in that country. In response to questions during the Commission's investigation, Mr. Friend testified under oath as follows:

> Q. Do you recall what the substance of your conversations with Mr. Frietsch was?
>
> A. My conversations regarding which subject?
>
> Q. The signing of the Algerian affidavit?
>
> A. The substance of those conversations was that he suggested that it was -- that I was the appropriate person to sign the avvidavits, [sic] because of my position, and that he urged that I do so because of the importance the Algerians placed on those affidavits and the very detrimental effect that our inability to produce an affidavit would have had on the agreements in our raslationship [sic] with Sonatrach.
>
> Q. What effect do you believe would have occured had the Algerians been informed of the consulting fees?
>
> A. Well, any response on my part to that question would be speculative.
>
> Q. Did Mr. Frietsch ever express to you what his concerns were about the Algerians on these consulting fees?
>
> A. Yes, he did. And I had my own concerns. I had an opinion. I was prepared [sic] to give you my own opinion as well.
>
> I think that it would have been a matter that the Algerians would not have been able to deal with.
>
> Q. That is your opinion?
>
> A. That was both of our opinions.
>
> Q. And also Mr. Frietsch's opinion?
>
> A. I believe.
>
> Q. When you say they wouldn't have been able to deal with it, what do you mean?
>
> A. I mean that they wouldn't have been able to handle it administratively, that they would have probably had to react by -- in a very tangible way be terminating all of our work.
>
> Q. Mr. Friend, why would the Algerians have been so upset about learning of these consulting fees?
>
> A. Well, Algeria is very --
> (the witness was consulting with his counsel).
>
> THE WITNESS: I am prepared to go on.
>
> Algeria is very determined and committed to eliminating intermediaries in any business affairs with them. Sonatrach has emphasized to us over and over again the importance of direct relationships, and in 1972, I believe, I have knowledge of the President of Sonatrach specifically asking Prichard-Rhodes [sic] not to have any further relationship with teh [sic] Arab Development Corporation involving Algerian work.

BY MR. SCHWARTZSTEIN:

Q. So that a decision was made then not to tell the Algerians about these consulting fees, is that correct?

A. That is correct.

Exhibit 75 at 87-89.

74. Following Mr. Friend's refusal to execute the affidavits, defendant Hofker, who was then vice-president and general counsel of ISC and a director of PIC, executed the affidavits. By letters dated July 30, 1976, PIC and PAL submitted the required affidavits to Sonatrach for Hassi R'Mel and Skikda, 4, 5 & 6 respectively. Exhibit 76. The affidavits were executed by defendant Hofker and submitted with a cover letter. The affidavit stated in part that:

2) In connection with the signature and performance of:

- the principal contract referred to above,
- and/or other contracts to which it has given or shall give rise,
- and/or any other contract signed in Algeria by my company,

Neither the Company, nor any of its affiliates, or subsidiaries or divisions, nor any its honorary or actual officers, directors, employees, representatives, advisors or finders have, directly or indirectly, without limiting the enumeration in (a) below,

(a) received from or paid to any broker, representative, employee, official, agent or other person or corporate body, either public or private, corporation or any other juridical entity whatsoever, domiciled in Algeria or abroad, any fees, commissions, bonuses, gratuities, donations or other payments or considerations whatsoever.

* * * *

3) The statements made in 2(a) and 2(b) above shall apply not only to the period preceding the signature of the contract but also to the contractual and postcontractual period.

* * * *

I further understand and acknowledge that my statements contained in the present affidavit constitute one of the fundamental bases upon which the contractual engagement of Sonatrach is conditioned. The inaccurancy of these statements will constitute the provocation of faulty consent of Sonatrach with all the consequences resulting therefrom.

Exhibit 76 at 5-6.

The referenced cover letter enclosed a copy of ISC's "company policy of long standing and which was enacted to prohibit transactions of the type to which the affidavit is addressed". Exhibit 76 at 1.

c. Concealment of Illicit Payments

75. As described below under the heading "Unbilled Receivables," ISC's Skikda and Hassi R'Mel contracts were converted from fixed-price contracts to cost reimbursable contracts. This conversion required the establishment of cost records for the Skikda projects which were to be available for review by Sonatrach. Because the payments to Masri were included in the existing cost reports on the projects as consulting fees, (Exhibit 81 at 79-80) ISC had either to remove the payments or disclose the payments to Sonatrach. In a report (Exhibit 80) to defendant Friedrich which was labeled "strictly confidential", Friend proposed a form of cost reports which "will make absolutely no mention whatsoever in any way, shape or form of ADC." Id.

76. The new cost reports involved not only ISC but its auditors as well. Pursuant to protocols of December 19, 1975, which converted the Skikda projects to a cost reimbursement basis, Arthur Young McClelland Moores & Co. ("AYMM") */ was to "audit" cost and expenditure statements which were then to be examined by Sonatrach's auditors, Touche Ross & Co. ("Touche Ross"). Touche Ross was also to have access to PAL's books. AYMM was aware that during the Skikda contracts certain "commission" payments had been made to ADC. AYMM resisted any involvement in concealing the commissions from the Algerians:

AYMM is aware that prior to, and during the course of this contract, certain "commission" payments have been

*/ AYMM is affiliated with Arthur Young & Co. ("AY") and prepared the "reporting packages" used by AY Houston in doing the audit of consolidated financial statements of ISC.

made to the Arab Development Corporation (ADC). The amounts passing through the books of Pritchard Rhodes, which are shown on the company's internal confidential cost reports as "commissions" amount to some £ 1,000,000 [APS] at April 30, 1976. It is not known by AYMM whether further such payments have been paid by other group companies on behalf of Pritchard Rhodes. (See attachement A)

At a meeting held in January, 1976, Pritchard Rhodes informed AYMM of this new protocol. At the same time they informed AYMM that they, along with all other foreign contractors in Algeria, were being asked to sign a declaration that no "commission" payments had been made. At that time Pritchard Rhodes suggested that they would "come clean" and inform Sonatrach of the payments.

Consequent upon this meeting, AYMM proceeded to assist in the preparation and to audit updated cost reports to December 19, 1975. The figures used were largely taken from Pritchard Rhodes internal cost reports, with the commission payments backed out. These workings were clearly visible, and a necessary part of AYMM's working files.

AYMM were then informed that Pritchard Rhodes had reversed their decision to "come clean". AYMM now understand that a document has been delivered to Sonatrach making the necessary certification. However, this had not been seen by AYMM, nor is there any directors' minutes relating to this subject.

As a result of this reversal a problem arose in that an examination of AYMM's working papers by Touche Ross would disclose these payments. AYMM informed Pritchard Rhodes that they were not prepared to "doctor" their files, and that if any papers were removed before the files were submitted to Touche Ross, AYMM would have to inform Touche Ross that this was the case.

Exhibit 61 at 3.

d. Unbilled Receivables

77. ISC reported in its financial statements in its 1978 Form 10-K, assets of $14.6 million in accounts and "unbilled receivables" attributable to the GTP and Skikda projects. Exhibit 56 at 8. The GTP and Skikda projects were originally fixed price contracts. Exhibit 81 at 23-24. When the GTP contract was completed in 1974 or early 1975, PRL had cost overruns in the amount of approximately 1.7 million British pounds sterling (Id. at 25-26) and was anticipating cost overruns on the Skikda contracts (Id. at 27).

78. In December, 1975, "Protocols" were entered into amending the Skikda contracts. Id at 28. The 1975 "Protocols" put the



Skikda projects on a cost reimbursable ceiling price basis and required that separate audited project bank accounts be established from the project cost reports prior to their presentation to and review by Sonatrach's auditors. Exhibit 75 at 34, 35.

79. The 1975 "Protocols" did not include any adjustments for the GTP contract and did not provide for any price adjustments for the completed GTP contract. Sonatrach had repeatedly excluded the GTP costs from consideration telling PRL had the award of the $170 million Hassi R'Mel contract to JFP should be compensation enough and ISC was forced to withdraw its claim on GTP. Exhibit 75 at 28; Exhibit 82 at 29-34; Exhibit 131. However, rather than write off the GTP loss, ISC transferred the GTP cost overruns as costs of the Hassi R'Mel project and continued to record them on its financial statements as "unbilled receivables." Exhibits 125 and 131. In 1976, Sonatrach reduced JFP's involvement on the Hassi R'Mel project and the contract was changed to a completely cost reimbursable basis; Sonatrach refused to recognize the GTP loss as a Hassi R'Mel cost. Exhibit 75 at 31. ISC transferred the GTP loss back to the books and records of PRL and continued to report them as "unbilled receivables." Exhibit 125 and see below.

80. In a letter (Exhibit 93) to the Board of Directors of ISC on accounting procedures and internal accounting control measures of PRL (which was a delayed submission of a general report dated February 1978), ISC's new auditors, Arthur Andersen & Co. ("AA"), informed ISC that there were serious issues about the financial impact of uncertainties on various PRL projects with Sonatrach:

Resolution of Contractual Uncertainties

We have previously raised with management the areas of uncertainties attached to the Algerian contracts. There is little doubt that the contractual documentation is in conflict with the Company's view of the intent of the parties to the contracts. Whilst [sic] we appreciate the problems of obtaining any further clarification from Sonatrach, the potential financial impact of these uncertainties is so great as to make their resolution vital to the continued existence of PRL and to the business sense of the company continuing its work at Skikda.

Exhibit 81 at 1. The "uncertainties," according to ISC's auditors, included the Skikda projects and the GTP contract. The significance of these uncertainties were summarized by the auditors as follows, Id. at 2:

> (1) If PRL's interpretation of the Skikda contracts and the intent of the parties should be incorrect substantial losses will be incurred on settlement. No meaningful quantification can be made of these losses at present but the areas of particular concern include the following:
>
> (a) £864,000 of recorded revenues and reimbursable costs relate to overheads incurred in excess of the overhead recovery allowed for in the contract.
>
> (b) Approximately £3,745,000 of costs incurred but not paid prior to the June, 1977 amendment have been taken as revenue. The contract amendment states that such liabilities should be treated as advances to be considered further at the final settlement of the contract.
>
> (c) Approximately £1,367,000 of costs relating to the Kobe heat exchangers are in excess of the purchase price agreed to by Sonatrach.
>
> (d) The total penalties that might become payable on the Skikda contracts amount to £8,800,000.
>
> (e) Sub-contractors and vendors on the Skikda projects have made claims against PRL in excess of £2,500,000. It is anticipated that further claims will be made. At 30th June 1977 PRL had included in revenues and reimburseable [sic] costs £1,274,500 being the estimated settlement of existing claims.
>
> (2) At June 30, 1977, the accounts included a receivable of £1,892,660 (£1,862,277 of which will be unbilled) in respect of the completed GTP contract. We know of no agreement by Sonatrach to pay further sums to PRL for their work on GTP.

One year earlier, the auditors had taken the same position regarding their inability to document any suggestion that the unbilled receivables would be recovered, Exhibit 84 at 1:

> We wish to emphasize our view of the collectability of the GTP receivables. We consider the position to be unarguable. No satisfactory evidence has been provided suggesting these amounts will be recovered.

81. Through ISC's FY 1978, ISC's London auditors were of the view that the books and records of PRL did not support the positions asserted by ISC with regard to the complete reimbursibility of the claims it was making against Sonatrach (Exhibit 83 at 4-5) and that



PRL's accounting records did not contain an adequate record of the assets and liabilities of PRL, in contravention of Section 12 of the English Companies Act of 1976 and that PRL had failed "to keep proper books of account in accordance with U.K. Companies Acts of 1948 and 1967." Exhibit 124 */

In a December 21, 1978, report (Exhibit 84) from the London office of Arthur Andersen & Co. to the Houston office of Arthur Andersen & Co. on their examination of the balance sheet of PRL and the related statements of income and retained earnings as of June 30, 1978, the London office reported that with regard to receivables:

> Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except that we were unable to confirm or otherwise corroborate accounts receivable and unbilled receivables (£11,787,000, $21,784,000) and advances under contracts (£6,290,000, $11,699,000) from the Company's principal customer. This matter is discussed in the following paragraphs.
>
> The contracts with Sonatrach described below have not been accounted for separately as required by the contracts and for a substantial period the systems for reporting contract costs were not operating effectively. Documentary support for certain transactions is incomplete. In a number of other respects the Company's accounting procedures have been inadequate to provide for the proper recording and allocation of costs and expenses and to assure proper stewardship of the Company's assets. As a result, the net receivable balance of £6,496,000 ($12,082,000) cannot be delineated by project from the accounting records.

Exhibit 85 at 1.

Arthur Andersen & Co. further noted that Sonatrach terminated the Skikda S/S contract in December 1976 because of significant delays and costs. ISC/PRL were to prepare a final financial statement for submission to Sonatrach -- this had not been done as of the date of the memorandum. Nevertheless, gross profits of approximately $1.5 million in excess of that allowed for

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*/ The auditors noted that "the penalties which can be imposed under the sections discussed above range from 6 months to 2 years imprisonment and/or a fine." The auditors further suggested that the U.S. Foreign Corrupt Practices Act of 1977 may have been violated. Id. at 4.

in the contracts were recorded on the PRL's final records. Exhibit 85 at 2. PRL's estimates of the maximum cost reimbursements allowable on Skikda 4 was $4.6 million less than PRL's estimated total costs of the project. Exhibit 85 at 2.

