The Foreign Corrupt Practices Act

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Anatomy of a Statute

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To Sandy

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Preface and Acknowledgments

This book developed from our teaching experiences in the fields of legal analysis and governmental processes in the Jesse H. Jones Graduate School of Administration at Rice University. The master of business and public management curriculum emphasizes the broader legal and political environment in which the modern corporation must operate. The book is part of a larger research program that we are conducting in the areas of business-government relations and regulation.

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1 Purpose of the Study

The Foreign Corrupt Practices Act of 1977 has been characterized as the most extensive application of federal law to the regulation of corporations since the passage of the 1933 and 1934 securities acts.[1] The revelations of improper payments abroad by American corporations shook the governments of Belgium, Holland, Honduras, Italy, and Japan. One commentator observed that "the leadership of American big business has never been held in such low regard since perhaps the days of the Great Depression. . . . big business is now close to the bottom rung in measures of public trust and confidence."[2]

There are two prevailing views of the Foreign Corrupt Practices Act (FCPA) of 1977.[3] The first view is that it has been a necessary and meritorious response to "widespread and massive" bribery of foreign governments, politicians, and political parties conducted systematically for the purpose of obtaining overseas sales. According to this viewpoint, the Foreign Corrupt Practices Act "clearly has deterred bribery abroad."[4] Adherents of this viewpoint conclude that the statute should not be revised. This position advocates retention of both the antibribery penalties and the internal-accounting-control provisions of the act. Often it is argued that bribes result, not from foreign competition, but from competition among U.S. firms. Elliot Richardson, then secretary of commerce, told Congress in 1976 that "in a multitude of cases—especially those involving sales of military and commercial aircraft—payments have been made not to outcompete foreign competitors, but rather to gain a competitive edge over U.S. manufacturers."[5]

Critics cite three areas where the Foreign Corrupt Practices Act involves costly impositions on the foreign operations of American companies: (1) facilitating payments to minor officials for expediting matters (as distinct from bribery to make policy decisions) are ill-defined and therefore avoided, with the risk of the loss of export trade; (2) companies are required to know what their foreign agents are doing;[6] and (3) the accounting-and-recordkeeping requirements are virtually impossible to meet.[7] Secretary of Commerce Malcolm Baldridge and the U.S. Special Trade Representative William Brock have both called for reducing the bookkeeping requirements and, in the case of the second item, eliminating U.S. responsibility

for the unauthorized actions of foreign agents.[8] The law presently holds a U.S. company liable for such activity if it had reason to know that bribery might happen.

Secretary Baldridge has argued that small and medium-sized companies withdraw from export markets rather than pay for the legal advice necessary to interpret the ambiguous provisions of the statute. In his view, facilitating payments (which are legal under the act) are necessary for foreign operations in many countries.[9] Senator John H. Chafee (Republican of Rhode Island) has sponsored legislation (the Business Accounting and Foreign Trade Simplification Act) that would restrict the accounting requirements to sales expenses having a *material* impact on the particular business. In Senator Chafee's view, "When Congress passed the act in 1977, our intention was to prevent U.S. companies from bribery of foreign officials in order to win contracts. It was not our intention to create massive confusion, consternation and uncertainty among the business community and the accounting and legal professions. We have done both."[10] Although recent proposals would leave bribery (as distinct from facilitating payments) illegal and punishable, at the time the Foreign Corrupt Practices Act was passed the alternative suggested by the Ford administration was simply full disclosure rather than prohibition.

