The Corrupt Practices Act

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I. Introduction

The Corrupt Practices Act (CPA or "the Act")[1] has created some serious, but manageable, problems for United States-based multinationals and has certainly resulted in the loss of some sales. A White House task force addressing itself to the appropriately named subject of export disincentives concludes the CPA is one, and attributes $1 billion in lost sales directly to the Act.

The moving force behind this legislation, of course, was the Securities Exchange Commission (SEC) and specifically its voluntary disclosure program conceived in 1975, under which registered corporations were encouraged to voluntarily conduct internal investigations into questionable payments and publicly report the results. This led to the disclosure festivals of 1976 and 1977 and as of today about 520 companies responded. One nondisclosure in connection with the SEC program was its determination to refer all company reports and documentation to a fraud unit of the Department of Justice for criminal investigation.

Foreign bribes, of course, were and are not peculiar to United States companies. Canada, our good friend to the north, whose ethical standards are at least as high as ours, advised Canadian companies that bribes were necessary to get foreign business, and certain of its Crown corporations have been found to have engaged in a pattern of accommodative foreign law violations. A recent article in *Stern* magazine estimates that German companies last year paid $250,000,000 in bribes to get foreign business. Senator Proxmire recently and publicly complained that German and Japanese trading companies in particular engage in the bribery of foreign officials to the disadvantage of both American and multinational corporations of other countries. Belgium, of course, permits a tax deduction for "secret commissions" which are

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[1]Pub. L. No. 95-213, 91 Stat. 1494 (1977) (codified in scattered sections of 15 U.S.C.).

payments in connection with Belgian exports to foreign persons to get business. The recent and dramatic upsurge in Korean and Japanese construction contracts in the Middle East and particularly Saudi Arabia may be part of this picture or, perhaps better, mosaic.

This is not a brief in support of such activities but it is recognition that such transactions are not limited to the United States or even the so-called underdeveloped third world countries. Moreover, one finds that United States companies are acting responsibly, even scrupulously. American lawyers are being asked to provide the analysis, advice and assurances to American business so that it may effect foreign sales in compliance with the Act. This, of course, is not easy because the Act is complicated, vague and without any current judicial interpretation.

Part of the problem, a large part, is that questionable transactions are not limited to scrutiny under the anti-bribery provision or by the SEC or the Department of Justice. These matters have also attracted, even excited, the interests of the Internal Revenue Service (IRS), the Federal Trade Commission (FTC), the Treasury Department, the Federal Communications Commission (FCC) and even the Federal Maritime Commission. The statutes which must be considered include, obviously, the Securities and Exchange Act of 1934[2] and specifically the disclosure, bribery and accounting sections, the Internal Revenue Code, the Robinson-Patman Act,[3] and the Federal Trade Commission Act,[4] as well as such criminal statutes as mail and wire fraud, false statements, aiding and abetting, conspiracy, anti-racketeering, and the Currency and Foreign Transactions Reporting Act.[5]

The types of transactions encountered involve, for the most part, other country or third-country agency payments, overinvoicing distributors, split payrolls, and local law compliance matters.

For purposes of perspective in this discussion, it is perhaps helpful first to consider the disclosure aspects of questionable payments. Disclosure under the securities laws is keyed into the concept of materiality. Previously, this was thought to mean financial statement materiality, that is, for example, if a substantial portion of corporate revenues are based on bribe payments, say five percent or ten percent, then disclosure is required so that shareholders and investors may make an informed judgment as to the business risks of the enterprise. There soon evolved, however, a second aspect of materiality, unrelated to financial statement materiality, and that is the quality or integrity of management. The SEC position was and is that if a senior officer authorizes foreign bribes that fact in itself is material to a shareholder in evaluating management.

This then brings us to an analysis of the CPA itself. In summary, the CPA prohibits corrupt payments *by* (1) United States issuers or domestic concerns,

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[2] 15 U.S.C. §§ 78a-78kk (1976).
[3] 15 U.S.C. §§ 13-13b, 21a (1976).
[4] 15 U.S.C. § 41-51 (1976).
[5] 31 U.S.C. §§ 1051-1062, 1081-1083, 1101-1105, 1121, 1122 (1976).

or (2) officers, directors, shareholders, employees or agents of United States issuers or domestic concerns; *to* (1) foreign officials, (2) foreign political parties, or (3) any person while knowing or having reason to know all or part will be paid to foreign officials or foreign political parties; *in order to* (1) obtain or retain business or (2) direct business.

The Act does not contain any monetary limitation or materiality standard either in terms of the amount of the payment, the business related thereto, the effect on the consolidated financial statements, or the related line of business.

II. Definition of Terms

A. *Corruptly*

Both the Senate and House Reports defined this term to mean an "evil" intent to "induce the recipient to misuse his official position in order to wrongfully direct business to the payor or his client or to obtain preferential legislation or a favorable regulation." These rather dramatic statements are to be contrasted with the SEC's position set forth in SAR No. 242 that "a negligence standard will govern civil injunctive actions brought to enforce the Act."[6]

B. *Payments*

Payments include money or other "things of value" which benefit the recipient or, by reference to the ALI model code, persons or entities "in whose welfare he is interested" such as, presumably, a beloved son, wife or nephew or, perhaps, his favorite charity or medical school.

