[Maryland Journal of International Law](http://digitalcommons.law.umaryland.edu/mjil)

Volume 4 | Issue 2 Article 14

Foreign Corrupt Practices Act of 1977

John M. Smallwood

B. Multinational Enterprises and Problems of Doing Business Abroad

FOREIGN CORRUPT PRACTICES ACT OF 1977

In December 1977, Congress completed its first efforts to outlaw American corporate bribery overseas. Two years of consideration culminated in the Foreign Corrupt Practices Act of 1977.[1] Several years of scandal prompted Congressional action. The Watergate scandals brought to public attention a variety of illegal corporate payments. Soon afterwards, the international arena erupted in turmoil with revelations of improper interference and payments involving American corporations, Americans allies and other nations. The Lockheed scandals greatly embarrassed the governments of Japan and the Netherlands in 1976.[2] American corporate activity in Italy and South America also came under scrutiny.[3] A Securities and Exchange Commission report to Congress found questionable and illegal corporate payments to be widespread and serious.[4] Perceiving that such practices undermine the efficiency of the free market system and tarnish the image of American business,[5] Congress determined to establish a clear policy against them.

The Act incorporates a dual approach to discourage corporate bribery. It imposes affirmative requirements upon issuers registered with the S.E.C. to maintain records and to develop internal controls which insure that corporate assets are properly used. Secondly, the Act creates civil liabilities and criminal penalties for acts of American corporate

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1. 15 U.S.C. §§78a, 78m, 78dd-1, 78dd-2, 78ff(a) and (c) (1976) [hereinafter referred to as the Act cited by sections].

2. When Lockheed admitted making payments to high Dutch and Japanese officials in February 1976, the political scene in those nations exploded. *See* N.Y. Times, Feb. 8, 1976, at 1, cols. 5 and 6. The crisis continued in those countries for the remainder of the year. It ultimately led to the arrest of former Prime Minister Kokuei Tanaka and the downfall of the then Prime Minister Tukeo Miki in Japan, and to the resignation from government positions of Prince Bernhard of the Netherlands.

3. *See* Wall St. J., Feb. 18, 1976, at 4, col. 2.

4. SECURITIES AND EXCHANGE COMMISSION, REPORT ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES 54 (May 1976). [hereinafter cited as the S.E.C. Report].

5. S. REP. NO. 114, 95th Cong., 1st Sess. 4, *reprinted in* [1977] U.S. CODE CONG. & AD. NEWS 4098, 4101; *See also* H.R. REP. NO. 640, 95th Cong., 1st Sess. 4 (1977).

bribery committed overseas. Stressing that these two aspects are to operate in tandem,[6] Congress believed that the new record-keeping requirements would reveal improper behavior. At the time the bill was passed S.E.C. investigations had already brought to light questionable activities in a number of companies.[7]

The Act first establishes specific accounting standards. Every issuer registered under section 12 and 15(d)[8] of the Securities Exchange Act of 1934 must keep records "in reasonable detail," which "accurately and fairly" represent the dispositions of its assets.[9] In not demanding exactitude, Congress intended that standards of reasonableness and principles of accounting would determine the specific degree of record-keeping necessary with respect to the special characteristics of the company involved.[10]

The Act also requires that issuers devise and maintain a system of internal accounting controls. This is intended to insure that corporate assets are used only in accordance with management's authorization and that records are available which reliably reflect an accountability for assets. The Act sets forth four specific objectives which the accounting controls are to incorporate.[11] Congress adopted these objectives from

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6. S. REP. NO. 114, *supra* note 5, at 7.

7. *See* S.E.C. REPORT, *supra* note 4, at 37-43. This report, which reveals questionable or illegal payments, is drawn from disclosures made by ninety-five companies.

8. Section 12 is codified in 15 U.S.C. § 78*l* and section 15(d) is codified in 15 U.S.C. § 78o(d).

9. The accounting standards are found in 15 U.S.C. § 78m.

10. S. REP. NO. 114, *supra* note 5, at 8; and H.R. REP. NO. 831, 95th Cong., 1st Sess. 10 (1977) [hereinafter cited as *Conference Report*].

