

THE FOREIGN CORRUPT PRACTICES ACT: IMPLICATIONS FOR THE PRIVATE PRACTITIONER

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The Foreign Corrupt Practices Act (FCPA) has had a noticeable impact on the ability of U.S. companies to obtain and retain business abroad. I will focus on the problems of the FCPA as some private practitioners see them. Particularly for those representing small companies, the FCPA has had an adverse effect on the character, extent and quality of our overseas business.

I. THE IMPACT OF THE FCPA ON U.S. BUSINESS

A recent State Department survey of 115 United States foreign service posts showed that thirty-nine percent of the posts, in countries with which the U.S. has significant commercial relations, report that the FCPA has caused a loss of competitiveness. The perceived loss is apart from any question of bribery. Those posts reporting—sixty percent of the posts in the Middle East and East Asia, fifty percent of the African posts, about forty percent of the Latin American posts, and fifteen percent of those in Europe—confirm the adverse impact of the Act. A survey conducted by the General Accounting Office (GAO), consisting of questionnaires sent to 250 companies randomly chosen from the Fortune list of the top 1000 companies, also indicates the adverse effect of the Act.¹

As some private practitioners interpret the statistics, and as the GAO interprets them, more than thirty percent of the companies reported that they lost business as a result of the FCPA. Among companies in the construction and aircraft businesses, the figure was about fifty-four percent. Moreover, sixty percent of all respondents perceived that U.S. companies could not successfully compete against other companies engaged in bribery. Now, that is not an indication that they should bribe, but it is a statement

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1. Comptroller General of the United States, *Impact of the Foreign Corrupt Practices Act on U.S. Business*, reprinted in SEC. REG. & L. REP. (BNA) No. 594, at 5-1 (March 11, 1981).

about what we are going to be facing if an international corrupt practices treaty is not achieved.

It is important to note that the loss of business, both real and perceived, is not due primarily to the inability to bribe. Rather, it has, to a large extent, been caused by the difficulty of determining what kind of action constitutes illegal bribery. Excessive record-keeping and accounting, necessitated by the provisions of the Act, go far beyond the goal of proscribing bribery. The unwillingness of foreign buyers and their representatives to become enmeshed in the coils of the Act has also caused business losses.

According to the GAO survey, and according to the Senate Banking Committee Report on S. 708,² many firms have withdrawn from existing markets or failed to enter new ones as a result of the uncertainty and difficulty caused by the Act. Many firms have lost valuable contracts because of the time needed to check agents and institute safeguards. Firms have withdrawn from joint ventures for fear of liability for the actions of their foreign partners, and have incurred prohibitively high costs in investigating their foreign sales agents. Very frequently, firms have simply been unable to obtain the services of an effective sales agent.

It has been estimated that the grey area, where firms are uncertain over what is permissible under the Act, has had a truly chilling effect on U.S. export trade. As a rule of thumb, depending on which Senator you listen to, each billion dollars in exports is the equivalent of 40,000 jobs. Moreover, the U.S. share of worldwide business has declined sharply. In 1977, the U.S. ranked fourth in worldwide construction and industrial project activities. By 1979, the figure had fallen to seventh worldwide.

II. ENFORCEMENT OF THE FCPA

Although Congress, when it enacted the FCPA, seemed to expect cooperation between the agencies and the business community, no real help has been forthcoming. In September 1978, only nine months after the Act was passed, President Carter directed the Department of Justice to give the business community guidance regarding its intentions to enforce the Act. It was only in March 1980, eighteen months later, that the Department of

2. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, REPORT TO ACCOMPANY S. 708, S. REP. NO. 209, 97th Cong., 1st Sess. 3-10 (1981).

Justice implemented its guidance program. Unfortunately, most observers view the program as not very useful. By January 1981, only five firms had asked for guidance.

