TRADE LEGISLATION IMPROVEMENTS

DENIS M. NEILL*

About ten years ago, a law firm in Washington D.C. representing a major United States company had occasion to search for a lawyer in Mexico City. The client, having decided to make a significant investment in Mexico, asked the firm to identify a competent and influential law firm that could assist in interpreting the laws of Mexico and provide credibility with the Mexican Government. After a thorough investigation, the firm selected just the right Mexican firm whose partners were extremely thorough in legal analysis and drafting, and who were closely connected through family ties and personal relationships with the highest governmental officials in the country.

Both firms represented the client successfully. The Washington firm used contacts with its former members in the Nixon Administration to convince the Administration to issue the appropriate export licenses. The Mexico City firm provided the "hard law," detailed legal analysis that enabled the corporation to avoid many problems under Mexcian law.

Thereafter, the relationship between the two firms flourished and many clients were referred back and forth. The members of both firms learned over the years to trust not only the others' legal analysis, but their political judgment as well. The Mexican firm charged substantial but reasonable fees, as did the Washington firm. Members of both firms participated actively in politics, and the political connections of both firms were emphasized to potential new clients. Everyone seemed very pleased with the relationship.

Three years ago, the relationship was abruptly terminated because of a law passed by the United States Congress. In the process of discussing the representation of yet another United States company, the Mexican firm was told that it would be required to submit to the United States company a statement that none of the fees paid to the Mexican firm for legal services would thereafter be paid to

* Partner, Neill & Mullenholz, Washington, D.C., specialist in legislation relating to foreign trade, former Assistant Administrator for Legislative Affairs, Agency for International Development.

any foreign official for the purpose of influencing his act or decision, or to induce him to use his influence with the Mexican Government. The firm was given a six-page statement for its partners to sign and furnish to the United States company.

Justifiably incensed, the partners of the Mexican firm refused to sign the statement, turned away the business, and severed their relationship with the Washington firm. The client and the Washington firm were left to explain (to each other and not to the Mexican lawyers) that their abundance of caution in interpreting the Foreign Corrupt Practices Act (FCPA) required them to seek such disclaimers from anyone to whom they transmitted any funds for advisory services in any foreign country.

In Senate Report No. 97-209, which accompanied amendments to simplify the FCPA, the Senate Committee on Banking, Housing and Urban Affairs included among more than a dozen examples the following recent reaction of an American firm to new business opportunities in Latin America:

> A multinational United States-based engineering company spent approximately $250,000 to evaluate its potential market in Latin America. Brazil, Mexico, and Venezuela were considered open markets for exporting engineering services and establishing local service branches. One of the major reasons the company chose not to expand was its uncertain liability under the FCPA for the activities of independent agents and subcontractors. Moreover, the cost of policing such activities would have markedly lessened its price competitiveness.[1]

The second example illustrates that the United States has lost substantial amounts of export business as the result of the passage of the FCPA. The first shows that the FCPA caused the United States to lose valuable friends and influential connections in its most important neighbor in the Western Hemisphere.[2]

Some Congressional opinion holds that the loss of business to the United States because of the FCPA has been negligible. It is important to note, however, that no research had been done on the

1. S. REP. NO. 209, 97th Cong., 1st Sess. 6 (1981). This report accompanied the proposed Business Accounting and Foreign Trade Simplification Act, S.708, 97th Cong., 1st Sess., 127 CONG. REC. S13983-85 (1981), which would amend the Foreign Corrupt Practices Act of 1977, Pub. L. No. 95-213, 91 Stat. 1494 (codified as amended in scattered sections of 15 U.S.C.).

2. See *Business Accounting And Foreign Simplification Act: Joint Hearings Before the Subcomm. on Securities and the Subcomm. on International Finance and Monetary Policy of the Senate Comm. on Banking, Housing, and Urban Affairs,* 97th Cong., 1st Sess. 105 (1981), p. 105, for the State Department's conclusions on these points [hereinafter cited as *Hearings*].

issue prior to passage of the bill. All recent studies show that the losses to American exports are counted in the billions of dollars and lost jobs in the tens of thousands. Thus, the adverse effect of the FCPA measured in economic and diplomatic terms is both deep and far-reaching. The FCPA is one of the worst examples of legislating morality without knowledge—knowledge of the impact of that legislation on the domestic and foreign commerce of the United States, and on public- and private-sector diplomacy.

This presentation will discuss the current status of legislative improvement on the FCPA. After a brief review of the development of the FCPA and its present state, amendments proposed in and passed by the Senate will be analyzed in detail. This analysis will show that the amendments have not solved the underlying problems created by the FCPA.