This book is a detailed study of the passage, implementation, and proposed revision of the Foreign Corrupt Practices Act of 1977. The act is of current interest due to substantial amendments proposed in 1981 by Senator Chafee and endorsed by the Reagan administration.[11] The administration proposed to go even further than Senator Chafee. In addition to clarifying the nature of facilitating payments and removing responsibility for unauthorized actions by foreign agents, the administration wished to eliminate entirely the accounting provisions enforced by the Securities and Exchange Commission (SEC). The Justice Department would retain responsibility for criminal prosecution of concealment of bribes.[12]

The basic elements of this book include an examination of how and why the present Foreign Corrupt Practices Act became law; an analysis of the basic difficulties in its interpretation and enforcement, which, we argue, are inherent in the hasty adoption of the act itself; and a consideration of the advantages and disadvantages that should be weighed in evaluating possible revisions of the statute. The methodology of the study is a detailed review of the legislative history of the act and the history of its enforcement, together with an analysis of the provisions of the act, the impacts or effects on business of those provisions and their enforcement, and the likely consequences of adopting proposed revisions.

We argue that the Foreign Corrupt Practices Act was passed under the pressure of a domestic political crisis (the Watergate scandal) that resulted in severe foreign repercussions (the revelations of questionable or sensitive

payments abroad by U.S. corporations). The statute as passed was justified by a moralistic theory of foreign policy endorsed by the new Carter administration. The approach taken is thus to argue that the present statute was adopted in the context of a domestic political crisis whose international repercussions were finally seen through the lenses of the Carter doctrine on foreign policy. The statute contains seriously conflicting or ambiguous provisions that affect its interpretation and enforcement. Finally, we point out that the Foreign Corrupt Practices Act incorporates a new and expanded role for the Securities and Exchange Commission in regulating the social accountability of public corporations as distinct from insuring their managerial integrity and financial soundness.

What we propose in this study is that the Foreign Corrupt Practices Act be reexamined from a different perspective. In our view, it is methodologically valuable to criticize the foreign-policy theory embraced by the Carter administration in supporting passage. What we substitute as a standard for evaluation of the statute's provisions and enforcement history is a marketplace theory of regulating questionable payments. The foreign-policy theory suggests that America's standards of moral conduct in foreign business are a vital component of our foreign-policy position and national reputation. We suggest a marketplace theory of business practices, fair dealing in markets, and promotion of domestic and foreign competition. Our fundamental conclusion is that, while the Foreign Corrupt Practices Act should definitely be retained in order to meet the criteria of the marketplace theory advanced here, that theory indicates that the specific requirements of the statute need to be much more clearly defined. In addition, bribery should be a crime under foreign law to be prosecuted with the assistance of the U.S. government. The Foreign Corrupt Practices Act should emphasize disclosure under a materiality standard rather than criminalization of payments per se. Failure to disclose material payments (materiality) and conspiracy to commit bribery overseas (scienter) are the appropriate foci for American action. This direction is indicated by the distinction between questionable and facilitating payments already incorporated, albeit in a most muddled fashion, in the act.

This book is addressed to multiple audiences, including lawyers, accountants, public officials, and business executives interested in the debate over the FCPA itself; those interested in the business and economic aspects of the conduct of American foreign policy in the 1970s and 1980s; those interested in the dynamics of business-government relations more generally; and those interested in the functioning of the legislative process under stress. The study is subtitled "Anatomy of a Statute," because it is used as an illustration of: (1) the legislative process under stress (the act in our view is largely a product of the Watergate investigations); (2) what we call a "proconsular strategy" of business-government relations (the Carter

administration and Senate activists sought to achieve foreign-policy goals through regulation of business conduct by the SEC and the Justice Department); (3) the development of what we call the "law of government control" (which we see as the steadily evolving expansion of traditional regulatory powers to encompass new noneconomic concerns); (4) the problems involved in extraterritorializing American moral standards and business practices; and (5) the potential for confusion among foreign-policy, ethical, and marketplace considerations.