For example, the attitude of the Securities and Exchange Commission has been less than helpful. The SEC, charged with civil enforcement of the bribery provisions, has primary jurisdiction over the accounting and control provisions of the Act. Initially, however, the SEC refused to be bound after May 31, 1981 by any clearance regarding the bribery provisions given by the Department of Justice. Although the agency has since agreed to go along, the refusal did little to assist U.S. companies in complying with the Act. The SEC has, until fairly recently, taken a very hard-nosed position. A former Director of Enforcement for the SEC is reported to have said in response to an early request that the SEC provide guidelines, "We do not have guidelines for rapists, muggers and embezzlers, and I do not think we need guidelines for corporations who want to bribe foreign officials."

Richard Shine expressed a similar point of view in 1979, at a forum sponsored by the American Society of International Law:

[T]o the extent that businessmen are waiting for guidelines which may in some way narrow the scope of the Act, I think they are waiting in vain. I would anticipate from the point of view of the Department of Justice and the Securities and Exchange Commission that whatever is done will be geared not toward a restrictive, but toward a broad interpretation of the Act, which will maximize enforcement, since they do not in any way intend to provide what some have called a road map to bribery.³

Why were guidelines so urgently sought by the business community? Why has there been so much momentum to amend the Act? What are some of the negative features that are the subject of complaints?

III. THE FCPA ACCOUNTING AND BRIBERY PROVISIONS

The FCPA reaches two areas—(1) accounting and control and (2) bribery. I will focus first on the accounting and control provisions, and will return to the bribery sections of the Act.

3. Remarks by Richard Shine, *Corrupt Practices in International Commercial Transaction*, PROCEEDINGS OF THE SEVENTY-THIRD ANNUAL MEETING OF THE AMERICAN SOCIETY OF INTERNATIONAL LAW 43 (1979).

A. Accounting and Control

The accounting provisions have been burdensome, although subsequent administrative interpretations have lightened that burden. Initially, such concepts as "reasonable detail" and "reasonable assurances" were not commonly understood by management. Since the inception of the securities laws, managers have lived with "materiality" concepts. The FCPA language was taken almost verbatim from the auditing standards of the American Institute of Certified Public Accountants (AICPA).⁴ That language is shop talk, intended and understood by accountants in their auditing functions. It was not very helpful to management to determine what kind of accounting and control requirements were necessary.

Although both the American Bar Association and the AICPA believe that the statutory language incorporated the classic materiality standards, the SEC says "no" — the standard is reasonableness.

The absence of a materiality standard exacerbated the vagueness and ambiguity the business community found in the Act. Laws of uncertain meaning, especially those punishable with heavy criminal sanctions, create excessive costs and care. Fifty-five percent of those companies responding to the GAO survey reported that their costs exceeded their benefits. Many corporate officials believe that the increased documentation required by the FCPA is excessively costly, particularly in light of their view of the primary function served by this paper-gathering device — a defense to SEC inquiries.

Firms incur unnecessary compliance costs, largely out of fear of the criminal penalties which might be imposed for unintended accounting errors. Some of this fear has been dissipated by more recent liberal interpretations of the Act, but these administrative interpretations could change with a change in personnel, or with a change in the administration. Ed Herlihy, former Assistant Director of the Enforcement Division of the SEC, once stated that "every error [in a financial statement, without regard to materiality] literally could be construed to be a violation of the Act." One practitioner has commented that the position of the SEC seems to

4. *Business Accounting and Foreign Trade Simplification Act: Hearings on S. 708 Before the Subcomm. on Securities and Subcomm. on Int'l Finance and Monetary Policy, 97th Cong., 1st Sess. 83-84 (1981).*

be: Every paper clip must be accounted for. If you have lost a paper clip, then there is clearly a violation of the Act. But by the same token, we want you to know that we are going to be reasonable in applying this Act, and we will take into account the importance of paper clips in your company in making a decision as to enforcement."

This is, of course, a prosecutor's paradise. The target is always guilty of the violation. The government has the option of deciding whether or not to prosecute. For practitioners, however, the situation is intolerable. We must be able to advise our clients as to whether their conduct violates the law, not whether this year's crop of administrators is likely to enforce a particular alleged violation. That would produce, in effect, a government of men and women rather than a government of law.