The GTP receivable also was discussed by the auditors:

> As discussed in Note 2(a), the GTP project was completed and accepted by Sonatrach in 1974. Unbilled receivables include Ll,293,000 ($3,520,980) in respect of this contract for which no formal submission has been prepared or submitted. We are informed that Sonatrach has indicated its willingness to discuss this matter further on the completion of all of the Company's contracts in Algeria. No discussions on these costs have taken place since December, 1976 and there is no contractual basis for including this project in any settlement of the Skikda contracts discussed below. Further the Company presently has no analyses available to support the amount at issue which are suitable for presentation to Sonatrach.

Exhibit 85 at 1-2. The auditors rendered an adverse opinion on PRL's financial statements. Id. at 3.

82. Nevertheless, ISC's Annual Report on Form 10-K for the fiscal year 1978 -- filed with the Commission in December 1978 -- continues to reflect as assets the millions of dollars in so-called "unbilled receivables". As to GTP the Form 10-K states that:

> One of the contracts [GTP], assumed in 1969 after another contractor was dismissed by the client, was completed in 1974. The final cost of the project exceeded the contractual revenues by approximately $3,500,000. The subsidiary provided for the recovery of such costs on the basis of understandings from meetings with representatives of the client that the final contract price would be renegotiated in connection with the final settlement of matters relating to other work in progress. Accordingly, such contract costs have been carried as unbilled receivables.

Exhibit 56 at 7 and F-15. As to costs on the Skikda contracts, the Form 10-K stated (emphasis supplied):

> Costs incurred on these contracts are expected to be reimbursed by the client and no penalties are expected to be included in the final settlement of contract amounts. (Emphasis supplied).

83a. For its fiscal year 1977, ISC's Form 10-K reflects approximately $41 million in "unbilled receivables" of which ISC has attributed



approximately $6.1 million to Hassi R'Mel. Exhibit 125.

b. On October 20, 1978, ISC sold substantially all the assets of JFP, including the approximately $7.9 million in "unbilled receivables" then being carried for Hassi R'Mel to a Korean business. See Exhibit 126 at 5. Section 3.3 of the Purchase Agreement provided for the allocation of the purchase price with an acknowledgment by both parties that each of the assets was individually bargained for as set forth in "Exhibit D" to the Agreement. Exhibit 127. That exhibit showed for "unbilled receivables" net of contract advances (the only asset shown as a netting) "$2,971,470". Exhibit 128.

The purchaser's auditors' workpapers on Exhibit D broke "unbilled receivables, nat of contract advances" into its component parts and show that the Hassi R'Mel "unbilled receivable" was reduced from $7,867,051 by $5,117,151. Exhibit 126 at 5. Included in a footnote explanation for the reduction is the statement that "ISC, J.P. Pritchard and the Buyer believe that ultimate recovery may approximate thirty-five percent of the original claimed amount, or approximately $2,750,000," in part based on Sonatrach's unilateral action in replacing ISC on construction and in part PRL's difficulties with Sonatrach. Id. Thus, the Hassi R'Mel "unbilled receivable" shown on ISC's 1977 Form 10-K financial statements as approximately $6.1 and on JFP's books as approximately $7.9 million in October, 1978, was valued at only $2.75 million when sold on October 20, 1978.

e. Verkor

84. ISC's Verkor subsidiary also entered into a contract for commissions ("Verkor Agreement") with a Belgian national, Hubert Renault, on April 23, 1973.

a. Attached hereto as Exhibits 77A and 77B respectively are the original Verkor Agreement, in French, and an English translation provided to the Commission by ISC. Article 5 of the original Verkor Agreement provided that Renault would receive 1%

of the amount of supply contracts Verkor received in Algeria.

Article 7 of the Verkor Agreement stated in part that:

> "[Verkor] shall pay to [Renault] the sum of 2% of the value of whatever contract(s) may be finalized, payable in the form of secret commissions "to one or more third parties" (emphasis supplied);

and Article 11 of the Verkor Agreement stated:

> "Each of the parties agrees to safeguard the confidential nature of the present agreement because of the mutual risks run in Algeria due to the effectiveness of Article 7 of the present agreement." (emphasis supplied).

Exhibit 77B.

b. Approximately two months after Sonatrach asked ISC/PRL to provide affidavits that they had complied with Algeria's "anti-agent" law and the provisions of its contract to similar effect (see paragraph 65 et seq. supra), and approximately one month after ISC's Board of Directors engaged Special Outside Counsel to investigate the possibility of illegal improper or questionable payments, and after ISC had received an inquiry from the Commission regarding its activities abroad, (see also, paragraph 39, supra), ISC secured a letter from Renault, dated June 16, 1976, to Verkor's president. The original letter in French and an English translation thereof are attached as Exhibits A and A1 to Exhibit 78. (Affidavit of Carole Metreau translating Exhibit 78A which translation is subexhibit A1 to her affidavit).

c. Renault's letter states that he has agreed to "delete certain texts" from the April 23, 1973, Verkor Agreement. (Exhibit 78A). Thereafter, his letter discusses each of the provisions of the Verkor Agreement and the "deletions" therefrom which he is prepared to make. Thus, Article 5 of the Verkor Agreement is changed by increasing from 1% to 3% the payment Renault is to receive based upon the amount of supply contracts Verkor received in Algeria. Article 7 of the Verkor Agreement, which provided that 2% of the value of whatever contracts Verkor received in Algeria was to be payable "in the form of secret commissions to one or more third parties" was deleted entirely and a new Article 7 substituted. And Article 11 of the Verkor Agreement was renumbered as Article 9 and modified by deleting the words "because of the mutual risks run in Algeria due to the effectiveness of Article 7 [of the Verkor Agreement]." Exhibit 78 Subexhibit A1.

d. The June 16, 1976, Renault letter significantly states that the deletions and modifications to "old Articles 5, 6 & 7 from the Verkor Agreement reproduce those articles without changing the essence". (emphasis supplied) Id at 2. Finally, Renault stated that if Verkor found it necessary, he would forward to Verkor a formal agreement based on his letter, deleting the commentaries and texts. Id at 4.

e. By letter dated July 12, 1976, Renault transmitted to Verkor's president an edited version of the April 23, 1973, Verkor Agreement "putting in one single account the 3% of the amounts of fees and commissions formerly separated into 2 different accounts of 1% and 2%" (see subparagraph (a) above). Exhibit 78B (letter in original French) and Exhibit 78 (affidavit of Carole Metreau translating Exhibit 80 which translation is Subexhibit B1 to her affidavit).

Thus, as the Renault June 12, 1976, "commentaries" and his July 12, 1976, letter make clear, the "essence" of the Verkor Agreement was not changed and 2% of the monies to be paid to Renault, in connection with Algerian contracts, were to be used for "secret commissions".

85. Thus, with respect to its activities in Algeria, ISC's Form 10-K for 1978 (and earlier years), is materially false and misleading and contained material omissions of fact relating to the collectibility of the approximately $14.6 million of so-called "accounts and unbilled receivables" in that it:

> (a) failed to disclose the risks created by its use of "intermediaries" in violation of Algerian law and the contract provisions;

(b) failed to disclose the risks created by its filing affidavits with Sonatrach regarding use of intermediaries which did not disclose its continued use of Masri (or the Verkor Agreement or the payments to Khalid Zeghar) after being warned that such activity could result in loss of its business relationship in Algeria;

(c) failed to disclose the risks created by its filing false cost reports with Sonatrach and then failing to provide the type of financial statement and support data Sonatrach required;

(d) failed to disclose that "the contractual documentation is in conflict with [its] view of the intent of the parties to the contracts";

(e) failed to disclose that the viability of a major subsidiary (PRL) was in doubt because of these uncertainties;

(f) failed to disclose that its subsidiary's books and records were so deficient that its auditors expressed the view that the subsidiary was violating the English Companies Act; and

(g) failed to disclose that ISC's financial viability was in further and greater jeopardy than already reported by the company because of, among other things, the foregoing.

SAUDI ARABIA

86. In its fiscal year 1974, ISC sought to obtain contracts in Saudi Arabia through its wholly-owned subsidiary, Sanderson and Porter, Inc. ("S&P").

87. In connection with its efforts to secure two engineering and construction contracts from the Saudi Arabian Saline Water Conversion Corporation ("SWCC") for proposed desalination power generation plants known as the Al Khafji ("AK") and Al Jobail ("AJ-I" or Phase A") projects, S&P entered into financial arrangements with the Vice-Governor of SWCC as described below.

88. The Vice-Governor of SWCC was Adnam Samman. Exhibit 86. Samman was to be paid a 5% "commission" on the price of the AK and AJ-I contracts. Exhibit 87 at 1. On or about November 1, 1974, S&P representatives met with Samman, at the latter's office, to discuss "resolving a problem" S&P had -- how to document payments to Samman.



Exhibits 87 and 88. */ Samman introduced the S&P representatives to his father-in-law Abdul Rahman Arnaout who owned a company, ARA International Est. ("ARA"), located in Beirut, Lebanon. For a fee, which was ultimately fixed at $10,000, Arnaout's company would issue ISC receipts and invoices for the monies paid for the benefit of Samman and ARA would sign a consultancy contract with ISC/S&P all of which documents S&P would prepare. Exhibit 87 at 1 and Exhibit 93 at 1.

89. In 1975 S&P made two payments to Samman of 570,000 rials and 815,657 rials or a total of approximately $400,000. The $400,000 was paid in cash which was left at Samman's home. The cash was generated through issuance of checks drawn on banks payable to the order of an S&P employee who then converted the checks to cash. Exhibit 87 at 1; Exhibit 89 at 2-4, 6-7. Samman's father-in-law issued receipts (Exhibit 89 at 1 and 5) to S&P for each of the two payments.

90. On or about August 25, 1975, negotiations were completed on an expanded contract on AJ-I. The commission payment on the contract was again paid through ARA under the guise of a $380,000 services contract. However, S&P officials subsequently informed their auditors that no services were contemplated or received and that the payment was strictly a "commission" to Samman. Exhibit 87 at 1-2.

91. Payments of $230,000 and $75,000 were made to a designated numbered account at the British Bank of the Middle East in Geneva, Switzerland. Exhibit 87 at 1-3, 4-7; accord Exhibits 90 and 91. S&P also contracted to pay ARA "an additional $5.2 million through fiscal 1978" which ISC's auditors considered to be "for nebulous consulting and representation type services". Exhibit 92 at 2. S&P also contracted with a Saudi based entity known as Best

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*/ Exhibit 87 is a document produced under Commission subpoena from Arthur Young & Co. ("AY"), ISC's former auditors to the Commission's staff during its investigation and, it is believed, was based upon AY's examination in 1976 of ISC's books and records and its personnel. Exhibit 79, at 122-123.

Trading Company to pay Best $10,000 per month for as long as S&P had a resident engineer in Saudi. Exhibit 87 at 2. The contract with Best was signed after Samman informed S&P that he had a minority interest in Best and requested S&P to sign the agreement. Id. The few services to be provided by Best for $10,000 per month were valued by S&P's project director at $2,500 per month and by its auditors as no more than $4,000 per month. Exhibit 87 at 3.

92. The funds to make the payments referred to in paragraph 97 above were transferred from the Chemical Bank, New York, New York. Exhibit 91.

93. On February 25, 1976, S&P signed a contract for AJ-II. Thereafter, on or about June 22, 1976, $831,438 was paid by wire transfer to a designated numbered account in Switzerland. Samman had orally advised S&P officials of the account number to which the transfer should be made. Exhibit 87 at 3-4.

94. During fiscal year 1976, S&P paid to ARA a total of $1,136,429. Exhibit 92 at 3.

95. Article 81 of the Saudi Arabian Tendar Regulations states, according to ISC's auditors:

> "If supplier or contractor is proven to be personally or through an intermediary, either directly or indirectly, offered or attempted to offer a bribe to any government official or employee connected with the work forming the subject of the contract, his contract shall be immediately cancelled and the deposit confiscated in full. In addition, his name shall be crossed out from [the list of] suppliers and contractors, and necessary action shall be taken to bring him to trial."

Exhibit 92 (emphasis supplied).

96. The fees paid to Samman through his intermediary father-in-law's firm, ARA (Exhibit 93), were recorded by S&P and ISC as "consulting services". Exhibit 89.

97. Among others, defendants Freitsch, Hofker and Stein were directly involved with and knew of the payments referred to above. Exhibits 91, 94, 95 and 96 at 2.



98. Neither ISC nor any of the defendants herein disclosed in ISC's public filings the facts stated above, the fact that ISC's books already were false and misleading, the fact that ISC's ability to secure over $100 million worth of business was not a reflection of its ability to compete on the basis of the price and quality of its services but rather was connected to the aforesaid payments to the Vice-Governor, and did not disclose the risks to ISC and its business resulting from these practices because of Saudi laws which proscribe such activities.

