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THE FOREIGN CORRUPT PRACTICES ACT: A CASE OF OVERKILL?

INTRODUCTION

During the investigation of illegal domestic political payments following the Watergate scandal, the Securities and Exchange Commission (SEC) uncovered secret corporate funds being used for questionable payments to foreign officials and political parties. This discovery led to congressional hearings concerning the extent of bribery (in American terms) by U.S. firms doing business overseas. To eliminate or at least reduce this behavior, the Foreign Corrupt Practices Act (FCPA) was passed by Congress and signed into law by President Carter in December 1977.[1]

The FCPA outlaws payments to foreign officials to secure business, establishing both civil and criminal penalties. Because many of the bribes discovered were made through foreign sales agents, the Act includes a provision making U.S. companies responsible for the actions of their overseas agents if there is reason to know of any misconduct. As a means of implementing the anti-bribery sections of the statute, the FCPA also establishes strict accounting standards requiring maintenance of accurate accounting records and an internal accounting controls system. The firm, through its accounting system, is responsible for providing reasonable assurances that economic events affecting the corporation are properly recorded and assets are adequately safeguarded.

After four years of experience with the FCPA, Congress is considering amending the Act. Several problems have been identi-

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1 Howard L. Weisberg and Eric Reichenberg, "The Price of Ambiguity: More Than Three Years Under the Foreign Corrupt Practices Act," Research Report, International Division, Chamber of Commerce of the United States, 1981, p. 4.

fied in testimony before committees investigating the effectiveness and the costs of the FCPA. Most of the comments concern the vague language of the Act, the severity of the criminal sanctions, and the unilateral nature of the FCPA. As Howard Weisberg, a representative of the U.S. Chamber of Commerce, recently testified, "[W]e are not questioning the objective of the FCPA to eliminate bribes to influence actions by foreign government officials. We do, however, feel strongly that the translation of that objective into statutory language was not well done."[2]

THE ACCOUNTING STANDARDS

If the purpose of the FCPA was to generate an internal review of accounting procedures, it has been an overwhelming success. In a recent survey conducted by the General Accounting Office (GAO) to determine the impact of the FCPA, 98.2 percent of the respondents reported reviewing their internal accounting procedures; more than 75 percent reported making changes to comply with the Act. Certain areas were identified as special targets for change: 1) the documenting of internal accounting controls, 2) the testing of internal control systems, 3) the strengthening of internal audits, and 4) the performing of special reviews designed to identify areas where certain types of policy violations are likely to occur.[3] The increased activity among accountants following passage of the FCPA has been so widespread that the Wall Street Journal referred to the Act as the "Internal Auditor Full Employment Act of 1977."[4]

Criticisms of the accounting provisions have centered on two major points. The most widely voiced complaint concerns the vague language of the Act. The FCPA requires "reasonable" efforts be made to ensure accurate books are kept. However, what a businessman defines as "reasonable" may differ substantially from the SEC definition. The Senate committee report on the FCPA mentioned cost/benefit analysis by management in setting accounting standards and establishing internal control systems. No objective criteria were offered, however, to ensure the same set of standards was understood by both the business community and those enforcing the law.[5] Members of the accounting profession, therefore, have been forced to attempt to interpret the law for their employers. For these reasons, more than 70 percent of the respondents to the GAO survey indicated that a stricter definition

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2 Statement by Howard L. Weisberg before the Subcommittee on Securities and the Subcommittee on International Finance and Monetary Policy of the Senate Banking Committee, July 23, 1981, p. 1.

3 "Impact of Foreign Corrupt Practices Act on U.S. Business," General Accounting Office report, March 4, 1981, p. 9.

4 Ibid., p. 11.

5 Weisberg and Reichenberg, op. cit., p. 8.

of a "reasonable effort" or some "materiality" standard easily understood by both those enforcing the law and the business community is desperately needed.[6]

The second criticism of the accounting standards concerns the criminal sanctions that may be brought against offenders. Many businessmen feel that the vague language of the FCPA allows the SEC to interfere in areas essentially the prerogative of management. Because criminal penalties can be imposed if the internal accounting procedures of a firm are not what the SEC considers "reasonable," the tendency of companies and their accountants has been to overcompensate in establishing accounting standards.[7]

This increased attention to accounting detail has raised the costs of businesses operating overseas. More than half of those participating in the GAO survey felt their costs had exceeded benefits. Of these respondents, 50 percent said their accounting and auditing costs were up 11 to 35 percent; 22 percent said their costs had risen by more than 35 percent.[8]

