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# *FOREIGN CORRUPT PRACTICES ACT*


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## ABSTRACT

The Foreign Corrupt Practices Act of 1977 was intended to prohibit bribery of foreign officials by American corporations. This report discusses the Foreign Corrupt Practices Act of 1977, the major 1988 amendments, and the 1998 amendments bringing the Act into conformance with the Organization for Economic Cooperation and Development's agreement on bribery.

Foreign Corrupt Practices Act


## Summary

The Foreign Corrupt Practices Act of 1977 was enacted principally to prevent corporate bribery of foreign officials. This Act had three major parts: 1. It required the keeping by corporations of accurate books, records, and accounts; 2. It required issuers registered with the Securities and Exchange Commission to maintain a responsible internal accounting control system; and 3. It prohibited bribery by American corporations of foreign officials.

The Act was amended in 1988 in response to numerous criticisms. One of the changes enacted a "knowing" standard in order to find violations of the Act. Certain defenses were provided against finding violations of the Act.

In 1998 Congress amended the Act in order for it to comply with the Organization for Economic Cooperation and Development's agreement on bribery.

# Foreign Corrupt Practices Act

During the mid-1970's investigations and administrative and legal actions against numerous domestic corporations revealed that the practice of making questionable or illegal payments by United States corporations to foreign government officials existed to some extent within the American business community. The legal and regulatory mechanisms for dealing with these payments had involved actions by the Securities and Exchange Commission (SEC) against public corporations for concealing from required public disclosure substantial payments made by the firm and the potential for an antitrust action for restraints of trade or fraud prosecutions by the Justice Department.

Government officials and administrators contended that more direct prohibitions on foreign bribery and more detailed requirements concerning corporate record keeping and accountability were needed to deal effectively with the problem. The revelations of slush funds and secret payments by American corporations were stated to have affected adversely American foreign policy, damaged abroad the image of American democracy, and impaired public confidence in the financial integrity of American corporations.[1] Congress responded with the passage of the Foreign Corrupt Practices Act of 1977.[2]

The principal purpose of the 1977 Act was to prevent corporate bribery of foreign officials. It has three basic provisions to accomplish this purpose. 1. The Act amended section 13(b)[3] of the Securities Exchange Act of 1934[4] to require issuers which must register their securities with the SEC to keep detailed books, records, and accounts which accurately record corporate payments and transactions. 2. SEC registered issuers must institute and maintain an internal accounting control system to assure management's control, authority, and responsibility over the firm's assets.[5] 3. Domestic corporations, whether or not registered with the SEC, are prohibited from corruptly bribing a foreign official, a foreign political party, party official, or candidate for the purpose of obtaining or maintaining business. Two provisions of the 1977 Act[6] provide criminal penalties for any American business which uses the mails or interstate commerce "corruptly" in furtherance of an offer or payment of money or anything of value to a "foreign official" or to a political party, party official, or

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[1] *See* S.Rept. 95-114, 95th Cong., 1st Sess., at 3 (1977).

[2] P.L. 95-213, Title I; 91 Stat. 1494, Dec. 19, 1977.

[3] 15 U.S.C. § 78m(b).

[4] 15 U.S.C. §§ 78a *et seq*.

[5] 15 U.S.C. § 78m(b)(2)(B).

[6] 15 U.S.C. §§ 78dd-1 and 78dd-2.

candidate for foreign political office in order to influence the person in his decision-making or to use his influence to assist the firm in obtaining or retaining business.

The 1977 Act also prohibits the payment of money to any person by a business if the business knew or had reason to know that the payment was to be used to bribe a foreign official for his influence in obtaining or retaining business. Congressional intent appears to place an affirmative responsibility on the corporation to exercise control over its officers, directors, and employees and to take steps to assure that its foreign agents are not using corporate assets or payments made to them to bribe foreign officials.[7]

Under the 1977 Act not all payments to employees of foreign governments were intended by Congress to be considered illegal bribes. For example, the definition of "foreign official" excluded employees of a foreign government "whose duties are essentially ministerial or clerical." Also, the legislative history of the Act specifically states that it was not intended to cover "grease payments" to foreign officials, explained as "payments for expediting shipments through customs or placing a transatlantic telephone call, securing required permits, or obtaining adequate police protection, transactions which may involve even the proper performance of duties."[8] The legislative history also suggests that extortions of money by foreign officials may be used as a defense against bribery charges by a business if its property or lives of its employees have been threatened. An example used to illustrate acceptable payments was the payment to a foreign official to prevent the dynamiting of an oil rig.[9]

Almost since passage of the 1977 Act, there has been frequent criticism of its operation. Opponents have argued that "grey" areas of the law, where what is permitted may not be clear, have had a chilling effect on United States export trade because many companies have ceased foreign operations rather than face the uncertainties in the Foreign Corrupt Practices Act. Some critics of the Act have contended that these provisions have cost up to $1,000,000,000 annually in lost United States export trade. Critics of the Act have argued for precise and specific guidelines to be enacted as to what is prohibited and what particular conduct is permitted, instead of the vague standards of the 1977 Act, and have argued for precise statutory language to effectuate Congress's original intent to allow "grease" payments.