OTHER QUESTIONABLE PAYMENTS

99. As set forth in the Commission's Complaint, ISC's questionable foreign payments were not limited to officials of the above-discussed nations. To the Commission's present knowledge and belief, activities of a similar nature occurred in at least Nicaragua, Chile, Ivory Coast and Iraq. Attached hereto as Exhibit 129 is a memorandum from Alfred M. Lerner, former director of ISC's Latin American operations, regarding ISC's attempts to secure a contract in Chile. It is highly instructive as to ISC's method of doing business. It is a study of the Chilean government and who in the government should be paid for securing government contracts and it demonstrates how ISC went about instructing officials in foreign governments as to methods for concealing the payments they were receiving for assisting ISC in its efforts to secure government contracts.

THE DEFERRED COMPENSATION CORPORATION

100. ISC established the Deferred Compensation Trust ("DCT") in 1964. In turn, DCT formed and initially owned all the stock of the Deferred Compensation Corporation ("DCC") as part of a "Deferred Compensation Plan" (the "Plan") which purports to provide incentive and retirement benefits to ISC officers, directors and key personnel. DCC has outstanding both common shares and $4 cumulative preferred shares with a $100 per share preference on liquidation.

Selected officers, directors and key personnel of ISC and its subsidiaries are given the opportunity, under the plan, to purchase common stock of DCC from DCC's treasury. Officers and key personnel of ISC and its subsidiaries, under the DCT program, receive allocations and later vesting of DCC preferred stock. Exhibit 56 at 31.

101. The assets of DCC consist primarily of common shares of ISC stock of which, at June 30, 1978, DCC owned 23%. DCC acquired these shares with bank loans, and loans and contributions made or caused to be made by ISC. Exhibit 56 at 31-34 and Exhibit 90 at 1. At December 20, 1978, ISC held notes and accounts receivable from DCC in the aggregate amount of $821,309. Exhibit 56 at 34. From August, 1965, through June 30, 1977, ISC "contributed" $158,000 per year to DCT. DCT used these funds to purchase DCC preferred shares. Exhibit 56 at 34. ISC subsidiaries purchased ISC common stock from DCC at DCC's cost - rather than the prevailing market at the time of the purchase - and then sold the stock to "key personnel" at considerable loss to the subsidiaries and, ultimately, to ISC. Exhibit 56 at 33-34. The DCC has never been audited. Exhibit 92 at 12. The benefits to defendant Kenneally and two of his associates, are discussed below.

102. In 1968, DCC declared a dividend of 15 shares of its preferred for each common share, payable May 3, 1968, to holders of record on that date. Exhibit 56 at 33. Defendant Kenneally and Ross and Lerner (see paragraphs 106-107 below) received 3000, 2550 and 3000 DCC preferred shares at the time of the 1968 dividend which were outside the Plan and vested immediately. Exhibits 98, 130 and 131.

103. There are essentially only three significant beneficiaries of the Plan, who have received the benefits of ISC's funding of DCT: defendant Kenneally, Alfred M. Lerner and N. L. Ross, II. Collectively, defendant Kenneally, Ross and Lerner own 73% of the outstanding DCC common shares and 72% of the outstanding



preferred shares, not including those presently being held by the DCT for possible future distribution under the Plan. Exhibit 98 at Schedule XIII, XV.

104. ISC's Annual Report on Form 10-K for its fiscal year ended December 31, 1978 ("1978 Form 10-K"), states that defendant Kenneally owns 400 shares (45%) of DCC's common stock and was allocated 950 shares of DCC preferred stock. The 1978 Form 10-K states that the maximum benefit to defendant Kenneally from those shares under the Plan will be $19,085 for each of the years 1991 through 2000. Exhibit 56 at 31.

105. ISC's 1978 Form 10-K does not disclose that Defendant Kenneally also possessed 3000 vested DCC preferred shares, which he received in the 1968 dividend, and does not disclose the benefit he has received or will receive those shares.

106. Ross has been a director of ISC since 1964, and is the Chairman of the Board of Ross, Stebbins, Inc., a member firm of the New York Stock Exchange. Exhibit 56 at 29. ISC's 1978 Form 10-K states that Ross owns 100 shares (11%) of DCC's common shares but fails to disclose that Ross also possessed 2,550 vested DCC preferred shares obtained in the 1968 dividend and does not disclose the benefit he has received or would receive from those shares. Exhibit 56 at 29.

107. Lerner, for a period prior to 1971, was a director of ISC's predecessor, HOMCO, and an officer of an ISC subsidiary. Thereafter, Lerner served ISC as a consultant and directed ISC's activities in Chile and Brazil which are discussed in the Commission's Complaint. See also paragraph 105, above and Exhibit 104. ISC's 1978 Form 10-K fails to disclose that Lerner owns 153 shares (17%) of DCC's common stock and possesses 3000 vested DCC preferred shares received in the 1968 dividend, and does not disclose the benefit he has received or will receive from those shares.

108. ISC's 1978 Form 10-K, and its annual reports for its fiscal years 1976 through 1978, including its proxy soliciting material, state that in May, 1976, DCC acquired ISC common shares from Kenneally in a privately negotiated transaction at a cost to it of $375,000 which was paid in cash. Exhibit 56 at 32. The said filings do not state that the purchase from defendant Kenneally was in an amount, at a time, and at a price determined by Kenneally. Exhibit 100 at 53-54, 58-66.

109. ISC's public filings fail to disclose that between April 30, 1973 and June 26, 1978, for options and future options for the purchase of 200 shares of DCC common stock owned by Lerner, DCC paid out $211,477.79 to Lerner and to a lending institution to which he was indebted. As of June 26, 1978, that common stock had no value. An option to purchase DCC common stock was extended to Ross in December 1971, the last payment thereon was due in March, 1979. Exhibit 99. The option agreements between DCC and Ross and Lerner were instances where common stocks was sold back to DCC, other than as provided in the Plan. Exhibit 100 at 75.

ISC has failed to disclose, and defendants Kenneally and Frietsch failed to cause ISC to disclose, the matters described in paragraphs 100 through 108 above in its filings with the Commission, or in its communications to its shareholders and the investing public.

PERQUISITIES

110. In 1970, defendant Kenneally used approximately $160,000 of ISC funds to purchase a large house and approximately 85 acres of farm land in Kilquade, near Dublin, Ireland ("Kilquade"). Defendant Kenneally took title to Kilquade in his own name. Exhibits 101, 102.

111. By June 30, 1974, Defendant Kenneally had used an additional $548,000 of ISC funds on improvements to the house and grounds and approximately $97,000 on antiques for Kilquade. Exhibit 101. During the period for 1970 through 1978, ISC expended an undetermined



amount of money, but approximately $243,000 was expended in one year alone, to purchase, decorate and maintain Kilquade. Exhibit 103.

112. Defendant Kenneally's wife and a Houston based interior decorator have been signatories on ISC bank accounts maintained for Kilquade. ISC corporate funds have been used to transport defendant Kenneally and his family to and from Kilquade. ISC has paid other perquisites for defendant Kenneally and for other officers and directors in amounts and for purposes not now known precisely by the Commission.

113. Certain expenses, including operating expenses for Kilquade have been paid through a London-based ISC subsidiary, ISC Europe. ISC Europe pays the Kilquade expenses, adds on three (3%) percent, and records them on its books as an asset due from ISC. ISC, in turn, reimburses ISC Europe and records the billings from ISC Europe as "Consultancy Fees" in a "selling, engineering and administration" account. Exhibits 101, 103, 104 and 105.

114. Although Kilquade has been used almost exclusively as a summer residence for defendant Kenneally and his family (Exhibits 106, 107 at 90), ISC's public filings, including its 1978 Form 10-K, describes Kilquade as "approximately 15,000 square feet of office space, support facilities and visitor accommodations ...." These filings and ISC's other reports fail to disclose that the only "office space [and] support facilities" located at Kilquade are defendant Kenneally's den/library and a desk, typewriter and telex machine in the basement which is used by defendant Kenneally's secretary when she accompanies him to Kilquade. See Exhibit 75.

115. ISC's public filings made with the Commission and disseminated to ISC's shareholders and the investing public have failed to adequately and accurately disclose, and defendants Kenneally and Frietsch have failed to cause ISC to adequately

and accurately disclose, the matters concerning Kilquade described above and have obscured the fact that defendant Kenneally was receiving additional benefits from ISC.

RECENT ACTIVITIES OF DEFENDANT ISC

115. On June 28, 1979, the Commission was informed, and confirmed the fact, that ISC was in the midst of massive shredding of corporate documents which had begun on or about June 14, 1979. Prior to June 14, 1979, ISC was aware of the imminency of the Commission's action and the Commission's intent to seek a receiver or agent of the Court for ISC who would be empowered, among other things, to review the foreign transactions referred to above, the use of ISC funds by the defendants herein and other officers and directors of ISC, and the sale or other disposition of ISC's assets since on or about January 1, 1978. On June 29, 1979, the Commission's staff requested the immediate production of all documents which ISC anticipated destroying as well as the logs of shredded documents. ISC agreed to turn over those materials to the extent it still had custody or control thereof.

117. The Commission is further advised that on or about June 18, 1979, ISC sold the principal assets of its BS&B subsidiary to another public corporation. The purchaser issued a release stating that it had purchased BS&B for "about $16 million in cash, notes and advances." The Commission has been advised by representatives of the purchaser of BS&B that the $16 million purchase price figure is composed of the following: $750,000 in cash (equal to the net worth reflected on a BS&B pro forma balance sheet), a note for $9 million payable over 10 years, issued by BS&B, Inc. (now a subsidiary of the purchaser) but which is not a general obligation of the purchaser, and an infusion into BS&B, Inc. of $6 million cash. The $750,000 in cash and the $9 million note were immediately



turned over to ISC's bank lenders. The stock and certain assets of BS&B were held as collateral by the bank lenders (see paragraphs 9-10 above) who released the collateral when they received the cash and note. The Commission staff also is informed that ISC presently is attempting to sell another subsidiary.

NEED FOR IMMEDIATE INJUNCTIVE RELIEF AND APPOINTMENT OF AN AGENT OF THE COURT AS PRAYED FOR BY THE COMMISSION

118. It appears to the Commission that the wrongful conduct of the defendants is so pervasive that it is imperative that action be taken immediately to determine the full extent of their unlawful activities and to prevent the disposition of, and to review the past disposition of, ISC's assets. For this reason, an agent of the Court should be appointed with instructions and powers to preserve the assets of ISC, to review all dispositions of ISC's assets during the period complained of, and to review the use of ISC's funds by the individual defendants and others, all as more fully prayed for in the Commission's motion for preliminary injunction and the Complaint herein.

/s/ Arthur M. Schwartzstein
Arthur M. Schwartzstein

Subscribed & Sworn
to before me this
9th day of July, 1979.

Notary Public

My commission expires:

UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

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| SECURITIES AND EXCHANGE COMMISSION,<br>500 North Capitol Street<br>Washington, DC 20549,<br><br>Plaintiff,<br><br>v.<br><br>INTERNATIONAL SYSTEMS & CONTROLS CORPORATION,<br>J. THOMAS KENNEALLY,<br>HERMAN M. PRIETSCH,<br>RAYMOND G. HOFKER,<br>ALBERT W. ANGULO, and<br>HARLAN M. STEIN,<br><br>Defendants. | : | CIVIL ACTION<br>NO. 79- |

SECURITIES AND EXCHANGE COMMISSION'S STATEMENT OF POINTS AND AUTHORITIES IN SUPPORT OF ITS MOTION FOR A PRELIMINARY INJUNCTION AND OTHER EQUITABLE RELIEF

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* Frederick W. Smolen, Staff Accountant, assisted in the preparation of this memorandum.



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## TABLE OF AUTHORITIES

*Cases or authorities chiefly relied upon are marked by asterisks.



UNITED STATES DISTRICT COURT
FOR THE
DISTRICT OF COLUMBIA

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| SECURITIES AND EXCHANGE COMMISSION, Plaintiff, v. INTERNATIONAL SYSTEMS & CONTROLS CORPORATION et al., Defendants. | Civil Action No. 79- |

SECURITIES AND EXCHANGE COMMISSION'S STATEMENT OF POINTS AND AUTHORITIES IN SUPPORT OF ITS MOTION FOR A PRELIMINARY INJUNCTION AND OTHER EQUITABLE RELIEF

## I. PRELIMINARY STATEMENT

Pursuant to Section 20(b) of the Securities Act of 1933, as amended ("Securities Act") [15 U.S.C. §77t(b)], Section 21(d) of the Securities Exchange Act of 1934, as amended ("Exchange Act") [15 U.S.C §78u(d)], and Rule 65 of the Federal Rules of Civil Procedure, Plaintiff Securities and Exchange Commission ("Commission") has moved this Court for a Preliminary Injunction and Other Equitable Relief against Defendant International Systems & Controls Corporation ("ISC"). The Commission submits this Statement of Points and Authorities and the accompanying Affidavit of Arthur M. Schwartzstein ("Aff.") in support of its Motion for a Preliminary Injunction and Appointment of a Special Agent of the Court.

