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ACCOUNTING FOR CORPORATE MISCONDUCT ABROAD: THE FOREIGN CORRUPT PRACTICES ACT OF 1977

Use of the securities laws to regulate foreign bribery entered a new phase with the passage of the Foreign Corrupt Practices Act of 1977 (FCPA).¹ Prior to the enactment of the FCPA, the Securities and Exchange Commission (SEC) attempted to curtail the flood of questionable payments made by domestic corporations to foreign governments by requiring disclosure to the investing public of material facts related to those payments. In contrast, the FCPA adjusts corporate foreign business practices by requiring the establishment of internal corporate accounting controls and criminalizing certain kinds of questionable payments.

Compliance with the FCPA is difficult as a result of certain ambiguities in the Act's provisions. This problem is further complicated by SEC enforcement actions which continue to emphasize pre-Act disclosure requirements. This Note first outlines the Act. The Note then discusses and proposes a solution to the FCPA's ambiguities. Finally, it suggests an enforcement scheme that would best effectuate the Act's purposes.

I

THE FOREIGN CORRUPT PRACTICES ACT OF 1977

The FCPA has a double-pronged approach to regulating corporate misconduct abroad. First, the FCPA requires all corporations under SEC jurisdiction to adopt and maintain internal accounting controls.² Second, the Act attempts to deter corporations from making questionable payments by criminalizing such payments rather than requiring their disclosure.³

1. Pub. L. No. 95-213, 91 Stat. 1494 (1977) (to be codified in 15 U.S.C. §§ 78m, 78dd, 78ff). Section 102 (the internal accounting controls provision) and § 103 (criminalization of payments by issuers) amend the Securities Exchange Act of 1934, 15 U.S.C. §§ 78a-78kk (1976). Section 104 (criminalization of payments by domestic concerns not subject to SEC jurisdiction) does not become part of the securities law. For a general description of the Act, see 19 HARV. INT'L L.J. 726 (1978). For a discussion of the possible effects and effectiveness of the FCPA, see Lashbrooke, *The Foreign Corrupt Practices Act: A Unilateral Solution to an International Problem*, 12 CORNELL INT'L L.J. 227 (1979).

2. 15 U.S.C.A. § 78m (West Supp. 1979).

3. *Id.* §§ 78dd-1 to 2. For a discussion endorsing the criminalization of questionable foreign payments, see Note, *Prohibiting Foreign Bribes: Criminal Sanctions for Corporate Payments Abroad*, 10 CORNELL INT'L L.J. 231 (1977).

This condemnation of questionable payments and commitment to ensuring corporate accountability reflect a congressional concern for the public interest in deterring unethical behavior which is unusually broad in the field of securities regulation.⁴ Thus the public interest should be carefully considered in the interpretation and future application of the Act.

A. ACCOUNTING STANDARDS

Section 102 of the FCPA⁵ requires all reporting companies to "(A) make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions" of corporate assets, and "(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances" of management authorization of transactions involving corporate assets.⁶ SEC officials stress that corporate management, not outside auditors or counsel, is responsible for assessing the weaknesses in existing internal controls and information systems and bringing these systems into compliance with section 102.⁷

Unfortunately, what constitutes compliance with section 102 is largely an unanswered question. There is some concern that the SEC will take advantage of its rulemaking powers⁸ to specify standards for records and

4. The primary legislative purpose behind the disclosure provisions, Securities Act of 1933, §§ 7, 10, Schedule A, 15 U.S.C. §§ 77g, 77j, 77aa (1976); Securities Exchange Act of 1934, §§ 12, 13, 14, 15 U.S.C. §§ 78l, 78m, 78n (1976), was to insure that adequate information concerning the financial condition of issuers of securities would be available to the investing public. See Note, *Foreign Bribes and the Securities Acts' Disclosure Requirements*, 74 MICH. L. REV. 1222, 1222-25 (1976). Accordingly, the SEC and the courts have limited the SEC's broad powers to require disclosure to items of economic materiality. The most recent Supreme Court formulation of materiality is that information is material and must be disclosed "if there is a substantial likelihood that a reasonable shareholder would consider it important." *TSC Indus., Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976) (proxy statements). Similarly, SEC rules define as material "those matters as to which an average prudent investor ought reasonably to be informed before buying or selling [a] security." 17 C.F.R. § 240.12b-2(j) (1978). Traditional economic materiality assumes that the average prudent investor or stockholder is interested only in the profitability of investing in an enterprise. See ADVISORY COMM. ON CORPORATE DISCLOSURE, 95TH CONG., 1ST SESS., REPORT ON CORPORATE DISCLOSURE TO THE SECURITIES AND EXCHANGE COMMISSION 326-27, 395 (Comm. Print 1977). Since questionable foreign payments often have little significant impact on the future financial performance of a corporation, Stevenson, *The SEC and Foreign Bribery*, 32 BUS. LAW. 53, 57 (1976), expansion of traditional definitions of materiality was necessary to compel their disclosure.