Promises to pay, contractual or otherwise, even if not consummated, are clearly covered by the Act and the concept was applied in the recent civil injunctive action, *SEC v. Katy Industries.*[7]

C. *Issuers*

Issuer means the SEC registrant and the legislative history makes clear foreign subsidiaries (and *a fortiori* foreign joint ventures) are excluded. However, the legislative history also makes clear that the United States parent may have vicarious liability for the acts of the foreign subsidiaries if it "engages in bribery of foreign officials indirectly through any other person or entity."[8] In this connection, the Senate Report states that "the bill would not cover payments by foreign nationals acting solely on behalf of foreign subsidiaries where there is no nexus with U.S. interstate commerce or the use of U.S. mails and where the issuer . . . had no knowledge of the payment."[9]

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[6]SEC. Act Release No. 242.
[7]Unreported Consent Decree, N.D. Ill. 1978.
[8]CONFERENCE REP. No. 95-831, at 14.
[9]S. REP. No. 95-114, at 11.

D. *Domestic Concerns*

Non-SEC registered companies are also covered by the antibribery prohibition as demonstrated by the very recent and first criminal case brought by the Justice Department in *U.S. v. Kenny International Corp.,*[10] but it is also significant that the definition of domestic concerns applies not only to United States companies incorporated in or having its principal place of business in the United States but also includes "any individual who is a citizen, national or resident of the United States."[11]

E. *Officer, Employee*

Officers of issuers have criminal exposure if they acted "willfully," a term which has had a wide variety of definitions applied to it in a securities context, ranging from simply doing the act which constitutes the violation to realizing the act or omission is wrongful under the securities laws but nonetheless proceeding deliberately and intentionally to act or fail to act. In a criminal context, the term may be subsumed in a finding of corrupt action.

An employee's liability is also predicated on a finding of willfulness but, unlike an officer's, his liability arises only if the issuer is found to have violated section 30A(a).

F. *Foreign Official*

The phrase clearly applies to officers and employees of the executive (including military), legislative and judicial branches of foreign governments, but also applies to any person "acting in an official capacity for or on behalf of" a foreign government, department, agency or instrumentality. A recent injuncture action would seem to include an uncompensated honorary consul appointed by a foreign government and based in the United States Consulate.[12] Techncial advisors and public sector agents also may fall within this category. In *SEC v. Katy Industries,*[13] moreover, the SEC complaint is capable of being construed to apply to officials of state-owned instrumentalities, in that case, an official of Pertamia, the Indonesian state-owned oil company.

G. *Reason to Know*

This phrase is undefined, has been described as too vague for a criminal statute, and former Secretary Blumenthal expressed "wonderment" as to its meaning. Each of the three SEC and Justice Department cases brought under the antibribery provisions sheds no light on its meaning since the allegations all involve direct, active and knowing participation in a bribe.

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[10]Unreported Consent Decree, D.D.C. 1979.

[11]*See* United States v. Holly & Carver, Unreported Consent Decree, S.D. Fla. 1979.

[12]SEC v. International Sys. & Control Corp., Unreported Consent Decree, D.D.C. 1979.

[13]*Supra* note 7.

In my opinion, however, the phrase is qualified by the word "corruptly" and therefore requires a finding that an issuer consciously disregarded known facts evidencing a substantial likelihood that a bribe would occur. (Bear in mind however, the SEC statement that a negligence standard applies in civil injunctive action.[14]) These facts, based on the experiences derived from the voluntary disclosure era, include: (1) the size of the payment; (2) the nature of the services; (3) the relationship of the recipient to the government contractor; (4) the method of payment; and (5) concealment features masking a foreign law violation, in other words, is the involvement of an intermediary and/or the full amount of his compensation hidden from the foreign government? Where one or more of these are present, it is clear that the United States issuer or domestic concern has a duty to investigate and satisfy itself that a bribe is not about to occur. Obviously, the due diligence procedures must be adequate and reasonable in the circumstances and a commensurate response to the kind and number of factors giving rise to the concern.

H. *Business Purpose*

The legislative history of the Act clearly supports the proposition that the business purpose test was added in order to limit the applicability of the antibribery provision to those situations where a payment was intended to influence the placement of government contracts. The language of the statute, however, is loose and is capable of being construed as applying, for example, to payments to obtain visa permits for employees which if not otherwise available would foreclose a company from performing services in that country.

I. *Facilitating Payments*

These are payments to low-level government employees whose duties are essentially ministerial and clerical, the purpose of which is to get them to do what they are supposed to do. They are best understood in a context of expediting the processing of forms and applications. There is another category of payments which does not appear to be covered by the Act and that is the so-called entertainment or goodwill expenditure, made with the generalized expectation of promoting goodwill but not directed in consideration of a specific act in connection with a particular transaction. Unlike facilitating payments, many countries, but not all, do not consider such payments to violate local antibribery laws.

J. *Accounting Provisions*

These provisions have not received the publicity that the antibribery provisions have, but for SEC registered companies they are more significant in terms of immediate and pervasive impact. The accounting provisions were intended to complement the antibribery section by requiring accurate recor-

[14]*See* note 6 *supra.*

dation of transactions so that bribes would not be concealed or disguised on corporate books, and by imposing on management a requirement to establish a system of internal accounting controls that would prevent the creation of off-book slush funds.

The SEC has implemented these provisions by adopting rules that outlaw false entries and lying to accountants, and it has proposed rules requiring a management certification in public documents that their system is sufficiently adequate to assure compliance with the law. Management also would be required to disclose any weaknesses in the system whether material or not, or corrected or not. Businessmen, accountants and lawyers have filed an unprecedented 1,000 comment letters in response to this latter proposal substantially all of which express vigorous opposition to its adoption.

In conclusion, our Congress has determined to criminalize the biblical injunction to "do good and avoid evil" and we as lawyers have the burden and challenge to assist corporate America in effecting sales abroad in full compliance with these laws.