## II. NEED FOR IMMEDIATE RELIEF AND APPOINTMENT OF A SPECIAL AGENT OF THE COURT

The Commission seeks preliminary relief against ongoing and further violations of the anti-fraud, reporting, and proxy provisions of the federal securities laws. ISC has failed, and is continuing to fail, to make or cause to be made adequate disclosure of: a) its true financial condition; b) the extent to which ISC has relied on illicit and other questionable foreign payments to obtain business and revenues; c) the risks its illicit and questionable foreign

payments present (i) to its ability to continue doing business abroad, (ii) to its ability to secure payment for work already performed and (iii) to its ability to collect $31 million of so called "unbilled receivables"; d) the questionable nature of those "unbilled receivables"; e) its inability to comply with the requests of certain foreign government-owned contracting authorities for accounting record support for certain of its claims for "unbilled receivables" and "escalation" costs; f) the extent of defendant J. Thomas Kenneally's */ personal interest and that of two of his associates in ISC's purported employee incentive program; g) the nature and extent to which ISC funds have been used to purchase, furnish and maintain a summer residence in Ireland for Kenneally and his family; h) the use and disposition of ISC's assets by and to its officers and directors; and i) other material matters.

The Commission also seeks the appointment, pursuant to the equity powers of this Court, of a Special Agent of the Court to, in effect, monitor the past and present activities of ISC pendente lite in order to preserve the assets, books and records of ISC, to review and inquire into the disposition of ISC's assets, to determine the true nature and circumstances of transactions involving expenditures of ISC's funds or assets for the benefit of its control persons, officers, directors and employees, to recover funds or assets and/or enforce any liability to ISC as a result of any improper or self-dealing transactions and to oversee ISC's filings with the Commission to assure compliance with the federal securities laws.

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*/ Kenneally, who owns or controls 42% of ISC's common stock, was, during the period relevant to the complaint until early 1979, the Chairman of ISC's Board of Directors and its Chief Executive Officer. After being made aware that the Commission intended to file an action against him, Kenneally resigned these positions but remains an ISC director. The remaining individual Defendants were at all times relevant to the complaint officers of ISC.

Although the Commission is not currently seeking preliminary relief against the individual Defendants, the Commission respectfully reserves its right to seek relief against any or all of the individual Defendants should it appear necessary.



Furthermore, such a Special Agent is necessary to insure the existence of ISC's corporate records. Beginning on or about June 14, 1979, ISC shredded its corporate documents at a rate of approximately 15 bags of shredded documents per day. The activity continued until on or about June 28, 1979, when the Commission learned of the shredding and protested about the existence of this activity to ISC through its counsel.

Furthermore, in the past year ISC has been engaged in a program of disposing of major subsidiaries in an apparent effort to satisfy its bank creditors and stave off bankruptcy. This program is being carried out in circumstances where the true financial condition of the company appears to be far worse than has been represented and by persons who cannot be relied on in due regard to the interests of a public company and its shareholders. In view of the true financial condition of the company, an independent person should be appointed to oversee these actions and report to the Court as to the appropriate course of action to be taken to safeguard the interests and property of the real owners of ISC - its stockholders.

## III. THE DEFENDANT ISC

Defendant ISC, is a Delaware corporation with its principal place of business in Houston, Texas. ISC purportedly has been engaged primarily in providing services and equipment in the fields of energy, agriculture, and forestry. Much of its activities have been conducted through subsidiaries operating in foreign countries, particularly in underdeveloped and developing nations. ISC's common stock is registered with the Commission pursuant to Section 12(b) of the Exchange Act and, until recently, traded on the American and Pacific stock exchanges. In November 1978, pursuant to Section 12 of the Exchange Act (15 U.S.C. 78l), the Commission suspended ISC's common stock from trading for a ten day period. Thereafter, trading of its stock did not resume on the American or Pacific exchanges.

Trading in ISC common stock is conducted in the United States in the over-the-counter market.

ISC is required to and has filed Annual Reports with the Commission on Form 10-K for its fiscal years ("FY") ending June 30. See generally 17 C.F.R. § 240.13a-1. ISC also is required to file with the Commission Quarterly Reports on Form 10-Q and Current Reports on Form 8-K. See generally 17 C.F.R. §§ 240.13a-11 and 13a-13. In addition, ISC has filed with the Commission and distributed to its shareholders proxy soliciting materials. See generally 17 C.F.R. § 240.14a-101.

In its Annual Reports, ISC originally reported growth in earnings and revenues for FY 1973 through FY 1976 - from $2.9 million on revenues of $178 million in FY 1973 to earnings of $8.4 million on revenues of $339 million for FY 1976. However, in its fiscal year 1977, ISC began to report substantial and increasing losses: $9.9 million on revenues of $283 million. In FY 1978 ISC reported losses of $43 million on revenues of $276 million. Moreover, its 1978 Form 10-K also reported a deficit in stockholders' equity of $5.3 million. Furthermore, ISC's auditors, Arthur Andersen & Co., were unable to, and did not, express an opinion on the fairness of ISC's financial statements contained in the 1978 Form 10-K. Aff. Ex. 56 at F-2.

## IV. ISC FAILED TO ADEQUATELY AND TIMELY DISCLOSE ITS ILLICIT AND QUESTIONABLE FOREIGN PAYMENTS IN REPORTS FILED WITH THE COMMISSION */

Since at least 1970, during a period of time in which ISC was engaged in making tens of millions of dollars of illicit and questionable payments affecting hundreds of million of dollars of contracts, ISC made no disclosure of any of these payments. Only

*/ For purposes of this motion, the Commission's discussion will focus on the false and misleading nature of ISC's Current Report filed on Form 8-K in April 1978, its 1978 Annual Report on Form 10-K filed in December 1978 and ISC's most recent proxy solicitation materials. As alleged in its complaint, the Commission contends and will prove at a trial on its claim for permanent injunctive relief that previous Annual, Quarterly and Current Reports, filed by ISC during the period 1970 to date, contained false and misleading information and omitted material facts.



after the Commission initiated an investigation, ISC in its 1976 Annual Report on Form 10-K, began reporting to the Commission and the investing public that it was conducting an internal investigation into slush funds, illegal political contributions and improper or questionable foreign payments. ISC reported that the investigation was being conducted through a "special committee of outside directors" with the assistance of special outside counsel and the company's independent auditors. E.g. Aff. Ex. 109, 1976 Form 10-K at 9. ISC further reported that the investigation was "intended to result in a written report and the disclosure of matters which might be determined to be material to the Company's business." Id. The 1976 Form 10-K reported generally that approximately $400,000 of payments to foreign government officials in connection with contracts valued at $8 million had been uncovered. Id. As demonstrated by the Schwartzstein Affidavit and its exhibits, the payments made were in the tens of millions of dollars and the contracts secured were valued in the hundreds of millions of dollars. The actual payments, which ISC and the individual Defendants herein were aware of, were far larger and far more significant to the amount of business ISC received than was disclosed in its filings.

By the fall of 1977, when ISC filed its 1977 Form 10-K, it had yet to make material disclosures resulting from its internal investigation; however, the Commission and the public were assured that "the investigation is in its final stages and it is anticipated that it will be completed in the near future." Aff. Ex. 81, 1977 Form 10-K at 8-9.

In April 1978, ISC filed a "Current Report" on Form 8-K for March, 1978 ("March 8-K"). Aff. Ex. 108. The March 8-K stated that ISC's special outside counsel, Watson, Ess, Marshall & Enggas ("Watson, Ess"), had submitted a report to ISC's special committee. ISC claimed that this was a "draft report" which was "tentative in nature and is incomplete." However, the March 8-K did report that the "Draft

Report" referred to $7.6 million in commitments, of which $5.8 million had been paid to or for officials of foreign governmental agencies; $19 million in commitments, of which $11.4 million had been paid to agents which possibly benefitted government officials or "government connected persons"; $2.7 million in commitments, of which $2.2 million had been paid to agents and involved questions of conflicts of interest or other improprieties; and $.6 million of other questionable payments. */

The March 8-K made only a vague, generic disclosure of these payments. E.g.:

> 1. In 1972 and 1973, a total of $310,470 was paid by check to a corporate agent, a company incorporated under the laws of a foreign country, half the stock of which was owned by an official of that foreign country. Some of the payments were made under a contract for services, but the Draft Report concludes that it appears that no services were performed by the agent on the project involved. Several of the checks issued for payments to the agent company were sent to the official and two of the checks were endorsed by him.

Aff. Ex. 108, March 8-K at 8. The March 8-K also disclosed that the Draft Report stated that certain ISC executives and officials knew of and in instances authorized the payments and that the Draft Report "directly questions the crediblity of certain individuals including a senior employee (who is not a corporate officer);" however, the March 8-K did not identify the individuals. The failure to identify the countries in which the transaction occurred, the timing of the payments, their relationship to the business

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*/ The March 8-K stated (page 1) that the committee of "outside directors" heading the invesigation consisted of directors Austin Wilson and Robert F. Medina and that:

> Mr. Wilson is a senior partner of the law firm of Wilson & Guest, which has received $430,000 in fees for legal services over the period covered by the investigation.
>
> Dr. Medina, [sic] is a principal in the management consultant firm of Medina & Thompson, which has received $604,000 in consulting fees for services over the period covered by the investigation. Wilson & Guest and Medina & Thompson have also been paid or have accured $141,000 and $61,000 respectively, as compensation for time devoted by Messrs. Wilson and Medina to the investigation. Aff. Ex. 108 at 2.

These disclosures were omitted in all ISC's Form 10-K's. In 1979, Medina became ISC's Chairman of the Board.



ISC was able to obtain and the identity of the corporate officers who were involved and whose credibility was challenged constitutes a failure to disclose material facts. See Berman v. Gerber Products Co., 454 F. Supp. 1310, 1323 (W. D. Mich. 1978).

With regard to the effect of the payments on ISC's business and operations, the March 8-K concluded:

> To date, no adverse effect of any of these transactions or payments, many of which are known to the related client and governments has occurred. The future effect, if any, of the transactions, payments, and restricted Company policies is subject to many political and economic factors which are not susceptible to determination.

To date, ISC has not publicly revised this statement. Furthermore, as demonstrated by the Schwartzstein Affidavit, the governments of Iran, Algeria and Saudi Arabia were not in significant instances timely aware of the payments complained of herein and Algerian officials were assured orally and by affidavit that third persons, intermediaries and agents had not been employed in connection with the securing of business in that nation.

By December 22, 1978, when ISC filed its 1978 Form 10-K, and to the present, the "Draft Report" was never "finalized." The 1978 Form 10-K does not even contain the vague, generic disclosures contained in the March 8-K.

Thus, although the Commission and the investing public were told in 1976 that the internal investigation into ISC's improper and questionable foreign payments was being conducted, and were told in 1977 that the investigation was near completion, the written report and material disclosures have never been issued nor has ISC's board of directors offered any explanation for its failure, almost 18 months after it received the Watson, Ess report, to finalize that report and disseminate a definitive document to its stockholders.

Moreover, although ISC has been reporting to the public that "[t]he Company has cooperated with the [Commission] staff in its investigation and has furnished records as requested by the staff" (Aff. Ex. 56 at 12), ISC has withheld records and documents, including

auditors' workpapers, requested by the Commission's staff, citing attorney-client privilege. Furthermore, the individual defendants, all senior members of ISC management during the questioned period, refused to testify before the Commission, during its investigation of these matters, citing their Fifth Amendment privilege. */

However, the Commission's investigation to date, portions of which are detailed in the accompanying affidavit and summarized below, clearly establishes a prima facie showing that ISC is engaged and is about to engage in violations of the federal securities laws, warranting a preliminary injunction and other equitable relief. Unless preliminary relief is granted and an agent of the Court appointed to perform certain tasks as prayed for by the Commission, ISC's shareholders, the investing public and its creditors will not be in a fully informed position regarding its past and present activities, the related party transactions involving its assets, or the impact of those events on the viability of the enterprise, and will not be able to assess the future financial condition and operations of the company with the type of informed judgment contemplated by the federal securities laws.

## V. "UNBILLED RECEIVABLES" AND ILLICIT AND QUESTIONABLE FOREIGN PAYMENTS

As will be shown below, the Commission's investigation has revealed, among other things, that ISC's financial statements include as assets "unbilled receivables" **/ in contradiction of ISC's

*/ The Commission reserves its right to ask the Court to draw an appropriate adverse inference from any Defendants' refusal to testify. See, e.g., Baxter v Palmigiano, 425 U.S. 308 at 318 (1976).

