SYMPOSIUM

The Foreign Corrupt Practices Act: Domestic and International Implications*

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AN OVERVIEW OF THE FCPA

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I. INTRODUCTION

The Foreign Corrupt Practices Act[1] (FCPA) really started with Watergate. The Special Prosecutor had investigated a number of illegal campaign contributions by American corporations.[2] The role of the prosecutor, however, was limited to determining whether the provisions of 18 U.S.C. § 602 of the Federal Criminal Code had been violated by these contributions. We at the Securities and Exchange Commission (SEC) were watching the Special Prosecutor, and were intrigued by the devices the corporate community had used to get the funds for the contributions out of the corporate arena, away from corporate books. To satisfy our curiosity, we filed motions to obtain Grand Jury transcripts of the Prosecutor's investigations. After obtaining some of these Grand Jury transcripts, the first thing we found was that these large contributions were coming from slush funds that were maintained off the books of the various corporations. It seemed that one of the principal devices for setting up the slush funds was payment through a foreign agent or a consultant who would, in turn, return the money to the corporation, allowing the corporation to set up an off-the-book fund. We also learned that only a very small part of the money that was going into these funds was coming back for campaign contributions. The rest, it seemed, was remaining in the hands of the agents and was being used for what we eventually called "questionable payments," or in some cases actual bribes, in order to obtain and retain business overseas.

Having seen this as the problem, the enforcement staff of the SEC tried to determine just what it was that this meant to the public investor, the shareholder in a public company. We came up with a number of theories that we thought would have to be em-

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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. See Foreign and Corrupt Bribes: Hearings on S. 3133, Before the Senate Committee on Banking, Housing and Urban Affairs, 94th Cong., 2d Sess. 3 (1976).

ployed in analyzing this problem. The first theory was that the investor had a right to know if the company's books were being tampered with; it seemed clear, we thought, that the investor had a right to know that there was a possibility of a dishonest accounting. We also thought that an investor had a right to know if management was using his money to violate either U.S. or foreign laws. We also believed that an investor had the right to know when and how management was obtaining significant lines of business through bribery, or was subjecting the company to risks of losing significant lines of business if the bribery activities of the company were discovered. Finally, we believed an investor had a right to know of management stewardship of corporate assets if that stewardship involved the outlay of millions of dollars to consultants with no accountability for the consultants' use of the funds.

We did not, however, make moral judgments about the corporations and what they were doing. We tried to separate morality and the law—a difficult task. We did not make a determination that a corporation was good or bad. We felt only that we were enforcing the applicable provisions of the federal securities laws. If an overseas activity resulted in a possible loss of business, or if it indicated that the corporation was not making an honest accounting to its shareholders, then we made a determination as to whether that activity was material to the shareholders. If we thought that it was material, we recommended an enforcement action.

In the early days when we were drafting some of the complaints in the first cases, the seeds were planted for the FCPA as we now know it. For example, the first thing we did when we drafted our complaints in these cases was to seek an injunction against the falsification of books and records. At that time there was no requirement that companies maintain accurate books and records, but we sought injunctions against false entries.[3] That was the seed for section 13(b)(2)(a) of the Exchange Act.[4]

In addition, we also drafted some language concerning internal controls in the early pleadings. This arose from an incident that occurred when we confronted a company that had entered on its books enormous payments to foreign agents and consultants, in

3. 15 U.S.C. § 78m(b)(2)(A).
4. *Id.*

contrast to those companies that paid agents through off-the-books slush funds. The company argued that it could not be charged with preparing false books and records, although it conceded it did not know how the agents and consultants had used the payments. In response to this, I suggested that we charge the company with failing to disclose that payments were made to consultants and agents without adequate records and controls to ensure that the services performed by the agents, if any, were commensurate with the amounts paid. That was the seed for the internal controls provisions for the FCPA.[5] And later, as part of the FCPA, the idea became a more vigorous and refined legal concept.

It is important to mention that, at the same time, the SEC was very concerned about the magnitude of the problem. It appeared to be impossible to handle all of these apparently questionable payments as enforcement cases; there was a serious question as to whether the SEC could bring enforcement cases in every instance. The commission did not want to continue exclusively along the enforcement tack, so they came up with what was called the voluntary program:[6] if a company were to do its own investigation and come in and discuss disclosure and stop doing whatever they were doing, there might be less necessity to bring an enforcement case. It was not an immunity program, but it was a mechanism to separate the big problems from the little problems. About 400 companies came in and disclosed that they had had problems.