I. DEVELOPMENT OF THE 1977 FOREIGN CORRUPT PRACTICES ACT

A. Background of the Act

In 1977, after a series of revelations that American companies had engaged in patterns of bribery and corruption to acquire business overseas, Congress passed the FCPA.[3] The Carter Administration did little to shape the legislation, and private interests, fearful of being accused of bribery, did not participate significantly in the process.

The legislative drafting was done in a rush as well as in a vacuum. Without extensive testimony or any thorough counterbalance to over-zealous committee staffs, the broadest and vaguest possible words were used in the statute with almost no legislative history to guide the government enforcer and the corporate interpreter. As a result, the lack of clarity in the FCPA and the impractical standards established therein have created unacceptable burdens for United States firms.

B. Current Status and Effect of the Act

The 1977 FCPA has two fundamental features. First, the FCPA provides stiff penalties against individuals and corporations found guilty of making payments to foreign officials to facilitate

3. CONG. REC. S13974 (daily ed. Nov. 23, 1981) (statement of Sen. Proxmire, Chairman of the 1977 Senate Committee on Banking, Housing and Urban Affairs) [hereinafter cited as 127 CONG. REC.].

sales, unless the payments are small and made to low-level bureaucrats to expedite the ministerial aspects of the transaction. Second, the legislation requires corporations to establish internal accounting controls and record-keeping to facilitate enforcement of the FCPA by the Securities and Exchange Commission (SEC) and the Justice Department.

The FCPA now establishes liability if an American firm knows or "has reason to know" that a payment made to a third party would result in a payment to a foreign governmental official or a political candidate for the purpose of influencing the actions of his government.[4] At least one cautious lawyer suggests that one has reason to know that there would be a corrupt payment if any payments are made in a particular country because all transactions in that country are suspect. Perhaps the test should be the reputation of the agent, or the amount of the commission, or an agent's refusal to make the representations required by the FCPA. Still others suggest that if the agent's or the lawyer's family or business relationships are close to high governmental officials, there is a substantial probability that part of a fee will be passed on to a foreign official.[5]

Under the FCPA, small businesses suffer far more than the large overseas competitor because small businesses must rely on foreign agents or distributors to make sales. Such small businesses have no control over the local businessmen, and attempts to intervene in local business practices often cause these small companies to be excluded.[6]

The accounting provisions of the FCPA generated hundreds of jobs among the "Big Eight" accounting firms, but have cost thousands of jobs on the production line. Corporate managers have testified to the Senate Banking Committee that they would rather avoid the transaction than incur potential liability with increased foreign sales.[7]

Two years ago, Senator John H. Chafee introduced a series of the most cautious possible amendments of the FCPA. The amendments were carefully drafted to meet specific objections to the existing legislation. The testimony supports far more extensive amendments than those originally proposed by Senator Chafee, but

4. 15 U.S.C. § 78dd-2 (1981).
5. 127 CONG. REC., *supra* note 3, at S13972.
6. S. REP. NO. 209, *supra* note 1, at 6.
7. *Hearings, supra* note 2, at 139-276, 388-422.

practical politicians realize that modification of the FCPA must be gradual and persistent.

II. THE CHAFEE AMENDMENTS AND THEIR IMPACT

Senate bill S. 708 (S. 708), as introduced by Senator Chafee on March 12, 1981, forms the basis for a current discussion of the issues in the Senate this year and sets the stage for consideration in the House next year. It is useful at this point to outline the major provisions of Senator Chafee's original bill. These are, as follows: (1) the name of the FCPA would be changed to "The Business Practices and Records Act";[8] (2) almost all enforcement authority would be removed from the SEC;[9] (3) criminal liability would be established only when a corporation or its principals "corruptly direct[s] or authorize[s]" a bribe—eliminating the "reason to know" test;[10] (4) payments would be permitted where legal and "customary" in the country, if intended only to expedite the performance;[11] (5) record-keeping would be restricted to transactions that are "material";[12] (6) executives' liability for record-keeping would be limited to situations where one knowingly falsifies accounts or circumvents control;[13] (7) corporations would not be required to keep records where the accounting costs are greater than the sum being accounted for;[14] (8) new guidelines for enforcement and compliance would be issued;[15] and, (9) statutory emphasis would be placed on the need for multilateral responses to the issues addressed by the FCPA and occasion would be provided for new legislative proposals.[16]

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8. *Id.* This provision was introduced as § 3 in S. 708. 97th Cong., 1st. Sess., 127 CONG. REC. S13969 (1981).