5. 15 U.S.C.A. § 78m(b)(2) (West Supp. 1979).

6. *Id.*

7. See, e.g., Statement by SEC Chairman Harold M. Williams to the Financial Executives Institute 1978 International Convention, summarized in 473 SEC. REG. & L. REP. (BNA) D-5 (1978).

8. Ralph C. Ferrara, Executive Assistant to the Chairman of the SEC, stated that the power to "require the maintenance of certain specific books and records" was available before the passage of the FCPA under § 23(a) of the Securities Exchange Act of 1934, 15 U.S.C. § 78w(a) (1976), which grants general rulemaking authority, and that § 102 strengthened this

controls.⁹ It is unlikely that such specification will occur in the near future, however, because the SEC assigned the task of developing compliance guidelines to the accounting profession.¹⁰ Furthermore, even if the SEC does decide that promulgation of rules is necessary to effectuate compliance with section 102, management's concern that it will be overburdened with exacting standards is somewhat groundless. The Commission has already indicated that it will read section 102's "reasonable detail" and "reasonable assurance" language as simply either a cost/benefit or good faith limitation

power. 466 SEC. REG. & L. REP. (BNA) A-5 (1978). In fact, prior to the enactment of the FCPA, the SEC had proposed several rules establishing accounting standards. Proposed Rules 13b-1 and 13b-2 were incorporated in § 102. The House, however, rejected the inclusion of Rule 13b-3, prohibiting the falsification of corporate books or records, and Rule 13b-4, prohibiting the making of false or misleading statements to an accountant. The Commission had also proposed that disclosure of management involvement in questionable or illegal payments or practices be required as Item 6(d) of Schedule 14A. See SEC Release No. 34-13185, 387 SEC. REG. & L. REP. (BNA) D-2 (1977). The SEC has not decided whether to enact all four proposed rules, only 13b-1 and 13b-2 (which would duplicate the FCPA's provisions), or none of them. 466 SEC. REG. & L. REP. (BNA) A-6 (1978).

9. As one critic stated, almost all corporate conduct is somehow connected with the broad books and records requirements of § 102. Thus that section could become a "jurisdictional hook" by which the SEC could dictate all aspects of corporate governance. 466 SEC. REG. & L. REP. (BNA) A-5 (1978); see 451 SEC. REG. & L. REP. (BNA) D-5 (1978).

At least two SEC officials have hinted that an enormous expansion of the Commission's enforcement powers may be another perhaps unintended consequence of § 102. The House Conference Report on the FCPA and a recent SEC release stated that the Commission's enforcement power would extend to "commencing administrative proceedings if appropriate." H.R. REP. No. 640, 95th Cong., 1st Sess. 10; see SEC Release No. 34-14478, 441 SEC. REG. & L. REP. (BNA) G-1, G-2 (1978). This statement implies that the SEC could use § 15(c)(4) of the 1934 Act, 15 U.S.C. § 78o(c)(4) (1976) (the Commission has power to issue orders and mandate compliance in an administrative proceeding), to order that deficiencies under § 102 be remedied rather than apply for a civil injunction and request ancillary relief from the courts. In fact, the Commission will "probably . . . use the FCPA accounting provisions where heretofore [it has] used the equitable powers of the court." Statement by Richard H. Rowe, Director of the Division of Corporation Finance to the PLI Tenth Annual Institute on Securities Regulation, in New York, *quoted in* 479 SEC. REG. & L. REP. (BNA) A-11 (1978). See 451 SEC. REG. & L. REP. (BNA) D-2 (1978).