Without getting into all the details of the so-called voluntary program, it was clear that the problem was of such magnitude that something else had to be done. That is when the Congress came into the picture.[7] Two Congressmen in particular were interested in what was going on, Senator Church and Senator Proxmire. Both decided that more had to be done because the enforcement approach was not sufficiently prophylactic. They vigorously urged the Justice Department to get involved and to bring a number of criminal cases, and Senator Proxmire began to think in terms of a statute that would preclude foreign payments.

At the same time, there were the foreign policy concerns. One American company had allegedly paid bribes in excess of forty

5. Section 102 of the FCPA requires that issuers "devise and maintain a system of internal accounting controls." 15 U.S.C. § 78m(b)(2)(B).

6. *See* Stevenson, *The SEC and the New Disclosure*, 62 CORNELL L. REV. 50 (1976).

7. Surrey, *The Foreign Corrupt Practices Act: Let the Punishment Fit the Crime*, 20 HARV. INT'L L.J. 293, 295 (1979).

million dollars in Italy. In fact, the Italian government nearly collapsed as a result of the activities of American companies. Another company had allegedly enaged in conduct in Japan that resulted in the Japanese government toppling. There were also the scandals in the Netherlands where Prince Bernhard was allegedly on the payroll of an American company. Concerns were expressed that our government was faced with foreign policy determinations or decisions being made by American corporations. In other words, some of our corporations were affecting foreign policy and there was also the overriding concern that the whole idea of foreign payments or corruption in business was really putting an arrow in the bow of the countries that oppose our system. It gave other countries the opportunity to argue that our system is based on corruption. Finally, there was a concern that U.S. business did not know what was good for itself, and to continue along these lines, relying on bribery, was not in the best interest of U.S. business. We had to develop the strength to compete based on quality of product and not on our ability to make a payment in a black bag.[8]

At the time Congress became very active, the SEC was sort of a reluctant dragon. The Commission thought that it had the authority to adopt rules or to bring enforcement action, so as not to have to seek a statute that actually prohibited foreign payments. When the Commission saw that there would be a FCPA, however, it sought a very strong statute.

The Ford Administration at the time took an approach to the statute that has variously been described as cool, lukewarm, and tepid. The Ford Administration did not vigorously seek a statute that prohibited foreign payments, but rather, advocated a statute that would only require disclosure of a company's foreign payments. The company would make the disclosure with the Commerce Department, the Interior Department or any Department except the Justice Department or the SEC. At that time, in the atmosphere carried over from Watergate, a mild dose of disclosure was not hailed as a measure likely to produce a lasting cure. What came out of the legislative process was the FCPA as we now know it.[9]

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8. *See* George & Dundas, *Responsibilities of Domestic Corporate Management Under the Foreign Corrupt Practices Act*, 31 SYRACUSE L. REV. 865, 868 n. 9 (1980).

9. See note 1 *supra*.

II. THE FOREIGN CORRUPT PRACTICES ACT

A. Provisions

The Act as adopted had antibribery provisions[10] and accounting provisions.[11] On the antibribery side, the FCPA first, through section 103, added a new section 30A to the Securities Exchange Act of 1934. That section and its prohibition applied to issuers, that is, companies that are public companies who file reports with the SEC.[12] Also, section 104 adopted antibribery provisions and prohibitions that extended to what were known as domestic concerns.[13] Domestic concerns were defined in the Act as anything other than reporting companies. A partnership, a Massachusetts trust, or an individual, for example, could be a domestic concern. Section 104 extended the same prohibitions as section 103 to domestic concerns.

The issuers and the domestic concerns were prohibited from making, authorizing or promising payments or gifts of anything of value to a foreign official, party or party official or candidate, or to any person that the issuer or the domestic concern knew or had reason to know would pass along the money to a foreign official or to a political party or to a member of a political party. Thus, there were prohibitions on payments to officials, political parties, and third persons, with reason to know that the payments will be passed along. The prohibitions went to the making of payments to influence a government official in some official act or to induce him to use his influence with his government to obtain or retain business, or to direct business for the company making the payment. There is no de minimus standard in the statute; it applies to anything of value.[14]

Note that a facilitating payment to move goods or to get an import license, or something that the company is entitled to in a country, was not prohibited. That was done not by specifying that those payments were allowed, but by defining a foreign official to exclude a ministerial official, or low level employee in an agency.[15]

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10. 15 U.S.C. § 78dd-1 (Supp. V 1981).