11. 15 U.S.C. § 78m(2)(B) provides the following:

> Every issuer which has a class of securities registered pursuant to section 78*l* of this title and every issuer which is required to file reports pursuant to section 78*o*(d) of this title shall—
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> (A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer; and
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> (B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that—
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> (i) transactions are executed in accordance with management's general or specific authorization;
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> (ii) transactions are recorded as necessary (I) to permit preparation of financial statements in comformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

authoritative accounting literature[12] and intended that the "accounting profession will . . . use their professional judgment in evaluating the systems maintained by the issuers."[13] The Act does allow an exemption from these requirements for national security reasons.[14]

Congress saw such requirements as part of management's stewardship responsibilities to shareholders and potential investors. This rationale underlies all information disclosure demands of the Securities Exchange Acts of which the new statute is part. Interestingly, the S.E.C. has emphasized that the new requirements do not alter the already existing obligation of such companies to disclose questionable and illegal corporate payments and practices.[15]

The Act's second approach to corporate bribery overseas is through the creation of criminal penalties for such activity.[16] The provisions apply not only to corporations whose stock is registered under the Security Exchange Acts but to every domestic business concern.[17] The statute prohibits directors, officers, employees, agents and shareholders from using interstate commerce "corruptly in furtherence of" an offer or payment of a bribe. The bribe's intended recipient must be an official of a foreign government, agency, instrumentality, or political party (or someone who will pass on the bribe to such an official). The offer's or payment's purpose must be to influence the recipient's decision in his official capacity to obtain, retain or direct business. It must be stressed, however, that Congress did not intend to outlaw facilitating payments ("grease payments") to officials with essentially clerical or ministerial duties.[18] The everyday occurrence of payments so as to speed and

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(iii) access to assets is permitted only in accordance with management's general or specific authorization; and

(iv) the recorded accountability for assets is compared with the existing assets at reasonable intervals and appropriate action is taken with respect to any differences.

12. AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS STATEMENT ON AUDITING STANDARDS NO. 1, § 320.28 (1973).

13. S. REP. NO. 114, *supra* note 5, at 8.

14. With respect to matters concerning national security, a federal department or agency head may temporarily exempt anyone from the Act's requirements. Such a directive must state specific circumstances and must expire in one year (if not renewed). *See,* 15 U.S.C. § 78m(3)(A) & (B).

15. S.E.C., Notification of Enactment of Foreign Corrupt Practices Act of 1977, 43 Fed. Reg. 7752–53 (1978).

16. 15 U.S.C. §§ 78dd-1, 78dd-2.

17. 15 U.S.C. § 78dd-2. The Act defines "domestic concern" as any U.S. citizen, national, or resident, or any business whose principal place of business is in the United States, or which is incorporated under the laws of a state, territory or commonwealth of the United States. *See* § 78dd-2(d)(1).

encourage the lower echelons of foreign governments remains completely outside the purview of the Act.

Several points should be noted concerning the potential scope of the Act. If a business enterprise is convicted of violating the anti-bribery provisions, the Act also allows punishment of any employee or agent who is subject to U.S. jurisdiction and who wilfully participated in the prohibited activity.[19] Thus, the Act reaches the business concern itself, its decisionmakers and its intermediary agents.

A conviction for bribery requires proof of criminal intent. By using the word "corruptly" Congress intended that the proscribed activity must be carried out for the purpose of wrongfully influencing a foreign official to misuse his position.[20] The activity must be deliberate and wilful.[21] The Act provides stiff penalties for those convicted of bribery. Corporations can be fined up to $1 million.[22] Individuals face maximum fines of $10,000 and/or five years imprisonment.[23]

The Justice Department and the S.E.C. share the responsibility for enforcing the Act. Congress intended that the S.E.C. would continue to play the major role in investigating practices of issuers.[24] Even before the law was enacted the S.E.C. had the power to investigate improper practices of issuers and to seek civil injunctions enforcing proper behavior.[25] Its ability to refer cases to the Justice Department for criminal prosecution is also retained under the new law. Finally this Act reaffirms the SEC's already strong authority to promulgate rules of accounting.[26] Thus, while the Act creates no new power for the S.E.C., the Justice Department has received entirely new responsibilities. In addition to prosecuting bribery violations referred from the S.E.C., the Justice

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18. 15 U.S.C. § 78ff(c)(3).

19. 15 U.S.C. § 78dd-1(b); *See also,* S. REP. No. 114, *supra* note 5, at 10.

20. S. REP. No. 114, *supra* note 5, at 10. The common law definition of bribery also requires corrupt intent. One writer has described such intent as the desire "to subject the official action of the recipient to the influence of personal gain . . . rather than public welfare." R. PERKINS, CRIMINAL LAW 478 (1969).

21. *See* 15 U.S.C. § 78dd-2(b)(A) & (B), and § 78ff(c)(2) & (3).

22. 15 U.S.C. §§ 78dd-2(b)(1)(A), and 78ff(c)(1).

23. 15 U.S.C. §§ 78dd-2(b)(B)(2) & (3), and 78ff(c)(2) & (3).