The extent of the complaints and the available data led the U.S. Chamber of Commerce to the conclusion that the accounting provisions of the FCPA are unjustifiably burdensome. The burden is the result of the ambiguous language of the bill and the potential criminal penalties, necessitating over-compensation.[9]

THE ANTI-BRIBERY SECTIONS

The FCPA prohibition on payments to foreign officials is designed to prevent attempts to sway discretionary decisions that may result in new contracts or the continuance of existing contracts. The Act exempts, however, facilitating or "grease" payments made to individuals solely to encourage them to do their jobs sooner rather than later. U.S. firms are responsible for agents acting on their behalf if there is "reason to know" the agents may be making corrupt payments. The enforcement of the anti-bribery sections of the FCPA is handled jointly by the SEC and the Justice Department.

There are several criticisms of the anti-bribery provisions of the FCPA. One problem is the degree of responsibility U.S. firms have for third parties operating abroad. "Reason to know" is an unclear expression of how much U.S. businessmen are expected to assume about the actions of their foreign sales agents. For example, is "reason to know" assumed in all countries where

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6 GAO report, p. 25.
7 Weisberg and Reichenberg, op. cit., p. 9.
8 GAO report, p. 13.
9 Weisberg and Reichenberg, op. cit., p. 26.

bribery of government officials is known to be commonplace? Joseph Creighton, General Counsel for Harris Corporation, related the following at committee hearings: In pursuit of a potential contract in a Third World nation, a representative of an American company called on the U.S. Embassy to see if Embassy officials could offer any help. The U.S. official at the Embassy made the comment that payoffs were common and that occasionally within the country one government agency had to make payments to another government agency in order to get any work done.[10] Should the company official then assume that for any contract the company received there was "reason to believe" an illegal payment had been made?

How much investigation of local agents is required before a company can safely say it has no reason to believe any questionable payments will be made? The U.S. Embassy in Muscat, Oman, reported a U.S. firm lost a $20-$30 million contract merely because of the time delays required to investigate local sales agents and assess responsibility under the FCPA.[11]

The "reason to know" question also arises for firms involved in joint ventures or owning a minority share of stock in a foreign firm. For example, an American company owned 20 percent of a Southeast Asian firm and held one seat on the board of directors. The manager of the U.S. company was required by the U.S. government to sign a quarterly statement of FCPA compliance. When the board was informed of this requirement, they suggested two courses of action: replacing the American board member with another national who would not be required to sign the release, or having the American firm sell its share in the Asian firm. Since the American firm felt that relinquishing its seat on the board would not free it of responsibility for practices which might be considered questionable under the FCPA, it was forced to divest itself of its interest in the foreign firm. The timing was bad and the one-year loss on the investment, management fees, and profit sharing was estimated at $2 million.[12]

In some cases, it is unclear where to draw the line between facilitating payments and bribes. The story is told of a U.S. firm's employee who paid a customs official $20 in order to have some recently arrived spare parts released immediately. The American had been told that without the payment it would take several days to process the paperwork. Having made what he considered a clear "grease" payment, the employee presented a voucher to his company for repayment. The voucher did not receive approval of the internal auditor checking for FCPA compliance.

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10 "Business Accounting and Foreign Trade Simplification Act," Report of the Committee on Banking, Housing, and Urban Affairs, United States Senate, p. 5.

11 Ibid., p. 6.

12 Weisberg and Reichenberg, op. cit., p. 16.

The American company has now spent over $30,000 investigating a $20 payment and deciding how to handle the situation under FCPA restrictions.[13]

Problems also arise when dealing with local customs. Can a company provide gasoline to policemen to allow them to patrol company facilities more frequently? Because police budgets are limited in many countries, they must rely on non-governmental income to improve their effectiveness.[14] In other cases, various U.S. companies have stopped paying the expenses incurred by government purchasing agents on trips to review qualifications, specifications, and delivery schedules. U.S. firms have stopped writing specifications for equipment without charge in the hopes of attaining future business, or paying the expenses for government employees enrolled in training programs. These are examples of payments or favors performed for government officials as part of local custom. The ambiguities in the FCPA, however, have led U.S. firms to cease such practices; firms from every other country are left free to conform to local conventions.[15]

To compound the problem, businessmen struggle with deciding exactly who is a "foreign official." In countries where many industries have been nationalized, for instance, are top managers with the nationalized firms considered foreign officials for the purposes of the FCPA?