10. The Special Advisory Committee of the American Institute of Certified Public Accountants (AICPA) has issued a tentative report on guidelines for compliance with § 102. No specific standards were suggested because:

The wide range in the size of [the over ten thousand publicly held companies in the United States], in their operating style, in the complexity of their transactions, in the diversity of their products and services, and in the geographic dispersion of their operations clearly makes it impossible to enumerate specific controls . . .

SPECIAL ADVISORY COMM. ON INTERNAL ACCOUNTING CONTROL, TENTATIVE REPORT, *reprinted in* 470 SEC. REG. & L. REP. (BNA) F-1, F-5 (1978). The committee, however, suggested that corporate management assess, evaluate, and monitor compliance with established accounting control procedures. It also mentioned that management must demand higher accounting standards than an independent auditor. 470 SEC. REG. & L. REP. (BNA) D-1 to 2 (1978). These unilateral, vague recommendations, if not strengthened in future reports, probably will result in action by the SEC.

on corporate practices.¹¹ The most specific SEC announcement to date states that section 102 "enhances" the importance of internal audit committees and limits the role of outside auditors to one of oversight.¹²

B. CRIMINALIZATION OF CORRUPT PAYMENTS

Congress chose to criminalize some types of questionable payments under the FCPA rather than continue the former practice of merely requiring their public disclosure. The primary goal of this change was more effective deterrence of corporate bribery, but Congress envisioned subsidiary benefits in the form of easier enforcement. Unlike disclosure requirements, the proscription of questionable payments tends to be a "self-enforcing, preventive mechanism."¹³

Sections 103 and 104 of the FCPA,¹⁴ which criminalize corrupt payments, are largely unrelated to section 102.¹⁵ These sections make it unlawful for any "issuer" or "domestic concern," or any agent acting on such an enterprise's behalf,¹⁶ to make, offer, or authorize "corrupt" payments to: (1) an official of a foreign government, (2) a foreign political party, official, or candidate, or (3) an individual who the payor knows will give or offer all or part of the payment to such foreign officials or party.¹⁷ Such payments, to be unlawful, must be made with the intent of influencing official action in order to obtain business.¹⁸ Willful violations of these sections can result in fines of up to \$1,000,000 for companies and up to \$10,000 for individuals, or

11. 466 SEC. REG. & L. REP. (BNA) A-6 (1978). SEC General Counsel Harvey L. Pitt prefers a good faith standard rather than what he views as the less demanding cost/benefit standard. *Id.* However, legislative history indicates that a cost/benefit approach was felt to be appropriate and both the accounting profession and the SEC have indicated that this is the proper standard to be applied. S. REP. NO. 114, 95th Cong., 1st Sess. 8, reprinted in [1977] U.S. CODE CONG. & AD. NEWS 4106; 470 SEC. REG. & L. REP. (BNA) F-2 (1978); 451 SEC. REG. & L. REP. (BNA) D-4 (1978).

12. 473 SEC. REG. & L. REP. (BNA) D-6 (1978).

13. S. REP. NO. 114, *supra* note 11, at 10. See H.R. REP. NO. 640, *supra* note 9, at 6.

14. 15 U.S.C.A. §§ 78dd-1 to 2 (West Supp. 1979).

15. For discussion of a possible relation between § 102 and § 103, see notes 48-49 *infra* and accompanying text.

16. The Senate Report suggested that the determination of whether an employee is acting on his own behalf or on behalf of the corporation be based on the following criteria: "the position of the employee, the care with which the board of directors supervises management, the care with which management supervises employees in sensitive positions and [the corporation's] adherence to the strict accounting standards set forth under section 102." S. REP. NO. 114, *supra* note 11, at 11. The similarity in outlook between these criteria and the provisions of § 102 suggest the relationship between § 103 and § 102.

17. 15 U.S.C.A. §§ 78dd-1(a), -2(a) (West Supp. 1979).