**/ ISC defines "unbilled receivables" as follows:

> "Long term contracts generally provide for customer payments on a predetermined basis which may precede or lag behind revenues earned to date under contractual provision. The amount by which revenues are earned in advance of contractual payment dates is an 'Unbilled Receivable' and the amount by which contractual billings precede earned revenues is unrealized revenue carried as 'advances under contract'. No amounts are included in unbilled receivables unless management is of the opinion that such amounts will be realized." 1978 Form 10-K at F-13, Aff. Ex. 56 at F-13.



own stated accounting practices; a significant portion of the "unbilled receivables" and so-called "escalation" payment claims are fictitious and included in claimed costs are reimbursement for illicit and questionable payments. ISC also solicited inflated bills from certain suppliers who rebated and kicked-back monies to ISC. Further, realization of the approximately $31 million of accounts and "unbilled receivables" is jeopordized by ISC's approximately $23 million of foreign illicit and other questionable payments which cast long shadows over the integrity of ISC's management. **/

ISC's balance sheet in its 1978 Form 10-K financial statements (on which, as noted above, its independent auditors were unable to express an opinion) shows a stockholders' equity deficit of $5.3 million. However, ISC is including as assets in the balance sheet approximately $31 million in accounts and "unbilled receivables." Thus, the stockholders' equity deficit may be even greater than reported.

Of the $31 million, ISC states that $28 million represents "unbilled receivables" relating to "Claims Under Contractual Provision and Customer Requests or Acknowledgements" for additions to contract values or billings with respect to adjustments caused by such items as "force majeure events, abnormal escalation and unforeseen delays which may not be sufficiently anticipated under contract provisions." Aff. Ex. 56 at F-13, 14.

ISC has attributed $11,700,000 of its "unbilled receivables to contracts in Iran, $14,624,000 to contracts in Algeria and $7,820,000 contracts in Saudi Arabia. Examination of ISC's illicit and questionable payments in these countries immediately demonstrates that

**/ The failure to disclose matters relating to the integrity of management is, of itself, the omission of material facts. See, S.E.C. v. Falstaff Brewing Corp., CCH Fed. Sec. L. Rep. ¶ 96, 583 (D.D.C. 1978), appeal pending; S.E.C. v. Jos. Schlitz Brewing Co., 452 F. Supp. 824 (E.D. Wisc. 1978); S.E.C. v. Kalvex, Inc., 425 F. Supp. 310 (S.D.N.Y. 1976).

ISC may never realize these "unbilled receivables" - particularly if these foreign countries become aware of the types of activites which surrounded the awarding of contracts to ISC.

The accompanying Schwartzstein Affidavit details these payments, the true nature of certain of the "unbilled receivables" and the material risks to their realization. These will be summarized briefly here.

a. Iran

ISC's wholly-owned Canadian subsidiary, Stadler Hurter Ltd. ("SHL") received contracts from an Iranian government agency, the Iranian Development and Renovation Organization ("IDRO"), and its subsidiary Technolog, Inc. ("Technolog"), for the design, supply, and installation of two pulp and paper complexes. Technolog was IDRO's consultant for the award and performance of the contracts. The first complex, located in the Iranian province of Gilan near the city of Rasht (the "Gilan" or "Rasht" project) was contracted for in 1973. The second complex, located in the Iranian province of Mazandaran near the city of Sari (the "Mazandaran" or Sari" project) was contracted for in 1974. Aff. ¶¶ 16, 21, 30, 43.

In order to obtain the Gilan and Mazandaran projects, ISC/SHL committed to make $22.3 million in payments to various highranking Iranian government officials and "agents" including Prince Abdorreza, then a member of the Iranian Royal family; F. Sid Askari, who was first managing director and then president of Technolog; */ and various other persons in the Ministry of Finance and the Ministry of Agriculture

*/ Another wholly-owned ISC subsidiary, Lang Engineering Corporation ("Lang") had sought a contract for a project from the Iranian port authority which had contracted with Technolog to be its consultant for the study of the project and the preparation of tender offers. Lang issued a $650,000 Swiss letter of credit to Askari, then Technolog's managing director, payable if Technolog remained the consultant to the Iranian authority for the award of the contract and if Lang and its Iranian associate received the contract. When at the last minute, Lang decided not to pursue the project, Askari, claimed pressure from others and sought a "loss of opportunity" commission. For fear that otherwise SHL would not get the Gilan project ISC paid him $250,000. ISC/SHL may have obtained the funds for this payment through the reimbursable portion of the Gilan contract. Aff. ¶¶ 17-20.



and Natural Resources who were in positions to influence the award of the Gilan and Mazandaran projects. Most of the payments were made through ISC's "agent" in Iran, Shamsedin Golestaneh. The commitments on Gilan totaled $8.2 million of which, as of June 16, 1977, $5.8 million had been paid. The commitments on Mazandaran were $14.1 million of which, as of June 16, 1977, $5.5 million had been paid. Payments on these commitments were made to various numbered bank accounts in Switzerland, Lichtenstein and France. **/ Aff. ¶¶ 22-44.

Furthermore, in order to obtain the Gilan contract, ISC/SHL had to reduce its contract bid price by $3 million. After they were awarded the contract, ISC/SHL immediately set about trying to recoup the $3 million as well as increase the profit margin on the contract. An agreement was reached among ISC/SHL, Golestaneh and Askari that ISC/SHL would submit a claim for "cost escalation" increases and include within this claim the $3 million and an additional amount for "real escalation." However, by March 7, 1975, before ISC/SHL realized its escalation claim, Askari was asked to resign as president of Technolog. Concurrent with the resignation, it was made known that the Shah of Iran had ordered an investigation into possible illegal payments on Gilan. Aff. ¶¶ 45-47.

The new president of Technolog, Dr. Motazed, requested affidavits from Stadler Hurter as to its use of agents in Iran. SHL ignored repeated requests to execute such affidavits. Moreover, when Dr. Motazed requested to review SHL records in order to evaluate the escalation claims, SHL refused to grant Technolog access to its books and insisted that the validity of the escalation claims should be determined on the basis of formulae and indices rather than on actual

**/ Some of the agency payments were made to Emeg. S.A., a Swiss Corporation, and deposited in Askari's Swiss bank account. Max Zeier, the head of SHL's Swiss subsidiary, Stadler Hurter Zurich, A.G. was also an official of Emeg. Zeier, at defendant Stein's instructions, "negotiated a termination agreement with Emeg of behalf of Stadler Hurter." ISC disclosed in its 1978 Form 10-K that it had sold Stadler Hurter Zurich, A.G. to several persons but failed to disclose that the purchasers included Zeier. Aff. ¶ 58.

increased costs. The reason for such refusal is apparent: an examination of SHL's books by the Iranians could have revealed that SHL had included its illicit and questionable payments in the contract as equipment costs; that SHL had caused its Canadian suppliers to mark up their invoices for submission to the Iranians and to kick-back the mark up to SHL; that the freight forwarder for the contract was giving SHL "rebates" and that SHL was including amounts in its "escalation claim" for recoupment of the reduction in its bid price to meet the competition. Aff. ¶¶ 48-57.

When Dr. Motazed continued to insist on a detailed analysis of the equipment and services costs before he would authorize escalation payments to SHL, Defendants Frietsch and Stein wrote on or about August 22, 1977, that (emphasis added):

> The foreign cost element in the DPR [Detailed Project Report] was $82,493,000. This total as shown in Schedule I was built up from $66,514,000 for costs related to equipment and $15,979,000 for costs related to services.
>
> It is standard industry practice that both of these total equipment and services amounts include sub-categories of the costs that are usually associated with the contractor's activities and obligations in supplying the equipment items and engineering outputs specified in the contract. Therefore, the total amounts include provisions for overhead and profit, marketing and promotional expenses, financing fees, contingencies, etc. ....

This letter as well as others discussed in the Schwartzstein affidavit place were written to obscure the illicit and questionable payments from Iranian officials scrutiny. Aff. ¶¶ 52-55. Accordingly, Mr. Motazed was not informed that the "costs" on which escalation was claimed included: illicit and other questionable payments made by ISC/SHL to obtain the contracts; additional payments already committed by ISC for still more payments upon recovery of its "escalation claim"; or that the reimbursable costs were not reduced by the kickbacks and rebates ISC received from its suppliers.

ISC's 1978 Form 10-K (Aff. Ex. 56 at F-14), reports that ISC/SHL had entered into an agreement with IDRO for the settlement of escalation



claims on one of the Iranian projects (Gilan) in the amount of $8.2 million but that payment had not yet been received. (An additional claim of $3.5 million "unbilled receivables" remained open). The report states that this $8.2 million was being carried on ISC's balance sheet as "unbilled receivables". ISC's Form 10-K states further that the realization of these unbilled receivables is subject to:

> IDRO obtaining customary approvals of governmental authorities in Iran and the appropriation of funds to meet the payment obligation. .... [H]owever, the current political situation in Iran could adversely affect or significantly delay the ultimate realization of this settlement although there have been no formal indications to this effect.

Aff. Ex. 56 at 7 and F-15.

ISC's 1978 Form 10-K does not disclose that its claim for "cost escalation" was not for legitimate escalated costs but in reality represents an attempt by ISC to recoup the $3 million by which it had to cut its contract bid to meet the competition, $2.5 million in commitments for bribes and/or commission payments in part for obtaining the false escalation claim and in part to pay illegal payments and/or commission's on a canceled agreement, and the balance for so-called "real escalation" which legitimacy, in the light of all other ISC practices including rebates, kickbacks, and illegal payments, appears highly doubtful. See Aff. ¶¶ 45-46. Furthermore, the 1978 Form 10-K does not report that SHL's business in Iran, including both the Gilan and Mazandaran projects, and its attempts to obtain additional revenues with regard thereto, were and are dependent upon ISC's making illicit and other questionable payments which it has concealed from the Iranian government.

b. Algeria

ISC's 1978 Form 10-K discloses that it is carrying as assets $14.6 million in "accounts and unbilled receivables" relating to "claims under contractual provisions and customer requests or acknowledgements" for three contracts in Algeria. The Form 10-K does not disclose that certain of these assets are being carried in contradiction of ISC's stated accounting principles or that

ISC's auditors have expressed an adverse opinion on the financial statement of the subsidiary to which the asset is attributed; and that its auditors have questioned whether the subsidiary, whose contracts in Algeria represent a major portion of ISC's revenues, violated the English Companies Act and the United States Foreign Corrupt Practices Act. Aff. ¶¶ 80-81. The Form 10-K also discloses the sale of $12 million in similar assets during its fiscal year 1978, most of which relate to a project in Algeria, but it does not disclose that these assets were sold for an amount substantially less than appeared on ISC's financial statements due, in part, to a determination that a substantial percentage of the "unbilled receivables" were uncollectible. Aff. ¶ 83.

ISC's wholly-owned United Kingdom subsidiary, Pritchard-Rhodes, Limited ("PRL") has had three fixed price contracts with the Algerian government agency, Sonatrach, for the design, engineering and construction of liquified natural gas facilities ("LNG"). The three contracts were referred to as: the "GTP" contract; the "Skikda 4" (or "Skikda 40") contract; and the "Skikda 5/6" (or "Skikda 50/60") contract. The GTP and Skikda 4 contracts were executed in 1971. The Skikda 5/6 contracts was executed in 1973. In February 1975, ISC's wholly-owned Delaware subsidiary, Pritchard International Corporation ("PIC") received a contract from Sonatrach for the completion of a gas treatment module in the Hassi R'Mel field (the "Hassi R'Mel" contract). */ Portions of the Hassi R'Mel contract were fixed-price; others were on a cost reimbursable ceiling price basis. Aff. ¶ 61.

By late 1974 - early 1975, PRL had completed the GTP contract. PRL had "cost overruns" on this project of approximately $3 million and was experiencing cost overruns on the Skikda projects as well.

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*/ PIC was a wholly-owned subsidiary of ISC's wholly-owned Delaware subsidiary J.F. Pritchard & Company ("JFP"). The Hassi R'Mel contract became associated with JFP as well as PIC. References to JFP will include PIC.



In 1975, PRL entered into negotiations with Sonatrach seeking additional reimbursement for these projects. However, Sonatrach repeatedly excluded the GTP "cost overruns" from the discussions and refused to agree to any further compensation on the claim. At the end of the 1975 negotiations, ISC was forced to withdraw its claim on GTP. However, rather than show a loss on its financial statements, ISC transferred the GTP "cost overruns" from the PRL books in England to the PIC/JFP books in the United States as part of the costs on the Hassi R'Mel project. The GTP costs were included in the fixed-price portion of the contract, although no adjustment was made to the price to include the GTP costs. Aff. ¶¶ 77-79. Nevertheless, ISC stated in its 1976 Form 10-K, for its fiscal year ended June 30, 1976, at 4 (Aff. Ex. 109 at 4) (emphasis added), and in its subsequent Form 10-K's:

> The Company [ISC] accounts for revenues from long-term contracts, which would include fixed-price contracts, on the percentage of completion method, which recognizes income over the life of the contract rather than irregularly as contracts are completed and ultimate costs determined. ....The percentage of completion method requires that the entire amount of any ultimately projected individual contract losses be recognized when known. (emphasis supplied)

Aff. ¶¶ 77-79 and Aff. Ex. 56 at 6.