The Act has also been troublesome because the SEC and the Department of Justice have disagreed on the interpretation of the FCPA. Even within the SEC there have been some disagreements. Now you might well ask what this has to do with bribery, which is what Congress was aiming at when it enacted the FCPA. The answer is that the Act, as interpreted, goes far beyond curtailing foreign bribery.

Led by the SEC, there has blossomed a broad concept of corporate accountability, in what seems to be a general attempt to legislate and regulate in the field of overall corporate management. Many commentators feel that the main issue now being presented under the Act is not bribery, but issues such as evasion by overseas subsidiaries of foreign tax and exchange control laws.

I do not want to get too deeply into the question of U.S. parent corporation responsibility for the books and record-keeping of its foreign subsidiaries, but I think the SEC views it in the following way: if the subsidiaries' accounts are consolidated in the parent company's report, the parent is responsible for the subsidiary's books and records. If the subsidiary is accounted for on an equity basis, the parent will also probably be responsible.

The Department of Justice had come up with the creative theory of using the mail and wire fraud statutes in enforcement. I would like to consider this for a minute because the Department has indicated that it may now use the accounting provisions of the FCPA in place of the mail and wire fraud statutes, under which some recent cases have been brought.

Suppose an overseas subsidiary maintains two sets of books,

paying employees outside of the local country, so as to help the employees avoid local taxes or exchange control regulations, or to reduce the high costs of salary related expenses, such as social security and similar benefits. The regulatory agencies may very well claim that there is a violation of the accounting and control provisions of the Act.

The Justice Department has sought to reach foreign bribery situations by way of the mail and wire fraud statutes. For example, in two recent cases which arose before the effective date of the FCPA, *Control Data* and *Williams Companies*, the Department of Justice was able to obtain consent guilty pleas from the defendants. The theory, which seems extraordinary to some of us, is that in bribing foreign officials, the defendants had defrauded the citizens of the foreign country of their right to the honest and loyal services of their government officials in the performance of their official duties. It does not take much more imagination to argue that in avoiding local tax or exchange controls, a company might similarly be held to be defrauding citizens of the country of their right to have taxes collected and exchange controls enforced. In fact, the Justice Department indicated in 1979 that in the future such cases will probably be treated as violations of the record-keeping provision of the Act. Thus, as the enforcement agencies view matters, the Act reaches far more than bribery alone.

In the case of firms registered with the SEC, the Act can be used to address such wide-ranging corporate practices as transfers to minimize local taxes, avoidance of exchange control regulations and reduction of costs by paying employees off the books, thereby avoiding social security, severance accruals and other salary related expenses, which in many countries are oppressively high. Fairly commonplace has been the practice of U.S. companies to pay a large portion of their American employee salaries outside the countries in which they are working. This can be accomplished, for example, by depositing fifty or sixty percent of those salaries in a U.S. bank.

There are very significant business reasons for these practices. Most companies adjust their employee salaries to produce a certain net when they are transferred abroad, usually at not less than what they enjoyed before they were transferred. The greater the amount taxed away by foreign authorities, the more the employer would have to pay to produce the agreed net. This practice has been an important factor in protecting the competitive-

ness of U.S. firms abroad and maintaining a high standard of employee quality at affordable costs.

The public perception of morality in local environments is also a factor that must be considered. In Italy, for example, legal fictions have existed with regard to taxation. The sum total of income taxes due under national and local taxing statutes actually exceeded one hundred percent of income in certain instances. The reason was political. To satisfy some political parties, local taxation on the statute books was made prohibitively high, while there was an unspoken understanding that no one would ever pay more than a fraction of the total tax theoretically due.

Another almost universal practice of international firms has been to bill local subsidiaries for "management" or other "services". This accomplishes a two-fold benefit of reducing the local tax burden, since such payments are normally deductible, and where exchange control restrictions exist, facilitating transfers out of the local country in circumstances where profit repatriation would not be allowed. The practice is often used to allocate a portion of central management costs to the local country.