9. *See Hearings*, *supra* note 2. This provision was introduced as § 5(a) in S. 708, 97th Cong., 1st Sess., 127 CONG. REC. S13969 (1981).

10. *See Hearings, supra* note 2. This provision was introduced as § 5(b) in S. 708, 97th Cong., 1st Sess., 127 CONG. REC. S13969 (1981).

11. *Id.*.

12. *See Hearings, supra* note 2. These provisions were introduced as §§ 4(a),6 in S. 708, 97th Cong., 1st Sess., 127 CONG. REC. S13969, S13970 (1981).

13. *See Hearings, supra* note 2. This provision was introduced as § 4(b) in S. 708, 97th Cong., 1st Sess., 127 CONG. REC. S13969 (1981).

14. *Id.*.

15. *See Hearings, supra* note 2. This provision was introduced as § 8 in S. 708, 97th Cong., 1st Sess., 127 CONG. REC. S13970-71 (1981).

16. *See Hearings, supra* note 2. This provision was introduced as § 10 in S. 708, 97th Cong., 1st Sess., 127 CONG. REC S13971 (1981).

A. The Bribery Issues

S. 708 as introduced by Senator Chafee and as passed by the Senate does not remove statutory prohibitions against foreign bribery. The FCPA will still prohibit United States corporations from bribing high foreign officials and, in this respect at least, the bill does not place United States corporations on a competitive par with many foreign countries. Simply stated, S. 708, if enacted into law, will not permit bribery.[17]

The current section 104 of the FCPA would be repealed and replaced by language which conforms to United States domestic bribery statutes. The "reason to know" standard would be replaced with the provision to limit a United States company's liability to situations in which that company "corruptly directs or authorizes" the payment. Thus, the conduct of the American party, not that of its foreign agent, would determine the scope of the United States company's liability. Recognizing that a United States firm could authorize a third party to bribe a foreign official by its course of conduct as well as by express direction, the Senate Banking Committee amended Senator Chafee's bill to cover this situation.[18] In all other respects, however, the basic thrust of Senator Chafee's bill on this point was adopted.

The current law is supposed to permit the facilitation of so-called "grease" payments to foreign officials or employees "whose duties are essentially ministerial or clerical." This focus on the recipient of payments, rather than on the activities and purpose of the United States corporation in directing or authorizing the payment, has caused enormous and expensive interpretative problems.[19]

The Chafee bill's provisions for clarifying the grease payments exceptions were substantially modified by the Senate Banking Committee. In this respect, the committee bill[20] was only slightly amended on the Senate floor.[21] The final Senate version would exclude from the provisions of the law payments that are lawful in the country of the recipient and intended to facilitate performance. Courtesies, tokens of esteem, hospitality, travel and lodging expenses, expenses associated with the demonstration or explanation of products and customary expenditures associated with the per-

17. S. REP. NO. 209, *supra* note 1, at 17.
18. *Id.* at 20.
19. *Id.* at 4-7, 18.
20. S. REP. NO. 209, *supra* note 1, § 5(b) at 20.
21. 127 CONG. REC., *supra* note 3, at S13980, S13984.

formance of a contract would also be excluded. In its report, the Committee emphasized that these specific exceptions needed for expedition of business performance and other similar payments should not be interpreted to undermine the basic anti-bribery purpose of the statute.[22]

B. The Accounting Issues

The FCPA's accounting provisions are intended to prevent corporations from hiding slush funds such as the ones used in the 1960s by major aircraft producers in many foreign countries.[23] Current law is designed to give the SEC a corporate "paper trail" to enforce the legislation.

Businessmen complain that the law does not indicate the degree of accounting required and that public accounting firms and their clients have overreacted out of anxiety and uncertainty. A General Accounting Office (GAO) study on the FCPA says that 55 percent of the firms it surveyed said that the costs of complying with the accounting standards of the FCPA were greater than the benefits received from foreign trade. One example often cited is that of a company that spent $30,000 investigating a $20 payment to a customs official.[24]

Present and former government officials, including former SEC Chairman Harold Williams, have argued strongly in favor of slightly amending existing accounting standards and against the "materiality" standard contained in Senator Chafee's original bill.[25] They felt that the application of that accounting standard would eliminate the evidence needed to track down corporate bribes. Senator William Proxmire, a principal sponsor of the FCPA in 1977 and a vigorous opponent of the Chafee bill as introduced, states unequivocally that "the accounting sections are the heart and soul of this legislation."[26]