In late 1976 Sonatrach replaced JFP on construction of Hassi R'Mel and replaced PRL on Skikda 5 and 6. PRL was, however to complete Skikda 4. Because of the change in scope of JFP's work, the fixed-price portion of the Hassi R'Mel contract was changed to a reimbursable basis. Sonatrach refused to recognize any GTP costs as being reimbursable on this contract and the costs associated with the GTP loss were transferred back to PRL. Aff. ¶ 79.

ISC's 1978 Form 10-K discloses that ISC is carrying the $3.5 million of GTP cost overruns as "unbilled receivables" "on the basis of understandings from meetings with representatives of the client that the final contract price would be renegotiated in connection with the final settlement of matters relating to other work in progress." Aff. Ex. 56 at F-15. However, ISC's auditors have

found no reliable evidence that Sonatrach intends to pay anything more on GTP. Aff. ¶¶ 80-82.

At the time PRL was terminated in 1978, it was agreed that PRL would be reimbursed for its costs to that point on the Skikda 5/6 contracts. PRL has yet to prepare an analysis of its costs for presentation to Sonatrach. Aff. ¶ 81. Nevertheless, ISC's 1978 Form 10-K (Aff. Ex. 56 at F-16) shows $14.6 million in assets, accounts and "unbilled receivables" for the Skikda projects and GTP. Although the 1978 Form 10-K also discloses (at F-15) that ISC may face penalties of up to $8 million on Skikda 4 it also states that "no penalties are expected to be included in the final settlement of contract amounts." However, PRL's auditors in London issued an adverse opinion stating that PRL's financial statements "do not present fairly its position as of 30th June, 1978 or the results of its operations for the year ended, in conformity with generally accepted accounting principles" */ and detailed the amount of "penalties" ISC could face in Algeria. Aff. Ex. 85. In fiscal year 1978, ISC sold substantially all the assets of JFP. These assets included $7.9 in "unbilled receivables" for Hassi R'Mel, ISC had been carrying in its financial statements as assets. ISC agreed with the purchaser that these "unbilled receivables" were in reality worth only $2.9 million. This agreed upon reduced value of the "unbilled receivables" was used to determine the purchase price. The 1978 Form 10-K is false and misleading in the manner in which it described this transaction. Aff. ¶ 83.

ISC has failed to disclose the risks to its recovery of any of the "unbilled receivables" or its avoidance of penalties due to its concealment from the Algerians of payments to Munib Masri. ISC has paid Masri commissions in excess of $3 million on the GTP,

*/ The London auditors also reported to ISC's Houston office that PRL's books violated the English Companies Act and the Foreign Corrupt Practices Act.



Hassi R'Mel and Skikda projects. ISC has failed to disclose that it made these payments, that it did so even though it had been warned by Sonatrach that if ISC used Masri it would risk loss of all its business in Algeria; that PRL and PIC were required to and did execute affidavits to Sonatrach as to their use of agents in Algeria which omitted reference to Masri for fear that disclosure of the payments would result in Sonatrach terminating ISC's work in Algeria; and that PRL and JFP adjusted and revised project cost reports to conceal the payments. Aff. ¶¶ 62-76. */

Saudi Arabia

ISC's financial statements in its 1978 Form 10-K show $7.8 million in accounts and "unbilled receivables" for "claims under contractual provisions and customer requests or acknowledgments" relating to ISC's contracts in Saudi Arabia. The underlying contracts were between ISC's wholly-owned New Jersey subsidiary, Sanderson & Porter, Inc. ("S&P") and a Saudi Arabian government agency, the Saline Water Conversion Corporation ("SWCC"). Pursuant to contracts, S&P was to provide engineering and construction services to SWCC for three desalination power generation plants known as Al Khafji, Al Jobail I and Al Jobail II. Aff. ¶¶ 86,87,91 and Aff. Ex. 56 at F-16.

ISC's public filings have failed to disclose, however, that in order to obtain those contracts, ISC, through S&P, committed to pay millions of dollars to the then Vice-Governor of SWCC, Adnam Samman, or to persons whom or entities which he designated. In fact, cash payments amounting to at least $1.5 million were left for Samman at his home. These payments were made through ARA, a company owned by Samman's father-in-law, Abdul Rahman Arnaout, who for a fee of $10,000 executed invoices and receipts and a contract for consulting

*/ ISC's subsidiary Verkor also contracted with an agent, Hubert Renault, for services which provided for the payment of "secret commissions" on projects in Algeria. ISC concealed this arrangement from the Algerian Government and provided Algerian officials with an affidavit that no agents were being used by Verkor in Algeria. Aff. ¶ 84.

services. These documents had been prepared for him by ISC/S&P. Aff. ¶¶ 88-98.

ISC has failed to disclose these payments or the risks which disclosure of the payments could have on the recovery of the accounts and "unbilled receivables" because of Saudi law, including the risk that ISC's contract could be voided, its name stricken from the roll of companies able to conduct business in Saudi Arabia and the possiblity of its being prosecuted in Saudi Arabia. Aff. ¶ 95. Furthermore, the nondisclosures mislead an investor into believing that ISC's financial growth was due to an ability to compete on the basis of the price and quality of its services.

d. Other Payments

In addition to the payments described above, ISC made millions of dollars in illicit and questionable payments and engaged in questionable and illicit transactions, in other countries including Chile, Nicaragua, Iraq and the Ivory Coast. */

VI. THE DEFERRED COMPENSATION CORPORATION

ISC's employee incentive program as disclosed in ISC's Annual Reports for 1978 on Form 10-K, as well as its recent Form 10-K's and proxy materials, consists of a "Deferred Compensation Plan" (the "Plan"), a Deferred Compensation Corporation ("DCC") whose primary assets are ISC common stock, and a Deferred Compensation Trust" ("DCT"). Pursuant to the Plan as described in ISC's filings, the DCC has outstanding common shares and cumulative preferred shares with a liquidation preference. Aff. ¶ 100 and Aff. Ex. 56 at 31-34.

The common shares of DCC are purportedly given to provide "equity incentives" to "selected officers, directors and key personnel of" ISC and its subsidiaries who "are given the opportunity to purchase

*/ See, also, Aff. Ex. 129, regarding ISC's attempts to obtain a contract from the Chilean government. That Exhibit is an ISC study of the Chilean government and who in the government should be approached. It also explains that ISC should have the persons to whom payments are to be made establish a company to receive and disguise the payments.



common stock of DCC ...." Aff. Ex. 56 at 31. DCC's preferred shares are supposed to provide "officers and key personnel" of ISC and its subsidiaries with "death and retirement benefits." Id. The shares are "allocated" by the DCT to such officers and key personnel and "vest" over a period of time. However, there exists a second class of DCC preferred which was issued as a dividend on DCC common stock in 1968, which is not within the Plan and which vested immediately. Aff. ¶¶ 100-02.

ISC funds the Plan through "contributions" made, or caused to be made, to the DCT, which then uses the funds to purchase preferred shares from DCC for "allocation." From August, 1965, through June, 1977, the contributions were $158,000 per year; for ISC's fiscal year 1978 the "contributions" equalled $118,500. Aff. Ex. 56 at 34.

In addition to the "contributions", ISC has supported DCC through purchases of ISC stock from the DCC at prices above the market. In instances where ISC common stock fell below DCC's cost, ISC caused its subsidiaries to purchase ISC common shares from the DCC at DCC's cost. The subsidiaries then sold these shares to their employees at the market price, suffering the loss. Aff. ¶ 101.

The Form 10-K discloses that there are 887 shares of common stock held by 13 individual participants in the Plan and "37,185 shares of DCC preferred stock outstanding of which 9,435 are owned by 11 participants, or former participants, in the Plan (as a result of the dividends), 3,769 have been allocated to 19 present participants in the Plan, and 23,981 are held by the Trust for further allocation." Aff. Ex. 56 at 34. The Form 10-K does not disclose, however, that there are only three substantial beneficiaries of DCC: Defendant Kenneally, and two of his associates, Alfred M. Lerner, and W.L. Ross II, */ who together, own approximately 73% of DCC's outstanding common stock and approximately 72% of DCC's preferred shares not presently

*/ For a discussion of Lerner and Ross' participation in DCC and the non-disclosed benefits which they, and defendant Kenneally received from DCC, See Aff. ¶¶ 102-09.

being held by the DCT for possible future allocation. All but 6% of the preferred shares held by defendant Kenneally and his associates were received in the 1968 dividend and not through allocations under the Plan. Thus, these were all "vested" shares which entitled Kenneally, Lerner and Ross to immediate benefits. Aff. ¶ 102.

a. Kenneally's Dealings with DCC

ISC's 1978 Form 10-K discloses that Kenneally owns 400 shares (45%) of DCC's common stock and was allocated 950 shares of preferred stock. Aff. Ex. 56 at 28, n.1. According to the Form 10-K the maximum benefit to Kenneally from those shares under the Plan as described, (Id. at 31 n.2-3), will be $19,085 for each of the years 1991 through 2000. The Form 10-K, however, fails to disclose that Kenneally also received 3000 vested preferred shares not under the Plan which he acquired in the 1968 dividend and fails to disclose what benefit he has or may receive from their sale. Aff. Ex. 56 at 28n.1, 31 n.2-3

The 1978 Form 10-K discloses that in 1976, "in a privately negotiated transaction," DCC purchase 12,500 shares of ISC common stock from Kenneally at $30 per share. The Form 10-K fails to disclose that the transaction occurred at a time, at a price and at a number of shares determined by Kenneally. DCC paid cash for these shares Aff. ¶ 108. The Form 10-K also fails to disclose that by selling his shares to DCC, Kenneally was able to acquire cash for his shares and still lose no control over ISC and retain a large percentage of the value of his shares by virtue of his interest in DCC. Kenneally made the transaction at a time when, as ISC's Chairman of the Board and Chief Executive Officer, it should have been evident to him that ISC's recovery of paper assets was questionable as described above.

b. The Need for Preliminary Relief to Freeze the Assets of DCC

Thus, undisclosed to ISC shareholders, ISC's employee incentive plan essentially benefits substantially only defendant Kenneally and two of his associates. If DCC is liquidated, its assets will principally be distributed to them. The Commission seeks to invoke this Court's



equitable power to to issue an order freezing assets, (See, e.g., S.E.C. v. General Refractories Co., 400 F.Supp. 1248 (D.D.C., 1975)) to ensure that these assets cannot be distributed until the issue of whether defendant Kenneally and his two associates are entitled to these undisclosed benefits can be litigated at the trial in this action.

VII. KILQUADE

ISC's 1978 Form 10-K states that the

> Company owns a facility in Dublin, Ireland, containing approximately 15,000 square feet of space, support facilities and visitor accomodations, which is used in connection with the planning, coordination and administration of the Company's operations outside the United States.

Aff. Ex. 56 at 18. That disclosure fails to state, however, that the "facility", located in Kilquade near Dublin, Ireland (Kilquade") consists of a house situated on 85 acres of farmland; that its principal use has been as a summer residence for Kenneally; that ISC has expended in excess of one million dollars in corporate funds to purchase, furnish and maintain Kilquade; that title to the residence is in Kenneally's name; and that ISC disbursements on Kilquade were at least $243,000 in one year. The disclosure also fails to state that the only office space at Kilquade is Kenneally's den/library and a desk, typewriter and telex machine in the basement which were used by Kenneally's secretary when she accompanied him to Kilquade; and that ISC funds are used to transport Kenneally and his secretary to and from Kilquade. Aff. ¶¶ 110, 111 and 114.

It was also not disclosed that Kilquade was "used in connection with the planning, coordination and administrating the Company's operations outside the United States" only to the extent that Kenneally had visitors at Kilquade while he was there. Aff. ¶¶ 114.

ISC's Form 10-K also fails to disclose that certain expenses for Kilquade have been paid through an ISC United Kingdom subsidiary, International Systems & Controls Corporation (Europe) Limited ("ISC Europe") and booked as "consulting fees". ISC Europe added 3% to

the expenses it paid and billed ISC in Houston. The Houston Office then mails an inter-company transfer crediting ISC Europe and records the transactions on its books as "consulting fees" in a "selling, engineering, and administration account". Aff. ¶ 113. ISC's recording of these payments as "consulting fees", after the enactment of the Foreign Corrupt Practices Act, violates Sections 13(b)(2) of the Exchange Act [15 U.S.C. 78m(b)(2)].

Finally, the Form 10-K fails to disclose that ISC established a European bank account for which the authorized signatories were Kenneally's wife and a Houston-based decorator. Aff. ¶112.