18. The limitation that the payments must be made in an attempt to retain or obtain business has two effects. First, it excludes payments made by company management, employees, or agents for their own personal benefit. See note 16 *supra*. Second, it might exclude payments not directly made to obtain business, for example, payments made to obtain favorable

imprisonment for up to five years, or both.¹⁹

Section 103 applies to issuing corporations already subject to SEC jurisdiction.²⁰ Because the SEC has access to the records of issuers, and because it had developed expertise in uncovering foreign bribery prior to the enactment of the FCPA, the SEC retains investigative jurisdiction under that section.²¹ The SEC's enforcement responsibilities under section 103 also include "bringing civil actions, . . . defending lawsuits against the Commission . . . , and referring cases to the Justice Department for criminal prosecution where warranted."²²

Section 104 applies to "domestic concerns," defined in the Act as "(A) any individual who is a citizen, national, or resident of the United States; or (B) any corporation, partnership, . . . or sole proprietorship which has its principal place of business in the United States, or which is organized under the laws of a State."²³ Thus the application of the FCPA extends to companies that are not required to register and make reports under the securities laws. The Department of Justice retains full investigative and enforcement powers under section 104. In addition to having the authority to bring criminal actions, the Attorney General may institute civil injunctive suits under this section.²⁴

II

AMBIGUITIES IN THE FCPA

Critics of the FCPA consider it poorly drafted and point to three important ambiguities.²⁵ First, what is a "corrupt" practice? Second, assuming a corrupt act, to what degree will corporations be held accountable for the actions of their agents and subsidiaries? Third, assuming the company is liable, what sanctions should be imposed: pre-FCPA or FCPA penalties?

tax treatment. SEC officials have stated, however, that they will take an "expansive view" of the business test. 452 SEC. REG. & L. REP. (BNA) A-4 (1978).

19. 15 U.S.C.A. §§ 78ff(c), 78dd-2(b) (West Supp. 1979).

20. The criminal penalties of § 103 apply to "any issuer which has a class of securities registered pursuant to section 78l of this title or which is required to file reports under section 78o(d) of this title." *Id.* § 78dd-1(a). Subsections 12(a) and (b) of the 1934 Act require an issuer to register a security to be traded on a national securities exchange with the SEC. 15 U.S.C. §§ 78l(a), (b) (1976). Subsection 12(g) requires issuers that have total assets exceeding \$1,000,000 and a class of equity security held of record by 500 or more (but less than 750) persons to register such security. *Id.* § 78l(g). Subsection 15(d) requires an issuer who has registered an offering under the 1933 Act to file periodic reports. *Id.* § 78o(d).

21. H.R. REP. No. 640, *supra* note 9, at 9.

22. *Id.* at 10.

23. 15 U.S.C.A. § 78dd-2(d)(1) (West Supp. 1979).

24. *Id.* § 78dd-2(c).

25. 479 SEC. REG. & L. REP. (BNA) A-9 to 10 (1978).

These ambiguities, and how they should be resolved to effectuate best the purposes of the Act, are discussed below.

A. WHAT ARE "CORRUPT" PRACTICES?

The FCPA imposes criminal penalties on companies or individuals acting on a company's behalf if they willfully²⁶ violate the provisions of either section 103 (issuers) or section 104 (domestic concerns) by making payments "corruptly."²⁷ Although the FCPA does not define "corruptly" explicitly, the House Report stated that the word is used "to distinguish between payments which cause an official to exercise other than his free will in acting [in his official capacity] . . . and those payments which merely move a particular matter toward an eventual act or decision or which do not involve any discretionary action."²⁸ Discretionary actions include business referrals to the payor, nonperformance of official functions, and legislative or regulatory enactments preferential to the payor.²⁹ Nondiscretionary actions are clerical or administrative in nature;³⁰ the most typical example is facilitation of customs inspections.

The House Report also noted that the word "corruptly" connotes "an evil motive or purpose such as that required under 18 U.S.C. § 201(b), which prohibits domestic bribery."³¹ A survey of payments considered "corrupt" in cases decided under that section³² indicates that there must be

26. Establishing willfulness has not required proof of intent to violate the law or knowledge that the law was being violated in cases involving the application of securities laws. *See* Arthur Lipper Corp. v. SEC, 547 F.2d 171, 181 (2d Cir. 1976); Tager v. SEC, 344 F.2d 5, 8 (2d Cir. 1965); United States v. Benjamin, 328 F.2d 854, 862-63 (2d Cir. 1964).

27. 15 U.S.C.A. §§ 78dd-1(a), -2(a) (West Supp. 1979).