Of course, these transactions are disclosed to parent company stockholders, either specifically or in accounts reflecting them, but the consolidations are based on information furnished to the parent corporation from confidential records that are either non-existent on the local subsidiary's books or not clearly and accurately disclosed on those books.

Suppose the local subsidiary uses two sets of books, one for the local authorities, and the other perfectly accurate, to provide figures for parent company consolidation. In this situation, even if the equity owners of the corporation are fully and accurately informed as to the transactions of the company, and even if the employees and officers have acted in accordance with instructions of management, and even if every penny of the company's assets are controlled by management and carefully preserved, and even if there was not the slightest act of bribery or hint of corruption, many companies fear, perhaps justifiably, that the SEC and the Department of Justice would say there had been a violation of the Act.

Of course, evading local laws is a risky business, and companies must be prepared to take the consequences of errors in assessing local views of expected and acceptable conduct. But local subsidiaries are usually managed by nationals or resident ex-

patriates, familiar with local cultural norms, local customs, and local mores. I suggest that they are better able to evaluate such factors than American enforcement officials thousands of miles away and unfamiliar with the local environment.

Mistakes are made, naturally, and I want to tell you a story about a mistake that was made in Japan. At that time, resident aliens in Japan were required by letter of the law to report all of their earnings, whether paid in Japan or not. But the law was broadly ignored by virtually all American and other foreign firms having offices in Japan. These firms generally paid a large portion of their expatriate employees' salaries outside Japan. The Japanese tax rate was considerably higher than the American rate and since expatriate salaries were structured so as to produce an agreed after-tax net, employers could save a considerable amount of salary expense if large portions of their employees' salaries were not subject to Japanese tax. This, of course, required that the employees' Japanese tax returns omit salary payments made outside the country.

Incidentally, the practice was completely legal in certain other countries such as England, where salaries currently earned by foreigners working there, but not paid in the United Kingdom or brought into the United Kingdom, were not subject to British taxation. I do not know if that is still the case, but during the 1970s it certainly was.

Well, one day, in 1969, a zealous tax agent in Tokyo "discovered" the practice (which had been known about for years), and the government suddenly began investigating all foreign companies, one-by-one, in alphabetical order. Criminal and civil penalties were ordained and those penalties, together with interest charges going back for five or more years amounted in many cases to hundreds of thousands of dollars. Companies and their employees were offered amnesty if they immediately and voluntarily disclosed all such unreported amounts, and in return, the back period for interest and the amount of penalties was reduced.

Now, virtually every American company in Japan at that time, and probably most other foreign companies, had engaged in this practice, and I doubt if any of them believe they were violating accepted legal, ethical or moral standards. They believed that a legal fiction existed, that it was accepted, and that they were entitled and even expected to behave as they had.

That the Act has caused a great deal of difficulty with busi-

nessmen, both in interpreting it and being willing to take the risks and incur the costs of compliance, was stated by Theodore Sorenson, who, in 1977, had been a strong supporter of the Act. In testifying before the Senate Banking Committee on the proposed amendment, he said: "The vague and sweeping language of the present law has to my personal knowledge caused some wholly honorable entrepreneurs to stop doing business abroad and caused others to erect distorted and inefficient business structures as a shield against any unintended liability."⁵

B. Bribery Provisions

I would like to turn now to the bribery provisions of the Act. Congress' main goal, and many believe its only goal in enacting the FCPA, was bribery. A Senate report on S. 305,⁶ which was the bill that became the FCPA, makes the statement: "[T]aken together, the accounting requirements and criminal prohibitions should effectively deter corporate bribery of foreign government officials."⁷ Most people are opposed to the bribery of government officials, especially in the arrant forms that emerged during the 1970s. Those disclosures genuinely affected the prestige of American democracy abroad, possibly more because of the publicity than because of the acts themselves. They also jeopardized the support of friendly nations, impaired our foreign policy and shook public confidence in the financial integrity of American companies.