## VIII. ARGUMENT

### POINT I

### ISC'S FALSE AND MISLEADING STATEMENTS AND OMISSIONS OF MATERIAL FACTS ARE PRIMA FACIE VIOLATIONS OF THE FEDERAL SECURITIES LAWS WARRANTING PRELIMINARY RELIEF

As shown above, Defendant ISC has failed, and is continuing to fail, to make adequate disclosure of, among other things: a) its true financial condition; b) the extent to which it has relied on illicit and other questionable payments to obtain business and revenues; c) the risks which its illicit and other questionable payments place on ISC's ability to realize its "unbilled receivables" or ISC's ability to continue doing business in certain foreign nations; d) its employee incentive program substantially benefitting only defendant Kenneally and two of his associates; and e) the extent to which corporate funds have been and are being used to purchase, furnish, improve and maintain a summer residence for Defendant Kenneally and his family. As discussed below, ISC's failures to disclose these activities complained of are prima facie violations of the federal securities laws and the Court should order a preliminary injunction and other equitable relief against ISC. See, e.g., SEC v. Jos. Schlitz Brewing Co., supra, and S.E.C. v. Kalvex, supra.

The proper standard for determining whether preliminary relief should be granted is whether the Commission has made a prima facie



showing that the defendants are engaged or are about to engage in violations of the provisions of the Federal securities laws. S.E.C. v. Management Dynamics, Inc., 515 F.2d 801 (2d Cir., 1975), S.E.C. v. Falstaff Brewing Corp., CCH Fed. Sec. L. Rep. ¶96,117 p. 92,020 (D.D.C., 1977, Corcoran, J.), S.E.C. v. General Refractories Co., supra, 400 F.Supp. at 1254; S.E.C. v. Paro [Current] CCH Fed. Sec. L. Rep. ¶96,816 at p. 95,245 (N.D.N.Y. 1979).

Because the Commission is authorized by statute (Exchange Act, Section 21(d); Securities Act, Section 20(b)) to seek injunctions in the public interest, issuance is not limited by the more narrow constraints which private parties must satisfy to obtain similar relief. The Commission need not show irreparable injury or a balance of equities favoring an injunction, as would a private plaintiff in an action grounded wholely in equity. Management Dynamics, Inc., supra. As stated in Management Dynamics, 515 F.2d at 808,

> [T]he SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws. Hence, by making the showing required by statute that the defendant "is engaged or about to engage" in illegal acts, the Commission is seeking to protect the public interest, and "the standards of the public interest not the requirements of private litigation measure the propriety and need for injunctive relief."

Affidavits, sworn investigative testimony and documents are admissible to support a showing at a preliminary injunctive hearing. F.R.Civ.P. Rule 65(a), S.E.C. v. Falstaff Brewing Corp., supra, at p. 92,021; S.E.C. v. General Refractories, supra at 1256. Moreover, a showing that defendants are about to engage in violations can be inferred from past violative conduct. S.E.C. v. Manor Nursing Centers, Inc. 458 F.2d 1082 (2d Cir. 1972).

The Commission here has made the required prima facie showing to warrant issuance of a preliminary injunction restraining further violations of the reporting provisions. (Exchange Act Section 13(a) and Rules 13a-1, 13a-11, 13a-13, and 12b-20), the proxy provisions (Exchange Act Section 14(a) and Rules 14a-3 and 14a-9) and the anti-fraud provisions (Securities Act Section 17(a), Exchange Act, Section

10b(5) and Rule 10b-5). The Commission has made this showing with regard to ISC's most recent filings: its 1978 Form 10-K (filed in December 1978) and its 1977 proxy materials. At trial on its claim for permanent injunctive relief, the Commission will prove that ISC's previous filings have also violated the securities laws, and that certain of its books and and records violate Section 13(b)(2) of the Exchange Act as promulgated by the Foreign Corrupt Practices Act of 1977.

POINT II

ISC'S PERIODIC REPORTS VIOLATE THE REPORTING PROVISIONS OF THE EXCHANGE ACT: SECTION 13(a) OF THE EXCHANGE ACT AND RULES 13a-1, 13a-11 AND 13a-13 AND RULE 12b-20 THEREUNDER.

The reporting provisions of the Exchange Act are not mere "technical requirements". Their significance and centrality were explained as follows in the Committee Report of the House Committee which considered the Exchange Act:

> No investor ... can safely buy or sell securities upon the exchanges without having an intelligent basis for forming his judgment as to the value of the securities he buys or sells. The idea of a free and open public market is built on the theory that competing judgments of buyers and sellers as to the fair price of a security brings about a situation where the market price reflects as nearly as possible a just price ... [T]he hiding and secreting of important information obstructs the operation of the markets as indices of real value .... The disclosure of information materially important to investors may not instantaneously be reflected in market value, but despite the intricacies of security values, truth does find relatively quick acceptance on the market .... Delayed, inaccurate, and misleading reports are the tools of the unconscionable market operator and the recreant corporate official ....
>
> The reporting provisions of the [Securities Exchange Act] are a very modest beginning to afford ... long denied aid ... in the way of securing proper information for the investor. */ (emphasis supplied)

Section 13(a) of the Exchange Act requires corporations registered with the Commission, including ISC, to file prescribed reports with the Commission. Rule 13a-1 requires the filing of Annual Reports including financial statements, generally on Form 10-K. Rule 13a-13 requires filing of Quarterly Reports including financial statements

*/ H.R. Rep. No. 1383, 73rd Cong., 2d Sess. 11-13 (1934). See also, S. Rep. No. 1455, 73rd Cong., 2d Sess., 68, 74 (1934).



as prescribed in Form 10-Q. Rule Rule 13a-11 requires the filing of current Reports upon the occurence of events specified in Form 8-K within a fixed period of time after the occurence of the event. And, as provided by Rule 12b-20,

> In addition to the information expressly required to be included in a statement or report, there shall be added such further material information if any, as may be necessary to make the required statements, in the light of the circumstances under which they are made not misleading.

Rule 12b-20 is applicable to Section 13 (see S.E.C. v. Jos. Schlitz Brewing Co., supra, 452 F.Supp. at 832).

> "The purpose of requiring issuers of securities to file reports with the Commission is to insure that investors receive adequate periodic reports concerning the operation and financial conditions of corporations." S.E.C. v. Kalvex, Inc., supra, 425 F.Supp. at 316.

These reports, which provide information about the affairs of public corporations, are a vital element in the disclosure scheme of the Federal securities laws. "Clearly the requirement that an issuer file reports under Section 13(a) embodies the requirement that such reports be true and correct.... " S.E.C. v. Kalvex Inc., supra. 425 F. Supp. at 316.

When a report which is required to be filed is materially false and misleading, Section 13(a) is violated. S.E.C. v. Parklane Hosiery, Co. Inc., 558 F.2d 1083, 1085 (2d Cir., 1977); S.E.C. v. Great American Industries, Inc., 407 F.2d 453 (2d Cir., 1968), cert. denied, 359 U.S. 920 (1969); S.E.C. v. Falstaff Brewing Corp., supra, at p. 94,470; S.E.C. v. General Refractories Co., supra, 400 F.Supp. at 1257; S.E.C. v. Kalvex, Inc., supra, 425 F.Supp. at 316.

ISC's 1978 Form 10-K does not disclose accurately ISC's serious financial condition, its illicit and other questionable payments, the effect of these payments on its "unbilled receivables," the effect of these payments on its ability to obtain business or secure payment for work already done, the questionable validity of the "unbilled receivables" and "escalation" claims, the risks to ISC's business caused by these activities, the interest of Kenneally and his two

associates in the Deferred Compensation Corporation, or the funding of Kenneally's summer residence by ISC, or the related party disposition of ISC subsidiaries. See, Aff. ¶ 58. These are all undisclosed material matters, and thus their non-disclosure constitute violations of the reporting provisions. S.E.C. v. Jos Schlitz Brewing Co., supra, 452 F.Supp. at 832 (failure to disclose potentially illegal marketing activities); S.E.C. v. Falstaff Brewing Corp., supra, at pp. 94,468-470, (failure to disclose serious financial condition of company, failure to disclose risks to which business subjected by incumbent management). Further, by not correcting its defective Form 8-Ks and proxy materials, ISC is continuing to violate Section 13(a) and the rules thereunder, including Rule 12b-20. S.E.C. v. Falstaff Brewing Corp., supra at pp. 94,471.

POINT III

ISC'S FALSE AND MISLEADING STATEMENTS VIOLATE THE ANTI-FRAUD PROVISIONS - SECTION 17(a) OF THE SECURITIES ACT AND SECTION 10(b) OF THE EXCHANGE ACT AND RULE 10b-5 THEREUNDER

ISC's foreign illicit and questionable payments are material not only in an economic sense, they also material in that reflect on the integrity and ability of ISC management. In its May 12, 1976, report to the Senate Banking, Housing and Urban Affairs Committee, entitled Report of the Securities and Exchange Commission on Questionable and Illegal Corporate Payments and Practices the Commission discussed the materiality of illegal and questionable payments: */ In determining whether payments are material consideration should be given to whether (1) they are significant in amount; (2) although not significant in amount, they relate to a significant amount of business; (3) regardless of their size or impact on business, corporate officials

*/ The Commission's "Voluntary Disclosure Program" encouraged corporations to conduct internal investigations and publicly disclose their material questionable and illegal payments. ISC commenced an investigation of its activities only after being told that the Commission had concerns regarding certain of ISC overseas activities. ISC has never made the material disclosures discussed herein and has refused to grant the Commission unfettered access to the underlying documents.



have made repeated illegal payments without board knowledge and proper accounting because of its relevance to the "quality of management" and possible improper exercise of corporate authority; (4) even when made with express board approval, they could have repercussions of an unknown nature which might extend far beyond the question of the significance of the payment itself or the business directly dependent upon them. Id. at 14-15.

Measured against these criteria, ISC's activities in foreign nations and their relationship to its business affected by them is economically material. They are also material because -- regardless of the knowledge of ISC's board of directors -- their repeated nature reflects on the quality and integrity of management and because the payments have possible repercussions far beyond the significance of the payments themselves (e.g. ISC's ability to recover its "unbilled receivables" or do any business in any of the affected countries.) */

Courts which have considered the question, have determined that questionable payments are material and must be disclosed. Berman v. Gerber Products Co., 454 F.Supp. 1310 (W.D.Mich. 1978); S.E.C. v. Jos. Schlitz Brewing Co., supra. Berman was a tender offer case in which management refused to reveal the timing and location

*/ Congress, in enacting the Foreign Corrupt Practices Act expressed the seriousness of corporate bribery:

> Corporate bribery is bad business. In our free market system it is basic that the sale of products should take place on the basis of price, quality, and service. Corporate bribery is fundamentally destructive of this basic tenet. Corporate bribery of foreign officials takes place primarily to assist corporations in gaining business. Thus, foreign corporate bribery affects the very stability of overseas business. Foreign corporate bribes also affect our domestic competitive climate when domestic firms engage in such practices as a substitute for healthy competition for foreign business.
>
> Senate Report No. 114, 95th Cong., 1st Session, May 2, 1977, p. 4.

of illegal and questionable payments abroad, **/ or the identitites and location of employees involved in the foreign payments. After extensively discussing the legislative history of the federal securities laws and their commandment that there be "full disclosure" of material facts (452 F. Supp. at 1321), the Berman Court held that:

> In circumstances where actions by some members of corporate management have been challenged as being questionable, if not outright illegal, and such actions have indeed been acknowledged by the corporation itself, it is certainly necessary that stockholders have knowledge of the individuals involved and the activities which transpired in order that they may have a full opportunity to appraise those activities and the participants. Such activities bear the closest relationship to the integrity of management. 454 F.Supp. at 1323 (emphasis added).

The Berman court then found that "the disclosures made by Anderson Clayton in this case were wholly inadequate with respect to the foreign payments operation," and that the filings made

> sought to camouflage the specific transactions by the continued use of euphemisms, generalizations, and vague, self-serving language that did not enlighten the shareholder about the true nature, scope, and effect of the transactions and of management's involvement therein. Id.

See also, S.E.C. v. Falstaff Brewing Corp., supra at p. 94,468-69 (buried disclosure is not adequate disclosure). Finally, the Berman court held that the location and timing of the

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**/ The offeror, Anderson Clayton & Co., had filed a Form 8-K with the Commission, just as ISC had done, stating in part, that:

> "[t]here were certain transactions in connection with foreign sales and operations which involved payments to agents under circumstances where it is reasonable to assume that the agents used part of such funds to make payments to foreign government officials although no employee of the Company has actual knowledge that such payments were in fact made."

The Anderson Clayton Form 8-K also stated that:

> "certain directors and officers were generally aware of the practice [of making these] sensitive payments [and that] entries in the Company's records were not fully descriptive of the transactions." 454 F.Supp. at 1315.

payments was material and that "it was of the utmost importance" for the stockholders to be cognizant of the identities of the corporate officials who took part in the scheme "so that a complete understanding of the management's intergrity could be possible." Id.

The Schlitz decision sounded the same theme as did Berman. In Schlitz, denying a motion to dismiss the Commission's complaint, the court rejected arguments that payments of $3 million made in violation of federal and state liquor laws to induce retailers to purchase Schlitz products on net sales of approximately $1 billion were not material and that the non-disclosure of such payments did not render Schlitz' financial statements, periodic reports, registration statements and proxy solicitation materials filed with the Commission materially false and misleading. 452 F. Supp at 827.