28. H.R. REP. NO. 640, *supra* note 9, at 8. The Report also indicated that the word "corruptly" does not require that the act be consummated. *Id.*

29. *Id.*

30. The Act's exclusion from the definition of foreign official of "any employee of a foreign government . . . whose duties are essentially ministerial or clerical," 15 U.S.C.A. §§ 78dd-1(b), -2(d)(2) (West Supp. 1979), substantiates the view that the FCPA does not criminalize payments made to influence nondiscretionary acts.

31. H.R. REP. NO. 640, *supra* note 9, at 8.

32. 18 U.S.C. § 201(b) (1976) provides in part:

Whoever, directly or indirectly, corruptly gives, offers or promises anything of value to any public official . . . , or offers or promises any public official . . . to give anything of value to any other person or entity, with intent—

- (1) to influence any official act; or
- (2) to influence such public official . . . to commit or aid in committing, . . . or allow, any fraud, . . . on the United States; or
- (3) to induce such public official . . . to do or omit to do any act in violation of his lawful duty, . . .

shall be fined not more than \$10,000 or imprisoned for not more than two years, or both.

some quid pro quo.³³ Corrupt intent does not exist if the payment "was motivated by some generalized hope or expectation of ultimate benefit."³⁴ The payment, whether it is a discrete transaction or part of a "course of conduct," must be in exchange for a specific action or a "pattern of official actions" favorable to the payor.³⁵

In sum, "corruptly" has the effect of criminalizing only those payments that are *intended* to influence a foreign official in the exercise of his *discretionary* duties and to be *in exchange for* a benefit received. Consideration of four categories of questionable foreign payments—the outright bribe, the goodwill payment, the "grease" payment, and the coerced payment³⁶—demonstrates that the contours of these elements are far from clear.

The outright bribe is the clearest example of a payment proscribed by the FCPA. Such a payment is typically made to secure a foreign government's discretionary grant of various business opportunities. Examples of such business opportunities include government sales contracts, operating permits, mineral or petroleum rights, price increases, and product registrations. Most of the payments challenged in enforcement proceedings brought by the SEC to date, including those not involving the FCPA, fall into the category of outright bribes.³⁷ Thus no interpretative problems should exist in the majority of cases prosecuted under the Act.³⁸

Payments made solely to establish goodwill between a corporation and a foreign government are not considered "corrupt" under the Act and thus would not subject the company to FCPA liability. However, if this category is not construed narrowly when significant payments are involved a massive loophole will exist. If the payments reflect attempts on the part of a company to induce even generalized favorable treatment by the foreign government, the threshold quid pro quo requirement may well be met. For example, consider an airline company practice of providing free air travel for government personnel and their families. This practice may be consid-

33. *United States v. Arthur*, 544 F.2d 730, 734 (4th Cir. 1976); *United States v. Brewster*, 506 F.2d 62, 81 (D.C. Cir. 1974).

34. *United States v. Arthur*, 544 F.2d 730, 734 (4th Cir. 1976).

35. *Id.*

36. These categories were suggested in Chu & Magraw, *The Deductibility of Questionable Foreign Payments*, 87 YALE L.J. 1091, 1091 n.3 (1978), and McLaughlin, *The Criminalization of Questionable Foreign Payments by Corporations: A Comparative Legal Systems Analysis*, 46 FORDHAM L. REV. 1071, 1073 n.13 (1978).

37. See, e.g., *SEC v. McDonnell Douglas Corp.*, 484 SEC. REG. & L. REP. (BNA) A-6 (D.D.C. Dec. 14, 1978); *SEC v. Katy Indus., Inc.*, 469 SEC. REG. & L. REP. (BNA) A-1 (N.D. Ill. Aug. 30, 1978); *SEC v. Boeing Co.*, 464 SEC. REG. & L. REP. (BNA) A-16 (D.D.C. 1978); *SEC v. Page Airways, Inc.*, [1978 TRANSFER BINDER] FED. SEC. L. REP. (CCH) ¶ 96,393 (D.D.C. Apr. 12, 1978).