24. S. REP. No. 114, *supra* note 5, at 11 and H.R. REP. No. 640, *supra* note 5, at 9.

25. 15 U.S.C. §§ 78u(a), 78u(e), 78u(f).

26. On January 26, 1977, the S.E.C. issued a series of proposed rules which included the same accounting standards later incorporated in the Act. The S.E.C. believed that such rules would be within its general rulemaking authority, and that legislative enactment was thus not the only route to enforce such standards. *See* 42 Fed. Reg. 4854-55.

Department has the sole investigative and prosecutorial jurisdiction over domestic concerns which are not otherwise within the S.E.C.'s jurisdiction.[27] The Act also equips the Attorney General with the power to seek civil injunctions to enforce compliance of domestic concerns.[28] As a result, the enforcement options available to the United States government will be the same regardless of the violating companies status under the Securities Exchange Acts.

Strict enforcement of the Act may prove difficult. The accounting requirements, upon which Congress placed heavy reliance, do not apply to concerns not registered under the Securities Exchange Acts. Although such firms may fall under the Act's bribery prohibition (if they are domestic), the Act creates no new investigative resources to reveal improper activity. Issuers regulated by the S.E.C. could contract for influence activities with firms not under such strict accounting standards. If such an intermediary firm were foreign, staffed by foreigners or acting on behalf of a foreign subsidiary, it may well stand outside the entire scope of the Act, especially if no nexus with American interstate commerce and an American firm can be proven.[29]

The locus of the criminal act itself may also hamper enforcement. When the illegal bribery occurs, it most likely will take place on foreign soil, often between foreign nationals. National boundaries may block avenues of investigation and place many of the principals beyond the reach of investigators.

Issues of enforcement naturally lead to consideration of the Act's effect on foreign subsidiaries of American corporations. The House, noting evidence which revealed that American corporations often use their foreign subsidiaries as channels for improper payments, included foreign subsidiaries under its bribery prohibition. "Failure to include such subsidiaries would only create a massive loophole," the House concluded.[30] The Senate bill had not included American-owned or controlled foreign subsidiaries.[31] The Conferees accepted the Senate view recogniz-

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27. S. REP. No. 114, *supra* note 5, at 12.

28. 15 U.S.C. § 78dd-2(c).

29. *See* S. REP. No. 114, *supra* note 5, at 11.

30. H.R. REP. No. 640, *supra* note 5, at 12. The House bill covered foreign subsidiaries of U.S. companies by defining "domestic concern" as any business organization "which is owned or controlled by individuals who are citizens or nationals of the United States." *Id.* The House justified this extraterritorial scope by several principles of international law. *Id.*

31. *See, supra* note 17 for the Senate's definition of a "domestic concern" which ultimately was incorporated into the Act. The Senate report indicates that the accounting standards apply to both a U.S. parent company and its foreign

ing the jurisdictional, enforcement, and diplomatic problems involved in the House approach.[32] The Conferees stressed that American firms which engaged in bribery through overseas entities are still liable under the Act, as would be anyone who is under U.S. jurisdiction and who aids such activity.[33] In spite of this optimistic pronouncement, activities of foreign subsidiaries for the most part may remain beyond the Act's scope.

A further consideration concerns the ability of and manner in which the S.E.C. is to enforce the new accounting standards. Of key importance is the enforcement of truthfulness in corporate records. The essential question here is whether this enforcement should apply to negligent as well as intentional actions. The original S.E.C. recommendations included strong prohibitions against any kind of falsification in corporate records.[34] To clarify that these sections would not apply to negligent conduct, the Senate added the word "knowingly" to the S.E.C. recommendations.[35] The House bill contained no such provisions because the House felt that the S.E.C. had already published proposed rules accomplishing the same ends.[36]

The Conferees ultimately decided to delete the entire section.[37] The inclusion or exclusion of the word "knowingly" raised the issue of the necessity of *scienter, i.e.,* the intent to deceive, and the Conferees did not want any treatment it gave this issue to be interpreted as a comment on the Supreme Court's decision in *Ernst & Ernst v. Hochfelder.*[38]

The S.E.C.'s final regulations do not require proof of scienter.[39]

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subsidiary. S. REP. NO. 114, *supra* note 5, at 11. Exactly how overseas subsidiaries of U.S. issuers are included within the Act's scope remains unclear.

32. *Conference Report, supra* note 10, at 14.

33. *Id.*

34. S.E.C. REPORT, *supra* note 4, at 63-66.

35. S. REP. NO. 114, *supra* note 5, at 9.

36. *See, supra* note 26.