In candor, however, some would disagree that it is the job of the American Congress to export American law and ethics to the world community, criminalizing here acts which not only have taken place in a foreign sovereign nation, but which are not punished, and are in many cases not even punishable, where they have occurred. The failure of the world community to adopt an effective international agreement against corrupt practices is perhaps the most serious factor casting doubt on the advisability of the FCPA, given the enormous competitive disadvantage thus created for American firms.

I would like now to review some of the specific bribery provisions that have caused problems. First, the "reason to know"

5. *Id.* at 401.

6. SENATE COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS, REPORT TO ACCOMPANY S. 305, S. REP. NO. 114, 94th Cong., 1st Sess. (1977).

7. *Id.* at 3.

clause to which we referred. The Act prohibits any payment to a person if the payer knows, or has reason to know, that all or a portion of the payment will be given directly or indirectly to a foreign political official. For lawyer and client alike, the "reason to know" language creates a massive problem. In the interest of protecting his client, many corporate legal advisors have equated "reason to know" with "reason to suspect." Theodore Sorenson, in his testimony before the Senate Banking Committee, stated that: "(N)o other provision of the Act has caused more confusion and deterred more export activity on the part of many an American businessman who had no intention to pay bribes but a great fear of finding himself unintentionally liable for the unauthorized, unforeseeable and unknown acts of his company's independent agents whose misdeeds some prosecutor might someday allege, that businessman had 'reason to know'."⁸

This difficulty has made many U.S. firms reluctant to participate in joint ventures with foreign businessmen because of the fear of criminal prosecution resulting from unexpected conduct by their business associates. This problem is especially acute in the case of small businesses which, after all, do not have large organizations, and have to deal through an agent or through a local partner.

Second, the Act is ambiguous in its definition of a "foreign official". The language is problematical for two reasons. First, is an employee of a government-owned business, such as a government-owned airline, a public official? Second, and more serious, is the definition of "grease payments" or "facilitating payments". Instead of saying that grease or facilitating payments are permitted, the Act states that payments to "ministerial" or "clerical" employees are not prohibited. Ironically, read literally, the Act seems to suggest that a large corrupt payment to a ministerial or clerical employee would be all right, but that a small "grease" payment to a Prime Minister to get rotting bananas off the dock, would be a criminal act.

A third problem is with the word "corrupt." As you know, the FCPA prohibits only "corrupt" payments. But what of gifts, entertainment and travel expenses? According to the State Department, our Athens embassy reports that the Mideast director of a U.S. management consulting firm is no longer allowed by his com-

8. *Hearings on S. 708, supra* note 4, at 402.

pany to send a car and driver to the airport to meet a visiting senior Arab government official, or place a basket of fruit in his hotel room, although these things are customary and normal courtesies.

The definition of "corrupt" raises another problem. In many Third World countries, especially in the Mideast, most prominent businessmen also hold government offices. Payments to them or to their companies, whether to act as local agents for goods and services, or by way of compensation for profit-sharing in a partnership for joint venture, clearly involves the risk of allegation of improper payments. The Senate Banking Committee Report on S. 708, reports that in Qatar, only one of that country's fourteen cabinet ministers has no known business ties.⁹ Obviously, American firms fear that business payments might be construed as illicit payments to government officials. Similar situations exist in other countries such as Oman and the United Arab Emirates.

I would like also to pose a question; one that I cannot answer. A "corrupt" payment is a payment made to a foreign official in the course of obtaining or maintaining business. What about a payment made to a foreign official who authorizes work permits thus providing a firm with necessary staff to maintain business? Is that a corrupt payment? I do not know the answer. If it is not a corrupt payment, would it be a mail or wire fraud if it takes place by way of mail or wire?

A fourth problem is defining a "facilitating payment." The GAO survey states that thirty percent of the respondents viewed this provision as unclear, and twenty-five percent viewed it as only marginally clear. That means that if the GAO survey is accurate, more than half of the companies interviewed were not actually sure what constitutes a "facilitating payment."