38. Interpretative problems may still exist in connection with outright bribes, however, if a defense of coercion is asserted. See notes 41-44 *infra* and accompanying text.

ered "corrupt" depending on: (1) the aggregate value of the airfare, (2) the prevalence of the practice, and (3) other circumstances, such as whether the government is currently considering regulations or legislation that may affect the company's foreign activities. If this category is not construed narrowly, companies making such at least colorably corrupt payments could escape FCPA liability.

The FCPA also clearly excludes from its operation "grease" payments which are payments that facilitate nondiscretionary actions, such as expediting shipments through customs, placing transatlantic phone calls, securing required permits, and obtaining adequate police protection.³⁹ Again, however, what constitutes a grease payment will be a difficult factual question in some situations. For example, a payment to a government official for providing procedural assistance in going through customs or in filing a tax return may not be a grease payment if it generates an expectation of special treatment.⁴⁰ In contrast to factual questions concerning goodwill payments, close factual situations involving grease payments should be resolved in favor of the company. Congress did not intend to deprive companies of the means to ensure efficient completion of necessary day-to-day business tasks abroad. By not criminalizing these payments, Congress implicitly recognized that in many foreign countries officials expect as a matter of course to receive payments before services are performed. This differentiation makes sense in light of the public interest. The harm to the public caused by grease payments is much less than that caused by outright bribes because the former payments merely expedite what would generally occur anyway. Furthermore, the benefits to companies that stem from allowing such payments are significant. Where the payor is seeking discretionary favoritism, however, the argument for recognizing the expectations of foreign officials is weaker.

Although the FCPA does not criminalize extortion payments where a foreign official threatens to inflict physical or personal harm,⁴¹ the status of economically coerced payments is not as clear. The domestic bribery statute⁴² apparently does not allow a defense of economic coercion. The Second Circuit has held that threats of economic injury made by the recipient of a questionable payment should be considered only in deciding whether

39. S. REP. NO. 114, *supra* note 11, at 10.

40. At least one commentary has suggested that the FCPA's definition of foreign official, *see* note 30 *supra*, excludes more than just the grease payment. "Clerical" foreign employees include custom officers and licensers; thus bribes given to them that reduce customs duties or procure licenses not otherwise available may not be proscribed by the Act. *See* Chu & Magraw, *supra* note 36.

41. S. REP. NO. 114, *supra* note 11, at 11.

42. 18 U.S.C. § 201(a) (1976).

the payor had the intent to influence official action.⁴³ A similar approach should be adopted under the FCPA. Otherwise the assertion of the defense of economic coercion would become widespread and eviscerate the FCPA's legislative purpose of prohibiting the giving and, implicitly, the expecting⁴⁴ of questionable payments.

B. WHEN ARE COMPANIES ACCOUNTABLE?

1. For Their Agents

A major purpose of the FCPA is to encourage companies to take responsibility for, and try to prevent, the misconduct of persons acting on their behalf. Violations authorized by management constitute direct corporate liability. It is likely, however, that there will be no explicit authorization for many corrupt payments. Therefore, in many cases, corporate accountability must be established on the basis of secondary liability.

Secondary liability is imposed on parties who are not direct participants in a securities violation if they "knowingly and substantially" assist in the violation, and are "generally aware" of its impropriety.⁴⁵ Such knowledge can be actual or constructive.⁴⁶ Constructive knowledge arises from a breach of the corporation's duty to inquire into corporate activities.⁴⁷ Thus corporations could be held liable for corrupt payments made by their employees, even though not explicitly authorized, if the payments were made in circumstances giving rise to a duty of inquiry.

In the case of a domestic concern subject to section 104, the duty to inquire should be no different from that imposed elsewhere in corporate law.⁴⁸ The standard governing an issuer's duty to inquire, however, is arguably more stringent because the issuer is also subject to the accounting provisions of section 102. It is a sensible interpretation of the Act to con-

43. *United States v. Barash*, 412 F.2d 26, 30 (2d Cir. 1969).

44. The House Report stated that one purpose of the FCPA was to help U.S. corporations resist corrupt demands. The Report quoted the Chairman of Gulf Oil Co.: "If we could cite our law which says we just may not do it, we would be in a better position to resist these pressures and refuse those requests." H.R. REP. NO. 640, *supra* note 9, at 5.

45. *SEC v. Coffey*, 493 F.2d 1304, 1316 (6th Cir. 1974).