Senator Chafee originally proposed a "materiality" standard that would simply permit the retention of records in conformity with generally accepted accounting principles when those principles are applied to the preparation and presentation of financial

22. S. REP. NO. 209, *supra* note 1, at 18.
23. 127 CONG. REC., *supra* note 3, at S13974.
24. S. REP. NO. 209, *supra* note 1, at 7.
25. *Hearings, supra* note 2, at 278-372, 483-502.
26. 127 CONG. REC., *supra* note 3, at S13974.

statements.[27] Former and present SEC officials testified that the threshold standards for accuracy of corporate books and records and internal controls should be that which "a prudent man would require in the management of his own affairs." Senator Proxmire finally accepted this provision and persuaded the Senate Banking Committee to include it in the bill as reported.[28]

The key element in the legislation is the direct responsibility of corporate management for the record-keeping system. In the final analysis, such responsibility is a major step in the right direction. The legislation and its history ties managers directly and immediately to their corporate records, for purposes of this law, just as managers are responsible for compliance with other statutes.[29]

SEC registrants and reporting companies would be required to "make and keep books, records and accounts, which in reasonable detail, accurately and fairly reflect the transactions and dispositions of [their] assets."[30] Those same companies further would be required to "devise and maintain a system of internal accounting controls" and a method of tracking expenditures to assure that management specifically or generally authorizes all transactions and dispositions of assets to achieve the specified goals of the legislation. Again, the law requires that the execution and recording of transactions be in accord with the will of management.[31]

The Senate also approved floor amendments which would eliminate any criminal liability for violation of the FCPA's accounting provisions. In lieu of a committee provision that would require *scienter* for civil violations, the Senate approved a provision establishing a defense in a civil action if a company could show that it acted in good faith and had no knowledge of its failure to comply with the accounting requirements. The SEC could bring civil action even if it could not show that the alleged accounting violation was done knowingly, but the Senate amendment would give a company a "good faith" affirmative defense. An individual would be liable only for knowingly failing to devise and maintain proper systems of internal accounting controls. This limited *scienter* standard is consistent with domestic law.

In committee, Senator Proxmire argued most forcefully against

27. S. 708, 97th Cong., 1st Sess., § 4(a), 6, 127 CONG.REC. S13969, S13970 (1981).
28. *Id.* at § 4(a).
29. S. REP. No. 209, *supra* note 1, at 12, 13.
30. S. 708, 97th Cong., 1st Sess., § 4(a), 127 CONG. REC. S13969 (1981).
31. *Id.*

Senator Chafee's proposal to remove the SEC substantially from the FCPA enforcement picture. Senator Proxmire lost this fight and the Justice Department was given civil jurisdiction to enforce the anti-bribery provisions against all companies that do not register with the SEC, in addition to its jurisdiction for all criminal enforcement.[32]

III. THE LEGISLATIVE PICTURE

On November 23, 1981, the Senate amended and passed S. 708 with little fanfare or public comment. The bill has been sent to the House where it has been referred to Chairman Tim Wirth's House Energy and Committee Subcommittees on Telecommunications, Consumer Protection and Finance. Mr. Wirth says he is not yet convinced that the FCPA needs amending.

It is uncertain at this stage whether the 97th Congress will pass some modifications to the FCPA. To the extent that new law would clarify the existing FCPA and facilitate legal interpretation, such amendments should go a long way toward eliminating the type of confrontation that destroyed the relationship between the Mexican and Washington law firms referred to above. One hopes that such amendments would encourage a constructive dialogue among trading partners rather than the destructive, offensive interventions in foreign countries, and the imposition of business standards that are not even applicable to United States domestic business.

V. CONCLUSION

If S. 708 is enacted, its most significant amendments to the FCPA would be the change in its name and the section providing for a report by the Administration to Congress that includes recommended legislation to amend further the FCPA. A slight modification, adopted on the Senate floor, would require that this report include legislative recommendations and other possible actions to be taken if international negotiations do not succeed in eliminating the competitive disadvantage of United States business. Such changes would promote future amendments and indeed may, at some point, permit the repeal of the FCPA.

Finally, S. 708 is a lawyer's bill. It would vastly facilitate interpretation of the law regarding overseas bribery and the account-

32. S. REP. NO. 209, *supra* note 1, at 20.

ing issues that arise from the law. S. 708 is not good legislation. It does not resolve the underlying requirements to balance morality, economics and diplomacy in shaping a bill that has such profound impact. The Congress must eventually face this task.