A final area of uncertainty is the extent to which extortion can be a defense. The Senate Report uses as an example of such a defense, the threat of criminal violence, such as the blowing up of an oil rig. This would be a defense, because no corrupt purposes would be involved. What about economic extortion, such as threatening license revocation, expulsion from the country, or expropriation? Or cutting off oil supplies so that a factory cannot be fueled or bauxite dug?

The law has affected not only American companies, but their

9. REPORT TO ACCOMPANY S. 708, *supra* note 2, at 7.

foreign trading partners. A Thai businessman says "we have been a nation for a 1000 years, and a culture for 3000, and resent the United States telling us that our business practices are immoral."

Many foreign agents do not really want to get involved with us because one of the procedures adopted by many American companies to comply with the Act, is to send the agent some form of questionnaire asking him what he does, with whom he has done it, and for how long. People are afraid of the Justice Department, even foreigners. Rightly or wrongly, they expect they may receive a subpoena in the mail.

On the question of the Act's extraterritorial thrust, I do not think that punishing American corporations for bribery is extraterritorial, but there are other extraterritorial ramifications. One of the clearance requests submitted to the Justice Department in 1980 under its review procedures, involved Castle & Cook, which asked for clearance to permit a foreign employee of one of its overseas subsidiaries, who had worked for that subsidiary for ten years, to run for public office in his own country. He asked his employer for permission to retain his job while being a candidate. With due solemnity, restating all of the submitted facts, including the favorable opinion of local counsel, the Justice Department determined that it did not presently intend to take enforcement action. As the NAM asks, "does a foreign national require clearance from our Justice Department before he can run for elective office in his own country while retaining his job with a U.S. owned company? Were a U.S. citizen seeking public office in this country to need a similar clearance from a foreign government, . . . we would consider it an intolerable foreign interference in our public affairs."

IV. CONCLUSION

I would like to suggest that notwithstanding the fact that the most sensational cases, such as Lockheed, were in the Western World, those were really very unusual cases. From my own experience, most of the kind of bribery we have been discussing is in the Third World, not in Japan, and not in Holland. According to the International Chamber of Commerce, corruption appears to be so common in Third World countries as to have been accepted as a way of life, which the national authorities seem unable or lack the political will to overcome.

In very sharp contrast to the FPCA is the Multinational

Guidelines of the OECD on illicit payments. The short and succinct statement of the OECD provides: "Enterprises should not render — and they should not be solicited or expected to render — any bribe or any improper benefit, direct or indirect, to any public servant or holder of public office."¹⁰ I recently asked a State Department office, from the Bureau of International Investment, Technology and Development, about the chances that our OECD partners will cooperate with us in trying to push through the international agreement. His comment was that they are extremely lukewarm, because of their cynicism, and because of their self-interest, i.e., helping their own companies.

The extent to which corruption is inherent in much of the Third World can be gleaned from an excerpt of the 1964 Report of the Committee on Prevention of Corruption published by the Indian Government. This report attacks "grease payments" (which Congress and the Justice Department seem to think are all right).

The Report states:

Certain sections of the staff concerned are reported to have got into the habit of not doing anything in the matter till they are suitably persuaded. It was stated by a Secretary that even after an order has been passed, the fact of the passing of such an order is communicated to the persons concerned, and the order itself is kept back until the unfortunate applicant has paid appropriate gratification to the subordinate concerned. Besides being a most objectionable corrupt practice, this custom of speed money has become one of the most serious causes of delay and inefficiency.

It is for these reasons that the international agreement is so important, and why in the absence of such an agreement, the FCPA poses such difficult problems for American business.

10. Declaration on International Investment and Multinational Enterprises, *adopted* June 21, 1976, Annex and Decisions of Council, OECD Doc. 21 (76) 04/1 14 (1976). 75 DEPT ST. BULL. 83,87 (1976), 15 I.L.M. 967,972.