Critics of the 1977 Act also argued for the removal of the "reason to know" standard concerning liability for actions of a firm's agent in a foreign country. This would eliminate the legal responsibility of the management of a domestic firm over the unauthorized and undirected actions of an agent without the necessity of management's also showing that it had no "reason to know" that the agent was using corporate funds, payments, or commissions to bribe foreign officials. These critics argued that American firms should not have to bear the responsibility of playing detective concerning the independent actions of persons that they retained as agents in foreign countries.

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[7] S.Rept. 95-114, at 1.

[8] S.Rept. 95-114, at 10.

[9] S.Rept. 95-114, at 10-11.

Critics also contended that the internal accounting controls required by the 1977 Act were too costly and burdensome upon domestic firms, especially when potential criminal penalties within the Act for failure to institute adequate controls arguably made officials of firms overly and unnecessarily cautious in implementing costly accounting controls. The public record keeping requirements were also criticized as unduly burdensome. Critics of the Act argued for a materiality standard for public record keeping in which a firm would be required only to report expenditures and outlays deemed material to the profits and revenues of the firm.

Another frequent criticism of the 1977 Act was that the United States was more interested in exporting its cultural biases than its products. It was argued that, in nations in which acceptance of a fee or payment by a government official from one doing business with the government is customary and not unlawful under the laws of that nation, no violation of a United States law should occur. Critics also argued that an international agreement among the world's industrialized nations prohibiting businesses of all those countries from bribing foreign officials was necessary to prevent businesses of other countries from gaining an unfair and harmful competitive advantage over American businesses.

In response to these criticisms, Congress for a number of years considered amending the 1977 Foreign Corrupt Practices Act. After a great deal of debate through at least three Congresses, the Foreign Corrupt Practices Act Amendments of 1988 were signed into law as Title V of the Omnibus Trade and Competitiveness Act of 1988[10] on August 23, 1988. Although the amendments maintained the three major parts of the 1977 Act discussed above, the accounting standards, the requirements of SEC registered issuers, and the anti-bribery provisions, the 1988 Amendments made some significant changes in the 1977 Act.

Section 5002 of the Trade Act amends section 13(b) of the Securities Exchange Act to provide that no criminal liability shall be imposed for violation of the accounting standards unless a person knowingly circumvents or knowingly fails to implement a system of accurate and reasonable accounting controls. According to the legislative history, this provision is intended to ensure that criminal penalties would be imposed where acts of commission or omission in keeping books or records or administering accounting controls have the purpose of falsifying books, records, or accounts or of circumventing the accounting controls. This is also intended to include the deliberate falsification of books and records and other conduct calculated to evade the internal accounting controls requirement.[11]

Section 5002 of the Trade Act also adds to section 13(b) of the Securities Exchange Act a provision that an issuer which holds 50% or less of the voting power of a domestic or foreign firm is required to use its influence only in good faith to cause the domestic or foreign firm to devise and maintain a system of acceptable accounting controls. The House Report states that this amendment is intended to

[10] P.L. 100-418, 102 Stat. 1107.

[11] H. Rept. 100-576, 100th Cong., 2d Sess., at 916-917 (1988).

recognize that it is unrealistic to expect a minority owner to exert a disproportionate degree of influence over the accounting practices of a subsidiary.[12]

For purposes of the accounting standards, "reasonable assurances" and "reasonable detail" mean such level of detail and degree of assurance as would satisfy prudent officials in the conduct of their own affairs. Thus, the prudent man qualification was adopted to clarify that the current standard does not require an unrealistic degree of exactitude or precision.

Section 5003 of the Trade Act amends the provisions of the Foreign Corrupt Practices Act which concern the anti-bribery prohibitions by issuers and domestic concerns. It remains prohibited for any issuer which has a class of securities registered with the Securities and Exchange Commission or for any officer, director, employee, or agent of the issuer or any stockholder acting on behalf of the issuer or for any United States concern to make use of the mails or other means of interstate commerce to offer, pay, promise to give, or authorize the giving of anything of value to a foreign official, a foreign political party, party official, candidate, or any person for the purpose of obtaining or maintaining business. Section 5003 amended the 1977 Act to prohibit payments to any foreign official for the purpose of "influencing any act or decision of such foreign official in his official capacity, or inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official." This language was inserted so that the foreign bribery standard would conform to the domestic bribery standard found in 18 U.S.C. section 201.[13]

The "knowing" requirement is retained, and the "recklessly disregarding" standard was abandoned in conference. However, the "knowing" requirement is intended to encompass the "conscious disregard" and "willful blindness" standards, including a conscious purpose to avoid learning the truth.