11. 15 U.S.C. § 78m (Supp. V 1981).

12. 15 U.S.C. § 78dd-1(a) (Supp. V 1981).

13. 15 U.S.C. § 78dd-2(d)(1) (Supp. V 1981).

14. *See Joint Hearings Before the Subcomm. on Securities and International Finance and Monetary Policy of the Comm. on Banking, Housing and Urban Affairs*, 97th Cong., 1st Sess. 84-6 (1981).

15. 15 U.S.C. § 78dd-1(b), 78dd-2(d)(2) (Supp. V 1981).

That a payment had to be made to obtain or retain business, or be directed to someone for those purposes, is an important concept because the argument can be made that payments to get tax legislation or some sort of a regulatory benefit in a country might not be included within the provisions of the statute.

Still another point to note is that jurisdictional means had to be used in order to violate the statute. The jurisdictional means, such as the mails or other instrumentality, need only be used in furtherance of the payment, not the actual making of payment. If one were to use the jurisdictional means to cover up payment or to send a message to get to the point where one was going to make an improper payment, that could well be in furtherance of the payment.

The accounting provisions apply only to companies whose securities are registered under the 1934 Act. The first accounting provision under section 104 of the FCPA put a new section 13(b)(2) into the Securities Exchange Act of 1934. This section has a provision that all issuers have to make and keep books and records and accounts, which in reasonable detail reflect transactions and dispositions of the assets of the issuer. The FCPA also added section 13(b)(2)(B) to the 1934 Act, a section which deals with internal controls. The provision requires that all issuers have to devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that transactions are executed in accordance with management's authorization; that transactions are recorded as necessary to permit the preparation of financial statements and to maintain accountability for assets; that access to assets is permitted only in accordance with management authorization; and that recorded accountability is compared to existing assets at reasonable intervals, with appropriate steps taken to correct any differences.

The internal control provisions,[16] therefore, are designed to deal with the problems of off-the-books slush funds or company employees going beyond company policy and using corporate assets to make payments, or whatever, in a way the management would not want them used. They were also designed to ensure that there are controls on the company assets—that a company knows what assets it has and that management is aware of what is going on within a company concerning its assets. After the statute

16. 15 U.S.C. § 78m(b)(2)(A) (Supp. V 1981).

was adopted and signed into law, the SEC adopted rules to further the purposes of the FCPA.[17] One rule adopted by the SEC prohibits the falsification of the books and records that are required to be kept under the FCPA. The other rule adopted by the Commission prohibits an officer or director from making a materially false or misleading statement or omitting to state a material fact to accountants or auditors in connection with audits or filings.

B. *Enforcement Responsibilities*

An important feature of the statute is that it is administered dually by the Justice Department and by the SEC. The SEC has civil enforcement responsibility for the accounting provisions, and the Justice Department has criminal enforcement responsibilities for the accounting provisions. The SEC has civil enforcement responsibility for the antibribery provisions that apply to issuers.[18] The Justice Department has civil enforcement responsibilities with respect to the antibribery provisions that apply to domestic concerns, and criminal responsibility with respect to antibribery provisions that apply to issuers and domestic concerns.[19] Thus, administration was carefully thought out to give the SEC responsibility for issuers who file reports with the SEC, and the Justice Department responsibility for the domestic concerns that do not file with the SEC. The FCPA maintains a traditional approach, as the SEC has no criminal authority in any arena and can only investigate and refer criminal matters to the Department of Justice.

III. RECENT DEVELOPMENTS

In the four years since the FCPA has been in effect, there has been a great rush to shore up internal controls. There has been a great debate about what is meant by some of the terms in the statute, such as what is meant by "reasonable detail" with respect to keeping books and records, or what is meant by "reasonable assurances" with respect to internal controls requirements.[20] A committee of the American Bar Association put out a guide with respect to the accounting provisions, stating, in general, that if the questionable conduct does not impact upon financial statements, then it is

17. Rule 13(b)(1)-(2), 44 FED. REG. 10, *codified in* 17 C.F.R. § 240.13(b)2-1 (1982).
18. *See* 17 C.F.R. § 201.2(e) (1978).
19. 15 U.S.C. § 78u(d) (1976).
20. See *supra* note 15.

beyond the reach of the accounting provisons.[21] The staff of the SEC countered with the argument that Congress intended the accounting provisions not to apply narrowly to financial statement preparation, but rather to apply broadly to bolster or rehabilitate corporate accountability in light of the questionable payments scandals. The result of the differing ABA and SEC staff views has been a shooting match that has flared up on and off for years at seminars and ABA meetings.

