S. 708: AN AMENDED VERSION OF THE FOREIGN CORRUPT PRACTICES ACT

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I. INTRODUCTION

I am going to approach the Foreign Corrupt Practices Act (FCPA)[1] from the standpoint of the government and public policy. I am very fortunate to have been able to work for the past seven years in a body which has as its primary interest the formulation of public policy, mainly by statutory enactment of moral, philosophical or social views; a process which sometimes adds complexity and earnings to a lawyer's life. My presentation will probably touch on some of the facts and considerations that you have heard others speakers talk about, although I am going to give them a slightly different slant. I want to see how these factors impact on the nation's public policy.

II. PUBLIC POLICY CONSIDERATIONS BEHIND THE FCPA

It seems to me that the paramount factors behind the passage of the FCPA are fourfold. The first, and one of the crucial factors, was the impact on the foreign policy of the United States.[2] The bribery of high government officials by American companies, the illegal payment of more than four hundred million dollars to these officials, had serious consequences.[3] We were not dealing with an isolated instance, or a series of isolated instances. We were dealing with a pervasive behavioral pattern of the corruption of foreign government officials by American companies in order to do business. The consequences for United States foreign policy

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1. Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, §§ 102-104, 91 Stat. 1494 (codified at 15 U.S.C. §§ 78a, 78m, 78dd-1, 78dd-2, 78ff (Supp. V 1981)), *reprinted in* Appendix I, *infra*.

2. S. REP. NO. 114, 95th Cong., 1st Sess. 3, *reprinted in* 1977 U.S. CODE CONG. & AD. NEWS 4098, 4101.

3. *Business Accounting and Foreign Trade Simplification Act: Joint Hearings on S. 708 Before the Subcomm. on Securities and the Subcomm. on International Finance and Monetary Policy of the Senate Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 350 (1981).

were simply enormous. The Japanese government fell, the Communist party was given a big leg up in Italy,[4] and Third World emerging democracies were being subverted. In Latin America, once again, we became involved with antidemocratic elements. In short, it seems to me that the bribery episodes substantially subverted our stated foreign policy objectives. Our image as the world's leading democracy was tarnished.

In this light, public policy could not sanction corporate foreign bribery. The United States could simply not permit foreign governments to be corrupted by citizens doing business abroad. In my view, it was no answer to say that we are merely following local customs and practice and that we would be imposing our moral views on the rest of the world if we proscribed bribery. The plain fact is that bribery of government officials is against the law in every society in the world. In every country where bribery has become known, the resulting scandal has been enormous, rocking the stability of every government involved with bribery. Given these facts, I think it was inevitible that a law would be passed to control the foreign policy implications of American companies corrupting foreign governments.

The second major factor leading to the passage of the FCPA was the impact of foreign bribery and domestic bribery on free market economies. We pride ourselves in having the greatest free market in the world. Bribery is fundamentally destructive to a free market. In order to function at an optimum level, in which the market allocates goods and services in the most efficient manner, purchasers and sellers must deal at arm's length, doing business on the basis of the price and quality of the product, with service being a part of the quality of the sale. Bribery undermines the free market: sales are no longer based on who sells the best product for the lowest price, but on who "pays off." The free market is so ingrained in our society and economic theories that public policy measures will always opt for it. This is buttressed by the fact that, according to Chairman Hills of the SEC, in every industry in which overseas bribes were paid, some companies were able to do business without bribery. The impact was not only overseas, but also at home, with bribing firms receiving the profits and the jobs which might have gone to the firms that refused to engage in that kind of anticompetitive behavior.[5]

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4. H. R. REP. No. 640, 95th Cong., 1st Sess. 5 (1977).
5. *See id.*

The third important factor in the passage of the FCPA was the impact of the bribery scandals on corporate responsibility. The size and scope of the scandals necessitated a review of the new role of the corporation and the kind of regulation needed to ensure that corporations would behave as responsible citizens. Overseas bribes, as has been noted previously, were accomplished by the maintenance of off-the-books slush funds. Presidents, chief executives and monarchs, not lower officials at the docks, were the recipients of bribes. Further, not nickels and dimes, but millions of dollars passed hands.[6] Corporate boards of directors and chief executive officers disclaimed knowledge or responsibility. The narrow concepts of disclosure under the SEC were meant to protect investors, but they were inadequate to deal with a substantial breakdown in the ability of managers of publicly-held companies to maintain accountability of corporate assets.

The question was, what kind of public policy response should there be to the accountability problem? It seems to me there were two possible paths. The first would dictate the composition of the boards of directors of corporations, which could generate accountability for assets. The other alternative was to leave management, who knew about the corporate business, in the control of boards, but to require those boards to maintain accounting controls to ensure accountability for assets. It seems to me that the FCPA clearly rejected the first option of public dictation of the composition of boards of directors. Instead, it opted for, in effect, good management. Management's responsibility, by a statutory prescription, is to set in place a system of internal accounting controls—which, incidentally, every well-managed company probably already has, or should have—to maintain accountability for their assets.