The authors come to these issues with a particular viewpoint that should be stated at the outset of the analysis. The debate over the question of which foreign payments are prohibited, and which not, or what is an adequate accounting control, and what not, partially obscures a broader issue of potentially greater significance for American corporations doing business abroad. The Foreign Corrupt Practices Act of 1977 seeks most fundamentally to convert the American business corporation operating abroad into an instrument of U.S. foreign policy. The statute thus marks a major attempt by the U.S. government to enforce a series of noneconomic foreign-policy objectives through an enterprise form whose principal purpose and rationale have traditionally been thought to be economic. Despite the uniqueness of the statute in subordinating the economic interests of corporations, little attention has been paid to this facet of the law. There is a need to have a better understanding of how the U.S. government, through the Foreign Corrupt Practices Act, seeks (in what we call a proconsular strategy) to use the corporation as an instrument of foreign policy.

The Foreign Corrupt Practices Act, though ostensibly designed to respond to a specific set of circumstances, was made part of a foreign policy that sought to be more ethically systematic, rather than created in response to a particular political crisis. The Carter administration, seeking to recover from Watergate and Vietnam, assumed that American foreign policy must be suffused with morality if it were to survive, in contrast to the older doctrine that the intrinsic moral worth of the nation justified self-preservation by all available means. The basic conflict over the Act has come down to this division: those who believe that concern for morality is irrelevant without survival, economic or political; and those who believe that survival is irrelevant without morality. To argue that the Foreign Corrupt Practices Act ignores the way things are throughout most of the world appeals to our sense of reality. But to agree that American businesses ought to be free to compete on exactly the same terms cuts directly against the American self-image. We suggest that characterizing the Foreign Corrupt Practices Act as mere moralizing is too easy and too limited. Moreover, the statute is not very clear, containing several purposes—some of which are contradictory, and all of which are muddled together. The choice between disclosure and criminalization depends ultimately on the theory of proper conduct under-

lying the statute. We suggest that there is a marketplace theory—introduced but largely ignored in the controversy over the existing statute—that potentially offers some guidance in the choice.

In part because of its erratic genesis, in part because of the variety of motives of those who supported it, and in part because of the period of corporate-reform activism in which it was born, the Foreign Corrupt Practices Act is a hodgepodge of conflicting ends and means. The act involves various purposes. Originally envisioned as strictly a disclosure statute, along the traditional lines of preceding securities laws, the act was finally transformed into a prohibitory criminal statute; nonetheless, the ties to the securities laws were maintained, despite the added confusion this relationship contributed to the understanding of the final product. Likewise, the desire to ban all corrupt payments was ameliorated by the successful attempt to exempt certain facilitating payments regarded as less reprehensible and, on balance, necessarily permissible for the practical conduct of business overseas. The result was a distinction between types of payments that no one really understands or, worse still, on which few businesses are willing to stake their futures considering the potentially severe criminal and civil liabilities.

The Foreign Corrupt Practices Act is a classic example of the ills that can be engendered by legislation shaped over a short period of time, under stress conditions, which draws support from different groups with different purposes, and which passes, ultimately, in the heat of a moment when something noble sounding must be done. More important, the statute is an example of how legislation is handled when its passage is made a moral imperative, and those who oppose it must say nothing for fear of appearing to condone the behavior that the public at large is decrying. Throughout the legislative history of the act, the most striking element is the absence of widespread business criticism of the proposed law as unwieldy, unworkable, or unwise. Still smarting from the scandal of the payment revelations in the backlash of the Watergate affair, business said little, if anything, in order to avoid the appearance of favoring bribery. Rather than make the difficult case for balancing the hope for a moral foreign policy and ethical corporate activities abroad against the possible needs generated by the realities of international commerce, business remained, by and large, silent.