> [T]he Conferees agreed that "simple negligence" or "mere foolishness" should not be the basis for liability. However, the Conferees also agreed that the so-called "head-in-the-sand" problem--variously described in the pertinent authorities as "conscious disregard," "willful blindness" or "deliberate ignorance"--should be covered so that management officials could not take refuge from the Act's prohibitions by their unwarranted obliviousness to any action (or inaction), language or other "signaling device" that should reasonably alert them of the "high probability" of an FCPA violation.[14]

The major changes which section 5003 of the Trade Act makes in the 1977 Foreign Corrupt Practices Act have to do with when the bribery provisions will not be found to apply to an American business or person acting on behalf of an American business. For example, the anti-bribery provisions shall not apply to any facilitating or expediting payment to a foreign official, political party, or party official if the purpose is to expedite or to secure the performance of a routine governmental action by a foreign official, political party, or party official.

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[12] H.Rept. 100-576, at 917.

[13] H.Rept. 100-576, at 918.

[14] H.Rept. 100-576, at 920.

Further, an American business or individual may use one of the "affirmative defenses" in urging that no violation of the FCPA has occurred. The first of these enumerated affirmative defenses is that the payment, gift, offer, or promise of anything of value that was made was lawful under the written laws and regulations of the foreign official's, political party's, party official's, or candidate's country. Another affirmative defense is that the payment, gift, offer, or promise of anything of value that was made was a reasonable and bona fide expenditure, such as travel and lodging expenses which were incurred by or on behalf of a foreign official, party, party official, or candidate, and was directly related to the promotion, demonstration, or explanation of products or services or the execution or performance of a contract with a foreign government or agency. This defense would not apply, however, if a payment or gift is corruptly made in return for an official act or omission because it would then not be a bona fide, good faith payment.

The Attorney General, after consulting with certain named other federal officials, is required to issue guidelines which describe specific types of conduct which would fit within the affirmative defenses and also general precautionary procedures which issuers may use in order to comply with the amendments. The Attorney General is also required to issue an opinion within thirty days of a request to provide a response to a specific inquiry by an issuer concerning the conformance of its conduct with Department of Justice guidelines.

In the definitional sections of the amendments, the terms "knowing" and "routine governmental action" are especially important. A person's state of mind is "knowing" with respect to conduct, a circumstance, or a result if the person is aware of engaging in the conduct, that the circumstance exists, or that the result is substantially certain to occur or if the person has a firm belief that the circumstance exists or that the result is substantially certain to occur. When knowledge of the existence of a particular circumstance is required for an offense, the knowledge is established if a person is aware of a high probability of the existence of the circumstance unless the person actually believes that the circumstance does not exist.

"Routine governmental action" is only ordinarily and commonly performed by a foreign official in obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country; processing governmental papers; providing police protection, mail pick-up and delivery, or scheduling inspections associated with contract performance or inspections related to transit of goods across country; or providing phone service, power and water supply, loading and unloading cargo, or protecting perishable products or commodities from deterioration. The term does not include any decision by a foreign official whether or on what terms to award new business to or to continue business with a particular firm.

The amendments also increased penalties for violations of the Foreign Corrupt Practices Act. The maximum criminal fine for a firm or domestic concern was raised from $1,000,000 to $2,000,000 and for individuals from $10,000 to $100,000. The maximum potential imprisonment for an individual remained at five years. There was also a new civil penalty of $10,000.

One of the continuing criticisms of the FCPA was that American businesses were at a disadvantage in obtaining business abroad because many of the other industrialized nations do not have severe penalties for bribing foreign officials. Over the years there has been a considerable amount of international interest in standardizing bribery statutes. In particular, the Organization for Economic Cooperation and Development (OECD) has given a great deal of attention to this issue. The OECD is an organization which permits governments from primarily industrialized democracies to study and formulate policies concerning economic and social issues. On November, 21, 1997, negotiators from the twenty-nine OECD member states[15] and five other countries[16] adopted in Paris a Convention on Bribery of Foreign Public Officials in International Business Transactions (Convention). A signing ceremony occurred in Paris on December 17, 1997.

In many ways the OECD Convention on Bribery is very similar to the Foreign Corrupt Practices Act. However, there were a few differences which necessitated changes in the FCPA in order for the FCPA to conform with the OECD Agreement. In the 105th Congress these needed changes were enacted as P.L. 105-366.

P.L. 105-366 revised the Securities Exchange Act of 1934 and the FCPA to prohibit conduct intended to obtain improper advantages from foreign officials by securities issuers, officials of international organizations, and domestic concerns. It redefined "foreign official" to include an official of a public international organization. It declared that it is unlawful for any issuer organized under United States laws to commit specified prohibited acts outside the United States. It also amended the FCPA to prohibit specified foreign trade practices by a covered person or any officer, director, employee, agent, or stockholder of the covered person while in United States territory.



[15] OECD member countries are Austria, Australia, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, New Zealand, The Netherlands, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States.

[16] Argentina, Brazil, Bulgaria, Chile, and the Slovak Republic.