In rejecting Schlitz' arguments and finding that the Commission had stated a claim for relief under Section 17(a) of the Securities Act and Sections 10(b), 13(a) and 14(a) of the Exchange Act, the court stated that "the question of integrity of management gives materiality to the matters" of which the Commission complained. Furthermore, the court observed that while $3 million in payments represented only 3% of Schlitz' sales, the economic implications of the payment to the company as a whole or to a significant line of its business assumes materiality particularly when measured against the amount of business that may be dependent on or affected by it. Finally, the possiblity of foreign governmental action was thought to be material too. 452 F. Supp. at 830. */

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*/ Subsequent to the Berman and Schlitz decisions, the Supreme Court had occasion to address the question of the breadth and purpose of the disclosure requirements of the federal securities laws and, in particular, Section 17(a) of the Securities Act. In United States v. Naftalin, 47 U.S.L.W. 4574 (May 21, 1979), the Supreme Court quoted approvingly from the legislative history of the Securities Act, Id. at 4576:

> "The purpose of this bill is to protect the investing public and honest business. . . . The aim is to prevent

Footnote continued on Page 30.

ISC's foreign payments are clearly material from both standpoints - i.e. economic materiality and integrity of management. As described above, ISC made illicit and other questionable payments to obtain substantial contracts and revenues in regard thereto in Iran, Algeria, and Saudi Arabia, among others, (e.g. Chile, Nicaragua and Ivory Coast). ISC then concealed these payments from at least the governments of Iran, Algeria and Saudi Arabia. While promising material disclosures since at least 1976, ISC has yet to issue a written report based on its internal investigation. ISC has only issued a generic Current Report on Form 8-K, in April 1978, about these payments which indicated that ISC executives knew of and have participated in these activities. Moreover, the use of corporate funds for personal benefit (i.e. Kilquade) and the undisclosed significant benefit to Messrs. Kenneally, Lerner and Ross from their dealings with DCC also are material facts which require more adequate disclosure. See S.E.C. v. Kalvex, supra.

POINT IV

ISC'S FALSE AND MISLEADING STATEMENTS VIOLATE THE PROXY PROVISIONS OF THE EXCHANGE ACT - SECTION 14(a) OF THE EXCHANGE ACT AND RULES THEREUNDER

Section 14(a) of the Exchange Act requires compliance with

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*/ Footnote continued from Page 29.

further exploitation of the public by the sale of unsound, fraudulent, and worthless securities through misrepresentation; to place adequate and true information before the investor; to protect honest enterprise, seeking capital by honest presentation, against the competition afforded by dishonest securities offered to the public through crooked promotion; to restore the confidence of the prospective investor in his ability to select sound securities; to bring into productive channels of industry and development capital which has grown timid to the point of hoarding; and to aid in providing employment and restoring buying and consuming power. S. Rep. No. 47, 73d Cong., 1st Sess. 1 (1933)."

The Court further noted that the Securities Act is intended to promote "ethical standards of honest and fair dealing", and was designed to protect not only investors but "ethical businessmen" as well and "to achieve a high standard of business ethics . . . in every facet of the securities industry." Id.



Commission regulations concerning the solicitation of proxies. Rule 14(a)(3), promulgated by the Commission requires that companies supply proxy statements containing specific items of information as set forth in Schedule 14A [17 C.F.R. §240.14a-10]. Rule 14a-9 prohibits the use and dissemination of proxy solication materials which contain material false or misleading information or omits material facts. */

The standard of materiality under Rule 14a-9 is set forth in TSC Industries, Inc. v. Northway, Inc, 426 U.S. 438, 449 (1976):

> An omitted fact is material if there is a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote.

The Supreme Court, recognizing that the concept of materiality is an elusive one, further observed that the trier of fact should consider the "total mix" of information given to a shareholder in deciding whether the statement alleged to be false or misleading, or the omission, is material. Id.

Since the Northway decision, a number of lower courts have examined the matter. In so doing, they have held that the Commission need only allege a material violation of the proxy rules to state a claim for relief. See, S.E.C. v. Jos. Schlitz Brewing Co., supra.

In addition, the courts have set forth certain facts which, if not disclosed, or if disclosed in a misleading manner, or in a manner which omits discussion of particular facts, consititue violations of the proxy provisions. For example, when, as here, incumbent directors, such as Defendant Kenneally, stand for reelection, the proxy solicitation materials must disclose material facts relating: a) to the total remuneration of those seeking election; b) to the serious financial condition of the enterprise; c) to the risks to which the enterprise has been subjected by incumbent management; d) to the prior year's transactions or presently proposed transactions

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*/ Rule 14a-9 may be found in the Statutory Appendix to this Memorandum.

to which the issuer or any of its subsidiaries was or is a party and in which the issuers' officers had or is to have a direct or indirect interest; and, e) the integrity of the incumbent management. See S.E.C. v. Falstaff Brewing Corp., supra at pp. 94,468-70; S.E.C. v. Jos. Schlitz Brewing Co., supra, 452 F.Supp. at 831; S.E.C. v. Kalvex, Inc., supra, 425 F.Supp. at 314-315. */

Normally, shareholders -- who are the true owners of the corporation and the individuals whose property is being administered by the enterprise's management -have but one opportunity to express an opinion on how and by whom they wish to have their corporation's affairs administered: the annual meeting of shareholders. It is in anticipation of those meetings that proxy soliciting materials usually are sent.

The question, therefore, is whether the vote of any ISC shareholder would have been influenced by full disclosure of the fact that:

1. ISC paid approximately $23 million in illicit and questionable foreign payments to secure business.

2. These questionable foreign payments subjected ISC to risk the loss of almost $31 million in "unbilled receivables", loss of contracting opportunities in the affected nations, and possible prosecution.

3. The "unbilled receivables" and "escalation" claims were of dubious validity.

4. Foreign government entities had been misled about, and particularly after they made inquiry with respect to, improper use of intermediaries and payments to government officials.

5. The books and records of ISC and its subsidiaries were not accurate and did not accurately record the use and disposition of its assets.

6. The books and records of a major subsidiary were so incomplete that the auditors could not express an opinion on the financial condition of that subsidiary except to question its continued financial viability and to note that it was in violation of the English Companies Act.

7. More than one million dollars was used to purchase, furnish and maintain a summer home in Ireland for Defendant Kenneally.

8. Foreign subsidiaries maintained off-book bank accounts.

9. Foreign subsidiaries were sold to persons associated with ISC.

10. Three persons, Kenneally, Ross and Lerner, were the principal beneficiaries of a compensation plan (DCC) supposedly established and funded by ISC for the benefit of its most important and "key" officers and directors.

11. After almost 18 months, the directors of ISC have not finalized and presented to the shareholders the investigative report by special outside counsel looking into ISC's illegal and questionable activities.

12. The firm of R.F. Medina, now Chairman of ISC's Board of Directors, received $604,000 in management "consulting fees" while he supposedly was in charge of the special review being conducted by special outside counsel. */

To ask these questions is to answer them: One does not elect as directors individuals who are using the corporation they represent for personal gain, S.E.C. v. Kalvex, supra 425 F.Supp. at 315, or who are so incompetent, or devoid of moral scruples, as to cause

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*/ A director-nominee (like Defendant Kenneally) has a duty to determine the validity of proxy materials submitted and to correct statements and facts which he knew or should have known were erroneous or misleading. S.E.C. v. Falstaff Brewing Corp., supra.

*/ It is inconceivable too that the shareholders of ISC would not care to know that since mid-June 1979, under its incumbent management, and in particular Defendant Kenneally, corporate records have been shredded at such a pace as to require the use of an automatic, belt fed shredder producing as many as 15 bags of shredded documents per day.

the enterprise to be placed into fatal jeopardy. Clearly, what was missing from ISC's proxy solicitation materials was, by any standard, the most material and critical information a shareholder would want, and need, to make an informed judgment.

POINT IV.

THE COURT SHOULD APPOINT A SPECIAL AGENT

As noted above, the Commission appears "not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws." S.E.C. v. Management Dynamics, Inc., supra, 515 F2d. at 808. Courts have repeatedly upheld the Commission's authority to seek, and the district courts' equitable power to grant, relief ancillary to the injunctive relief the commission is specifically authorized to obtain. The equitable remedies which the Commission seeks - a preliminary injunction and the appointment of an agent of the Court to assure compliance with the federal securities laws and to preserve the assets and books and records of ISC - are essential to correct the Defendants' fraud and mismanagement.

Where corporations, as here, have been the target of fraud, mismanagement, gross abuses of trust and used as vehicles for the private purposes of individuals, courts have granted the Commission's request for receivers or special agents. E.g. S.E.C. v. Bowler, 427 F.2d 190 (4th Cir. 1970); S.E.C. v. Koenig, 469 F.2d 198 (2d Cir. 1972). Moreover, as noted by the Court in S.E.C. v. Golconda Mining Co., 327 F.Supp. 257 at 259 (S.D.N.Y. 1971) an "injunction against future violations while of some deterrent force does not correct the consequences of past conduct."

Recently, in a case involving violations of the antifraud and reporting provisions of the federal securities laws, false and misleading company books and records and misappropriation and diversion of corporate assets for the benefit of incumbent management, the District Court, on an ex parte application by the Commission, issued a temporary restraining order enjoining the defendants from "destroying, mutilating, concealing or disposing of in any manner" corporate books and records, freezing the assets of the corporate and individual defendants, establishing voting trusts over the defendants; stock and appointed a "temporary receiver". The Court ordered the "temporary receiver" to take custody control and possession of all assets and property, including books and records, bank and trust accounts, securities, property and premises, "in order to prevent irreparable loss, damage and injury" to investors, to remove the individual defendants from control and management of the enterprise, to make an accounting of all assets and liabilities of and funds paid to or received by the corporate defendant and, finally, to inquire into and account for misappropriated corporated assets. S.E.C. v. Aminex Resources Corporation, [1978 Transfer Binder] CCH Fed. Sec.L.Rep. ¶ 96,352 at p. 96,458 (D.D.C. 1978).

The facts of this case clearly warrant the immediate relief prayed for by the Commission -- the appointment of a special agent to assure adequate supervision of defendant ISC and its assets and property.

The false and misleading statements which ISC has made in, and the material facts which it has omitted from its disclosures relating to its past and present activities, its claims for "unbilled receivables" and "escalation" payments, the kick-backs and rebates it received from suppliers, the effect of those activities on its business, as well as the related-party transactions and officer and director compensation and benefits, have misled and continue to mislead investors in just those areas of required disclosure most vital to informed investment decision and the federal securities laws disclosure provisions. Thus, there exists an immediate pressing need to assure that ISC's future disclosures are made with due regard to the letter and spirit of the federal securities laws and that ISC's corporate decision making is motivated solely by an informed evaluation

of its financial condition and in the best interests of the shareholders. This can be accomplished only by granting the preliminary relief that the Commission has requested including the appointment of a special agent of the Court to perform the tasks enumerated in the instant motion.

## IX. CONCLUSION

For the foregoing reasons, the Commission respectfully requests that the Court issue a preliminary injunction and appoint a Special Agent of the Court, as prayed for in the Motion for Preliminary Injunction, and should issue such other orders and grant such further and additional relief as the Court deems just and proper.

Dated: July 9, 1979

Respectfully submitted,

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By: _____

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* The Commission wishes to express its appreciation for the assistance it received from Frederick W. Smolen, C.P.A.

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

Judge Cannella
79 Civ 1959

| | |
|---|---|
| SECURITIES AND EXCHANGE COMMISSION : Plaintiff, : | 79 Civil Action File No. |
| - against - : | COMPLAINT |
| MARLENE INDUSTRIES CORP. : CHARLES MELTZER SAMUEL MELTZER : Defendants. : | |

U.S. District Court Apr. 18 3 17 PM '79 S.D. of N.Y.

Plaintiff, Securities and Exchange Commission ("Commission") for its Complaint herein alleges upon information and belief that:

1. Defendants Marlene Industries Corp. ("Marlene"), Charles Meltzer and Samuel Meltzer have been engaging in acts which constitute and will constitute violations and aiding and abetting violations of Sections 10(b), 13(a), 13(b)(2) and 14(a) of the Securities Exchange Act of 1934, as amended, ("Exchange Act"), 15 U.S.C. 78j(b), 78m(a), 78m(b)(2) and 78n(a), and Rules 10b-5, 12b-20, 13a-1, 14a-3 and 14a-9 thereunder, 17 C.F.R. 240.10b-5, 240.12b-20, 240.13a-1, 240.14a-3 and 240.14a-9.

2. The Commission, pursuant to authority contained in Sections 10(b), 13(a), 14(a) and 23(a) of the Exchange Act, 15 U.S.C. 78j(b), 78m(a), 78n(a), and 78w(a) has promulgated Rules 10b-5, 13a-1, 14a-3, 14a-9 and 12b-20 thereunder, 17 C.F.R. 240.10b-5, 240.13a-1, 240.14a-3, 240.14a-9 and 240.12b-20 respectively. Said Rules were in effect at all times mentioned herein and are now in effect.