The result has been a law that refuses to admit of potential problems in the conduct of transnational business, that is proving impracticable in daily operation, and that no one—government official, corporate executive, lawyer, accountant, or would-be rewriter of the act—seems able to address effectively. Government guidance to business concerning enforcement of the act—split between two agencies, and subject broadly to the foreign-policy standards of the White House—has been sporadic, groping, and in the end, inadequate. The agencies responsible, rather than illuminating the

intricacies of the act and clarifying its ambiguities, have, by their jurisdictional squabbles and pursuit of separate policy agendas, failed to provide adequate guidance to the business community. Business, in turn, first refused to speak against the act. Now that it must comply, business has created a series of policies and procedures that meet the requirements of the law most often by the outright abandonment of business opportunities overseas that might create liabilities under the statute. Corporate lawyers and accountants have, in their role as advisers, been of very little help, each pointing the finger of responsibility for interpretation of the act at the other.

We examine the controversy over enforcement of the FCPA partly from the perspective of the U.S. corporation—which is profoundly affected by the statute whether or not it is engaged in foreign activities. We seek to answer two questions concerning the act. First, what are the business implications of the statute's provisions and their enforcement for U.S. corporations? Second, what has been the operating response of American business to the act? We believe that this particular perspective—handled analytically—is a useful addition to the debate. Not surprisingly, the business community has been the most vociferous in its complaints about the act—after its passage. Whether a fair or unfair supposition, it is nevertheless an understandable suspicion that U.S. companies may be shedding crocodile tears—a suspicion possibly reinforced by the Reagan administration's support for going well beyond the amendments proposed by Senator Chafee. An analysis of the implications for business conduct is therefore highly germane to the present reassessment of the statute.

Notes

1. American Bar Association, Committee on Corporate Law and Accounting, "A Guide to the New Section 13(b)(2) Accounting Requirements of the Securities Exchange Act of 1934 (Section 102 of the Foreign Corrupt Practices Act of 1977)," *The Business Lawyer* 34 (November 1978):308.

2. Nicholas Wolfson, professor of law, University of Connecticut, formerly assistant director and special counsel with the Securities and Exchange Commission, in U.S. Senate, Committee on Banking, Housing and Urban Affairs, *Foreign Corrupt Practices and Domestic and Foreign Investment Disclosure: Hearing on S.305,* 95th Congress, 1st Session (March 16, 1977), p. 215.

3. On the act in general see Judah Best, "The Foreign Corrupt Practices Act," *Review of Securities Regulation* 11 (February 13, 1978):975–982, reprinted in *The Foreign Corrupt Practices Act of 1977: Do You Know*

This Act Covers Domestic Business Activities? New York: New York Law Journal Seminars Press, 1978), pp. 127–134.

4. Norman C. Miller, "U.S. Business Overseas: Back to Bribery?" *Wall Street Journal* (April 30, 1981), p. 24. Reprinted by permission of *The Wall Street Journal,* © Dow Jones & Company, Inc. (1981)—All rights reserved.

5. Ibid. (cited).

6. For an analysis, see Bruce A. Mann, "Payments Excluded from the Prohibitions of the Foreign Corrupt Practices Act and Disclosure Obligations for Such Excluded Payments (March 31, 1978)" in *The Foreign Corrupt Practices Act of 1977,* pp. 367–377.

7. For an analysis, see Ray Garrett, Jr., "Responsibilities and Liabilities for Directors and Officers—Audit Committees (April 4, 1978)" in *The Foreign Corrupt Practices Act of 1977,* pp. 379–385.

8. Bill Neikirk, "OK 'Small' Bribes, U.S. Aide Urges," *Chicago Tribune* (March 23, 1981), section 1, pp. 5–6.

9. Ibid.

10. "Letters to the Editor," *Wall Street Journal* (May 13, 1981).

11. "Payoff Perspective: Senate to Begin Debate of Administration's Plan to Ease Rules Against Paying Bribes Overseas," *Wall Street Journal* (May 20, 1981), p. 48; "Move to Clarify, Soften Antibribery Law on Foreign Business Is Backed by Reagan," *Wall Street Journal* (May 21, 1981), p. 7.

12. Ruth Marous, "FCPA Bill Would Loosen Controls on Foreign Payoffs," *National Law Journal* (June 1, 1981), p. 3.