The FCPA provides no specific answers to these questions, nor does the legislative history in most cases. Thus, the interpretation of the Act is left largely to SEC and Justice Department employees. To complicate matters further, Justice and the SEC do not always agree. Firms attempting to comply with the Act must not only worry about complying with a strict interpretation of the rather vague terms in the FCPA, but they must also comply with the stricter of the two interpretations. Considering the criminal sanctions that may be brought against them and the resulting bad publicity, firms generally are advised to take a conservative attitude when questions arise in conducting their business overseas.

In an effort to alleviate some of these problems, the Justice Department has established a guidance program entitled the "FCPA Review Procedure." Firms may seek guidance on contemplated foreign transactions by submitting a detailed statement of all facts material to a proposed transaction. Within thirty days, the Justice Department will advise the company whether it would prosecute under the described conditions. There are three problems with the program. First, the ruling applies only to a particular case and particular conditions. Second, the Justice Department's

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13 Ibid., p. 19.
14 Ibid., p. 18.
15 Ibid., p. 21.

decision is included in a public release with a description of the general nature of the transaction in an attempt to provide guidance to other firms. While the Justice Department promises to avoid revealing any competitively damaging facts, some businessmen have little confidence in the Department's ability to determine which facts should be kept confidential. Finally, and most important, the decision applies only to the Justice Department, and there is no guarantee that the SEC will concur.[16]

A final criticism of the anti-bribery sections concerns the very attempt by Congress to force American companies to do business abroad the way they do business in the U.S. Because moral values vary throughout the world, the FCPA in effect forces U.S. firms to compete under different rules than other firms. In addition, many foreign agents, companies, and governments resent being labeled corrupt by the U.S. government. As one Thai businessman expressed it, "We have been a nation for 1,000 years and a culture for 3,000 and resent the United States telling us that our business practices are immoral."[17]

The close scrutiny the U.S. government imposes on foreign agents' business dealings has caused such resentment that some sales agents have refused to handle any further business for U.S. firms. In many cases, this makes doing business difficult, if not impossible -- particularly in Middle Eastern and Asian markets.[18] The case of the American firm with minority ownership in a Southeast Asian firm was an example of nationals refusing to continue doing business with Americans subject to the FCPA. In another example, a contract was awarded to a group of European firms for an amount 333 percent greater than the preliminary bid of the U.S. firm. No reason was given for accepting the higher bid, but the U.S. firm believes the potential customer did not want to deal with a firm which had to comply with the FCPA.[19]

There are many similar examples. Consistently bad experience with the FCPA has led to widespread agreement among U.S. businessmen about the detrimental affect of operating under a unilateral anti-bribery agreement. More than half of those responding to the GAO questionnaire felt an international bribery agreement would strengthen the competitive situation of U.S. firms abroad.[20] Compliance with strict anti-bribery statutes by U.S. firms, while companies based in other countries are allowed much greater latitude in conforming to local customs, places U.S. businessmen at a distinct competitive disadvantage. Furthermore, there seems to be no indication that the number of questionable payments has been reduced. U.S. businessmen are just being hampered in their

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16 GAO report, pp. 41-42.
17 Weisberg and Reichenberg, op. cit., p. 13.
18 Ibid., p. 14.
19 Ibid., p. 17.
20 GAO report, p. 45.

attempts to compete on the same basis as the rest of the world's firms. Thomas Holmes, Chairman and Chief Executive Officer of Ingersoll-Rand, summarized the problem before the Senate subcommittees considering amendments to the FCPA:

> [T]here are limits to the export of American morality throughout the world, especially in countries whose legal and commercial systems of doing business have been different from our own for thousands of years; and second, it is fundamentally unfair for American companies to have to compete with one set of rules while others play by no rules at all.[21]

AMENDING THE FCPA

The FCPA contains language which is ambiguous and confusing. The first priority in amending the Act, according to the accountants, attorneys, and businessmen who deal with it, should be to clarify vague terms. Senator John Chafee (R-RI) is attempting to do this in his bill to amend the FCPA. Passed by the Senate on November 23, S. 708 replaces "reason to know" in the anti-bribery sections with the imposition of liability when a corrupt payment is made and the U.S. firm authorizes the payment directly or by a course of conduct. In addition, the accounting provisions are changed so that the "reasonable assurances" term is more explicitly defined in terms of costs and benefits, and a scienter standard is included, making it plain that only a knowing failure to comply with the accounting standards can be basis for liability. S. 708 will clarify the extent of responsibility of U.S. firms for the accounting standards of partially-owned subsidiaries. Finally, the distinction between facilitating payments, lawful in the country where made, and bribes is sharpened.