37. *Conference Report, supra* note 10, at 10.

38. 425 U.S. 185 (1976). In this case, victims of a brokerage firm fraud sued the firm's accountants for failure to reveal the fraud. The cause of action was based on 15 U.S.C. § 78j(b) and its accompanying S.E.C. rule 10(b)(5). The Supreme Court held that a private action would not lie on that basis without an allegation of *scienter.*

The House report on its bill specifically mentioned this decision and stressed that *scienter* would not be necessary in an S.E.C. enforcement. *See* H.R. REP. NO. 640, *supra* note 5, at 10. It is this type of legislative comment on *Hochfelder* which the conferees wanted to avoid.

39. 44 Fed. Reg. 10964, 10966-68. The key provision which is coded as "Regulation 13b-2" will ultimately appear as an amendment to 17 C.F.R. § 3240 in the following form:

Commission member Karmel dissented on the grounds that such a requirement should have been included. He noted, "Although, in my view, 'falsify' implies an element of deceit, it does not go far enough in articulating a standard of wrongful intent for culpable conduct."[40] The Commission report which accompanied the new regulations indicated, however, that they should be read in the larger context of the Act, which only requires "reasonable detail" and "not perfection."[41]

As a result of the new regulations issuers may be held to an extremely high standard of accuracy and accountability. Criminal penalties will still only be imposed when the government can prove that the accused, "willfully violate[d]" the anti-bribery section of the Act. Thus as the Senate Committee suggested, while "[i]t is often difficult to assemble the degree of evidence required in a criminal action, . . . enough evidence may exist to enable the SEC to halt a continuation of the corrupt practices through an injunctive action."[42]

One area of potentially great importance which received little attention is the difficulty encountered when one tries to distinguish bribery from extortion. This problem is exacerbated by the myriad of low and middle level foreign government officials who each in their own small way exert some control over U.S. business enterprises. Extortion occurs when an official corruptly misuses his position to force the victim to pay. Bribery lacks this element of duress or compulsion. As a U.S. Court of Appeals recently expressed it: "[t]he distinction [separating extortion] from bribery is . . . the initiative and purpose on the part of the official and the fear and lack of voluntariness on the part of the victim."[43]

The Senate Committee did consider the distinction between bribery and extortion. According to the Committee, bribery occurs when the American company can "make a conscious decision whether or not to pay a bribe," regardless of who initiated the negotiation.[44] The Committee gave an example of a company paying a bribe to enter a market or gain a contract.[45] In such a case, the company would have a corrupt purpose,

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> § 240.13b2-1 Falsification of accounting records.
> No person shall directly or indirectly falsify or cause to be falsified, any book, record or account subject to Section 13(b)(2)(A) of the Securities Exchange Act.

Id. at 10970.

40. 44 Fed. Reg. 10964, 10970.
41. *Id.* at 10968.
42. S. REP. NO. 114, *supra* note 5, at 12.
43. United States v. Hyde, 448 F.2d 815, 833 (1971).
44. S. REP. NO. 114, *supra* note 5, at 10–11.
45. *Id.*

an intent to wrongly influence. "On the other hand," the Committee continued, "true extortion situations would not be covered . . . since a payment to an official to keep an oil rig from being dynamited should not be held to be made with the requisite corrupt purpose"; such a payment would be made under duress.[46]

Obviously a corporation which exists entirely outside a national jurisdiction has the freedom to refuse to pay a bribe to enter that market. However, when a corporation has already invested a considerable amount of money to establish itself within a national market, and then a payment is suggested to allow the corporation to remain, the corporation's freedom of choice is quite different.

By only mentioning the less than difficult cases, the Senate Committee has merely set out the range of possible scenarios failing to provide workable standards. Moreover, even assuming that standards could be created, unravelling a given incident when the evidence and witnesses are beyond U.S. jurisdiction may ultimately prove to be impossible.

In sum, the Act expresses a clear Congressional desire to require more comprehensive corporate accountability and to prohibit American corporate bribery overseas. Problems will be encountered in adequately enforcing this policy. Whether "the criminalization of foreign corporate bribery, will to a significant extent act as a self-enforcing, preventative mechanism," as Congress hoped, remains to be seen.[47]

John M. Smallwood

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46. *Id.*

47. A substantial problem which requires some discussion concerns the inability of large transnational corporations to effectively control their field salespersons. One company which engages in the highly competitive airplane manufacturing business has recently received some publicity in this area. *See* Carley, *Evading and Edict — Grumman Panel Finds Payoffs Continued Despite Board's Policy,* Wall St. J., Feb. 28, 1979, at 2, col. 6.