With the antibribery provisions, the difficulty has become the problem of dealing with agents overseas. The provision states that a payment to a third party, with knowledge or with reason to know that the third party is going to pass the money on to a foreign official, is illegal. The problem arises with the definition of "reason to know." That is a concept that is going to be applied with hindsight. Many companies groped for safeguards that would withstand investigation at some later stage. Procedures have been developed over the years to try and help people who have to deal with the "reason to know" provision. For example, lawyers recommend that companies use a certain amount of diligence to investigate the qualifications and background of an agent, to outline his duties, and to set up a mechanism to monitor his activities. In essence, companies have been advised to record and document their efforts to demonstrate that they have operated in good faith. Good faith is the antithesis of corruption, thus, when a company documents its efforts to determine who the agents were and so forth, it establishes good faith and cuts against the argument that anything might have been done corruptly. There are obviously problems where foreign government officials double as businessmen and that conduct is not prohibited in their countries. Though such problems can be dealt with, it is sometimes difficult.

The Justice Department, with respect to the FCPA, has a review procedure through which a company can seek to get some assistance, and can determine whether or not the Justice Department will prosecute on a given set of facts. The Justice Department stated that it would not prosecute a company where a government official who represented a company, and at the same time had an official function with respect to the company's activities,

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21. ABA Comm. on Corp. Law and Accounting, *A Guide to the New Section 13(b)(2) Accounting Requirements of the Securities Exchange Act of 1934*, 34 BUS. LAW. 307 (1978).

isolated himself from any official decision affecting his client company. The Department, however, has stated that its position is not to be viewed as a precedent.

In any event, the tougher problems come along when there is sufficient time to utilize the review procedure, such as the last minute demand from a government official to a company to pay a commission of X percent to an agent new to the transaction. The company, faced with complying with the demand or the loss of business, has a serious problem under the statute. It has been my experience that the business community in this country recognizes the problem and aborts transactions like that. The company will usually walk away even though it may be at a substantial cost to their shareholders.

IV. CONCLUSION

In general, as a result of ambiguities in the books and records provisions, and the very rigorous antibribery provisions, the cry has gone out that the statute is destroying our ability to compete overseas, and has destroyed or decreased our exports. There is also a complaint that aids, such as the Justice Department review procedure, are too little, too late. Companies do not want to become laboratory experiments for determining how some of the terms are going to be interpreted. Finally, there is a complaint that the costs of compliance are so great, and the burden so great that foreign transactions are just not worth the effort, so they are aborted. There has been a great deal of evidence from Senate hearings on potential amendments of the FCPA, that the Act is difficult to live with.

The cries about ambiguity or the potential for uneven enforcement are seriously overdone. In my view, the enforcement record of the SEC and the Justice Department has been extremely modest. In the four years since the FCPA has been passed, only a handful of cases have been prosecuted. Cases brought under the accounting provisions of the FCPA have been very straightforward. For example, officials of a company had collected the proceeds of a public offering and used them for personal purposes. The SEC brought an action, maintaining the company violated the internal controls provisions and the books and records provisions of the FCPA. In another case, officers of a public company had allegedly paid themselves a travel expense every day, for a two year period, during which they actually spent a lot of time at

home. So the Commission brought a case charging violation of the accounting provisons. In another case, the Commission was concerned that a public company was not making its filings under the 1934 Act, and so sent out staff to find out why. The staff found that the company did not have any books and records, so it could not make any reports. The Commission brought charges of violations of the accounting provisions.

These are not examples of earthshaking cases or cases involving difficult interpretive issues.[22] As to the antibribery provisions, no more than four or five cases have been brought in four years. Thus, the enforcement of the FCPA has not been extreme. In any event, there is a strong movement to amend the statute. There are ambiguities in the FCPA; we now have experience with it, and it can stand amendment. This amendment process is under way now.

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22. *See generally* Timmeny, *International Aspects of the Accounting Provisions of Foreign Corrupt Practices Act*, 360 CORP. L. & PRAC. 53 (1981).