Finally, the fourth, and most important reason why the FCPA was passed, is the impact of bribery on capital markets and the capital raising function. The United States is often described as having the greatest capital market in the world. We have great securities firms and independent and commercial banking houses. This gives us a tremendous structural capability to develop and put capital together and sell it, not only in this country, but all over the world. Knowledge of the functionings of corporations

6. *See generally Lockheed Bribery: Hearings Concerning Payments to Foreign Government Officials by the Lockheed Aircraft Corp., and the Emergency Loan Guarantee Act Before the Senate Comm. on Banking, Housing and Urban Affairs*, 94th Cong., 1st Sess. (1975).

plays a key role, because disclosure means that investors can analyze what is taking place within a company.

Public policy formulators considered bribery had the potential to subvert the capital market.[7] The cynical view that bribery may be good for short-term profits fortunately did not prevail. The long-term view prevailed. Bribery can subvert long-term profits. Even more important, off-the-books slush funds can compromise the integrity of management. All managers of public corporations, whether in foreign sales or in purely domestic sales, should maintain accountability for corporate actions.

III. SENATE ACTION TO AMEND THE FCPA

Recent actions by the U.S. Senate show that the key factors I have discussed are essentially not debatable. In any reexamination of the FCPA, some things will not change: the United States will never adopt a policy that it is acceptable to corrupt foreign governments; the United States will never permit bribery to corrupt a free market; the United States will always require corporations to behave as responsible citizens; the United States will always seek to preserve the integrity of its capital markets. If the law changes, it will have to continue to meet the public policy objectives I have outlined.

Regarding the specifics of S. 708,[8] the export community argued very strenuously that the FCPA is an export disincentive.[9] I think we may well argue with this. The evidence is fragmentary and consists largely of conclusions and stories. Let us look at some of the basic facts. In the last four years, since the passage of the FCPA, our exports have doubled. We have outperformed, in the export market, every other country in the world, including the Germans, the French, the Italians, and I think we have even outperformed the Japanese. We have done this at a time when the world economy is winding down, and it is no surprise that when the international economy *winds down*, some export sales from domestic producers are going to be lost.

Now, the FCPA may provide a convenient excuse for exporters who wish to explain away a decline in their business. Some sales are in fact lost because of the FCPA. But, I believe, if con-

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7. S. REP. NO. 114, *supra* note 2, at 3.

8. S. 708, 97th Cong., 1st Sess., 127 CONG. REC. 13,983-85 (1981).

9. *Business Accounting and Foreign Trade Simplification Act*, *supra* note 3, (testimony of William Brock).

fronted with a situation of either paying a bribe or losing an export sale, we should never have in our lifetime a policy that in effect says: "Okay, go bribe, you have to do it to get the business." For example, I think the prevailing public view is that we would have been a lot better off had we never sold those Lockheed airplanes to Japan. I suppose to some extent that is a pretty rough thing for me say. But I do think that we live in a country where there are some things we just cannot do. And if other countries might allow such practices, then we cannot, and should not, compete on that level.

As introduced, S. 708 would have gutted the bribery law. But S. 708, as passed by the Senate, retains, in my judgment, the objectives that I have outlined.

A. Accounting Provisions

S. 708 as introduced would have amended the accounting provisions to include a threshold standard of materiality. In my judgment, the materiality standard is wholly inappropriate for the maintenance of assets accountability. Materiality may have sound reference to disclosure for investor protection, but I do not believe it has any place in the standard-setting or the responsibility of a board of directors to maintain the accountability for the assets of the corporation.

The FCPA accounting standard is one of reasonableness, requiring records to be kept accurately to maintain accountability for assets. The phrase inserted in the FCPA was: "in reasonable detail." At the time it was inserted, with the agreement of the American Institute of Certified Public Accountants, its purpose was clearly, and without any controversy whatsoever, to allow the management of a company to set up categories of accounts so that they would not have to deal with every nickel and dime in the company. It was clear that the company would have the right to set up a reasonable accounting standard that met the further statutory standards of maintaining the accountability for assets. So, I do not think a case could be brought where there is an inadvertent mistake or error.

A favorite criticism of the accounting sections is that the standards are too high. The argument is made that there is in the FCPA's accounting standards absolute liability without fault.[10] I

10. *Id.* (testimony of John Subak).

disagree strenuously with this interpretation. At the time the FCPA was passed, the authors made crystal-clear that a standard of reasonableness was implied,[11] and within a few months thereafter, the Chairman of the Securities and Exchange Commission, Harold Williams, said so in crystal clear language in a major policy pronouncement. Unfortunately, the drumbeat continued and S. 708 was introduced.

The problem with the term "materiality" was spotted by the SEC, it seems to me, early in the game. The SEC recommended a definition of "materiality" based on the prudent businessman's test.[12] That would have been fine, except, in my judgment, we are better off without even using the term "materiality," since its use would only lead to confusion. Accountability of assets necessarily has to have a standard higher than materiality because we are talking about the way a board of directors manages a company. The Administration, seeing the problem with the term "materiality," as I have outlined, recommended that we drop the accounting provisions entirely. Fortunately, the Administration's position on the FCPA was never seriously considered.