In response to other problems identified by businessmen subject to the FCPA, S. 708 consolidates the enforcement of the anti-bribery provisions into the Justice Department. Furthermore, Senator Chafee's bill combines the various accounting standards into one requirement of internal accounting controls. While this is viewed as an improvement, it does not go as far as the Reagan Administration has hoped. The White House favors abolishing the accounting standards and substituting a criminal penalty for the falsification of books and records for the purpose of concealing a bribe.[22] The GAO suggests that if the accounting standards are retained, the criminal sanctions for non-compliance should be repealed. This would allow the business community to work toward

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21 Norman Pacun, "The Impact of Foreign Corrupt Practices Act on United States Business," National Association of Manufacturers, May 21, 1981, p. 2.

22 Jonathan Rauch, "The Foreign Corrupt Practices Act -- Anti-Bribery or Anti-Business," National Journal, August 8, 1981, p. 1422.

cost-effective compliance without fear of criminal prosecution for failing to meet what the SEC considers to be "reasonable" accounting standards.[23]

Finally, S. 708 places a statutory emphasis on the need for multilateral anti-bribery agreements.

On the House side, the Telecommunications Subcommittee of the House Energy and Commerce Committee is holding oversight hearings that are expected to continue into January 1982. Representative Matthew Rinaldo (R-NJ) has introduced H.R. 2530, a bill almost identical to Senator Chafee's S. 708. However, the committee staff expects substantial changes to be made in the proposed legislation before it is reported out of committee.

CONCLUSION

The costs of the FCPA are extensive and take many forms. Most obvious are the increases in accounting and legal staffs of firms attempting to comply with the Act. The need for extensive accounting and legal advice has been cited as a primary reason why many smaller firms have chosen to by-pass potential export opportunities.[24]

Furthermore, the GAO survey of companies operating under the FCPA found that more than 30 percent of businessmen responding felt they had lost overseas business as a result of the Act. Some industries have been particularly hard hit. When representatives of the construction and aircraft industries were polled separately, 54 percent of those responding claimed to have been adversely affected in obtaining overseas business as a result of the FCPA.[25]

In a period of unemployment and increased competition between American and imported goods in this country, concern has been expressed about the slow growth in U.S. exports. A 1980 White House task force examining export disincentives found that fifteen of the forty-five State Department foreign officials questioned believed the FCPA had a negative impact on U.S. exports. All fifteen of the officials reporting a negative impact were located in developing countries.[26] A spokesman for Bill Brock, the U.S. Trade Representative, said:

> Time and time again, the [FCPA] has been mentioned to us as a serious impediment to exports. A small business-

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23 GAO report, p. 19.
24 Weisberg and Reichenberg, op. cit., p. 27.
25 GAO report, pp. 14-15.
26 GAO report, p. 37.

man can't turn around without wondering whether he's violating the Act, and he's pulling his hair out.[27]

Clearly, in the best-of-all-possible-worlds, there would be no bribery, no need for "grease" payments or gifts or special considerations for someone's uncle's cousin's brother. Goods would compete in this "best-world" solely on the basis of quality and price. U.S. firms do not operate abroad in an ideal setting, however; and while it is widely agreed that anything approaching bribery is a distasteful, undesirable way to do business, a reading of the available data indicates that the FCPA has had no real impact on the number of corrupt payments being made in the world. It has merely hampered American firms attempting to compete internationally. No other nation has anti-bribery prohibitions approaching the severity of the FCPA.[28]

To give American firms abroad a chance to compete, Congress should consider carefully the means used to prevent undesirable practices. Compliance costs should not be made unnecessarily burdensome. Greater sensitivity should be shown to business practices not exactly in line with U.S. traditions. Efforts to achieve multilateral anti-bribery agreements should continue, so that American firms are not the only ones competing with strictures on a broad range of conduct. Proponents of amending the Foreign Corrupt Practices Act feel that the bills under consideration are a step in the right direction.

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27 Rauch, op. cit., p. 1423.
28 GAO report, p. 37.