S. 708, as passed in the Senate, retains the accounting provisions intact, in my view. There is no standard of materiality. S. 708 provides a defense of good faith to a company in a suit commenced by the Securities and Exchange Commission. It makes clear that the accounting requirements are to be enforced by the SEC in civil suits, provides that individuals cannot be held liable for less than knowing violations, and it provides criminal penalties if accounting controls are circumvented.

I believe that if S. 708 is passed into law, it will improve on the different interpretation of the accounting requirements under the existing law. We can all learn, over a period of time, that the way things are sometimes intended and are done are not quite received in the same way. When that happens, I think the best thing to do is to reform the statute, which I think is the Senate's job.

B. Bribery Provisions

The FCPA currently holds a company liable where a foreign government official has been bribed by an agent and the company

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11. H. R. REP. NO. 831, 95th Cong., 1st Sess. 10, *reprinted in* 1977 U.S. CODE CONG. & AD. NEWS 4121, 4122.

12. SEC Release No. 15,570, [1979 Transfer Binder] FED. SEC. L. REP. (CCH) 81,398.

"knows or has reason to know." Bear in mind that this is a criminal statute. No case can be brought unless the prosecutor is prepared to prove beyond a reasonable doubt that the company has actual knowledge or acted in wanton disregard of facts which would have resulted in its actual knowledge.

The statute requires companies to police their agents' activities. I ask you if this is at all unreasonable. Is it not good corporate management to know what your agent is up to? The current standard is a tough standard. But remember, the FCPA is intended to stop corruption of foreign government officials. A company cannot deliberately insulate itself from the fact, and escape liability for the act of paying a bribe. Any student of agency law will recognize this as ridiculous, not to mention the important foreign policy and economic issues at stake in foreign bribery.

S. 708, as introduced, would have replaced the reason to know standards with a standard of "directly authorized." Here is what the Chairman of the Securities and Exchange Commission, Harold Williams, said under the directly authorized standards:

> I am concerned with the pending Bill's deletion of the reason to know standards from the Act. If enacted with this deletion, it would be possible for management to adopt a shut-eyed approach whereby liability would be avoided by remaining that oblivious to the actual facts and circumstances underlying the subject transaction. Further, it would encourage a form of managerial irresponsibility. It should not be the underlying respect of federal legislation and would give rise to an environment of 'do what you need to do, just don't tell me.'

Chairman Williams' testimony on this point was simply devastating, and after his testimony I do not think there was ever any hope that that language could have passed without amendment.

Following the testimony, the Banking Committee undertook a bipartisan effort to find a solution to the problem. S. 708, as passed in the Senate, continues the "directly authorized" language modified by the terms "explicitly or by course of conduct." I submit that an authorization by "course of conduct" is a workable standard that should proscribe bribery.

I do not happen to think that a case would ever have been brought based upon the "has reason to know" standard that could not meet the test I have described, and if it were I think it would have gotten thrown out of court. Certainly it would have been thrown out of the Court of Appeals. But we have to live with

perceptions, and so I think it is right, at this point, to take up the amendment as it stands. In any event, I think the language: "directly authorizes explicitly or by course of corporate conduct" is fine substitute language, and I am hopeful that it is language that will prevail because it is tantamount to "know or have reason to know" as illegal standard.

IV. CONCLUSION

As I have said, the Senate undertook the amendment of the FCPA on a bipartisan basis, with a unanimity about the need to revise the statute, and unanimity about how the statute ought to be revised. Now, I believe that the House Committee is going to give this matter very serious consideration. I know that we are in an election year. I know with the economic situation being what it is, politics will undoubtedly play a very important role in what bills are going to come up and which bills are going to pass. Nevertheless, I don't think that the amendment of the FCPA is one of those pieces of legislation that falls into the political category. I think that it is above, or set apart from, the social, economic, and political issues.

My information is that the House Committee is going to be working on its own formulation of amendment to the FCPA. It will come as no surprise to anybody that the House members think that they have the right to proceed in their own fashion. They might even feel that they have an obligation to do something a little different than the Senate has done. Nevertheless, they are going to be formulating their own bill. They are going to take a slightly different approach than the Senate Bill. Perhaps their approach will be keyed more to the criminalization provisions. I just do not know to what extent they will change the accounting provisions. I hope that, after having arrived at the consensus that we did arrive at in the Senate on the accounting provisions, that, unless it can really be improved upon, the better part of valor might be to leave it alone. We had a consensus, as I say, on both sides of the aisle. Part of the consensus, I believe, was the whole business community. Everybody seemed to be pleased with it, the United States Chamber of Commerce, and, in the end, the AICPA, and so on.

I think we have struggled now, if we go back to the origins of this, for about seven years, and after a lot of gnashing of teeth, we seem to have arrived at the point where everybody is feeling very

comfortable with the accounting provisions as they have come out of the Senate. I sincerely hope, because I believe that public policy needs this Foreign Corrupt Practices Act, that we have done a good job. I also believe that we have finally done something that everybody can live with and still accomplish a valid public policy purpose. I believe very strongly that the Senate's action with respect to the accounting provisions accomplishes those basic purposes.