46. *Hochfelder v. Midwest Stock Exchange*, 503 F.2d 364 (7th Cir.), *cert. denied*, 419 U.S. 875 (1974); *SEC v. Spectrum, Ltd.*, 489 F.2d 535 (2d Cir. 1973); *SEC v. First Sec. Co.*, 463 F.2d 981 (7th Cir.), *cert. denied*, 409 U.S. 880 (1972).

47. *See* cases cited in note 46 *supra*. *But see Ernst & Ernst v. Hochfelder*, 425 U.S. 185 (1975) (scienter required for liability under SEC Rule 10b-5).

48. Section 102 does not apply to "domestic concerns" as defined in § 104. While § 102 and § 103 amend the Securities Act of 1934, 15 U.S.C. §§ 78a-78kk (1976), § 104 does not. *See* note 1 *supra*. Because domestic concerns are generally not as large as issuers, the establishment of internal controls may not be as imperative; in smaller concerns the lack of management knowledge and/or authorization of illegal or questionable activities is not as likely to occur.

clude that a breach of the provisions of section 102—which were designed to prevent corporate management from “looking the other way” in regard to questionable activities—constitutes a breach of the duty of inquiry.⁴⁹ Thus a section 103 company should be liable for a corrupt payment made by an employee if compliance with section 102’s “reasonable detail” and “accurately and fairly” standards would require the payment to be recorded in company books. In other words, the corporation should be held to have actual knowledge of all transactions recorded in company books and constructive knowledge of all transactions that should be reported under section 102.

This interpretation will not give rise to strict liability for corporations. If every corrupt payment made but not reported were considered a breach of section 102, a corporation would be liable for every corrupt payment made. But such strict liability will not result in fact because the accounting provisions are not expected to catch all corrupt payments, only those that would be recorded if the books were kept in reasonable detail.

2. *For Their Foreign Subsidiaries*

The FCPA does not criminalize corrupt payments made by foreign subsidiaries of U.S. corporations. The House version of the bill defined “domestic concern” in section 104 to be “any corporation . . . which is owned or controlled by individuals who are citizens or nationals of the United States, which has its principal place of business in the United States, or which is organized under the laws of a State of the United States.”⁵⁰ The committee reporting on the bill felt it “appropriate to extend the coverage of the bill to non-U.S. based subsidiaries because of the extensive use of such entities as a conduit for questionable or improper foreign payments authorized by their domestic parent.”⁵¹ The bill as ultimately enacted, however, did not define “domestic concern” to include U.S.-controlled foreign subsidiaries.⁵² The Conference Report explained the exclusion of such foreign subsidiaries from the Act’s coverage by citing the “inherent jurisdictional, enforcement, and diplomatic” difficulties that would otherwise result.⁵³ The Conference Committee did not feel, however, that this exclusion would create a loophole in the Act since any citizen, national, or

49. See note 16 *supra*.

50. H.R. REP. NO. 640, *supra* note 9, at 11-12 (emphasis added).

51. *Id.* at 12 (footnote omitted). The extraterritorial application of federal criminal law was said to be supported by at least three established principles of international law: territoriality, nationality, and the domestic effects doctrine. *Id.* at 12 n.3.

52. See 15 U.S.C.A. § 78dd-2(d)(1) (West Supp. 1979).

53. H. CONF. REP. NO. 831, 95th Cong., 1st Sess. 14, *reprinted in* [1977] U.S. CODE CONG. & AD. NEWS 4121, 4126.

resident of the United States or any foreign national or resident otherwise under the jurisdiction of the United States would be subject to U.S. jurisdiction for engaging in bribery indirectly through a foreign subsidiary.⁵⁴

There are at least three situations in which a parent company indirectly bribes a foreign official by using a foreign subsidiary as a conduit. First, if a domestic corporation has actual knowledge of an unlawful practice and if it authorizes or substantially assists such practice, criminal penalties should be imposed on the parent corporation as an aider or abettor. Examples of authorization of illegal practices of a subsidiary by a parent company are not uncommon.⁵⁵

Second, where no actual knowledge or authorization can be proved, parent companies should be charged in appropriate cases with constructive knowledge. For example, unusually large cash disbursements by foreign subsidiaries should give rise to a duty of inquiry. In cases involving relatively small questionable payments occasionally made by employees of a foreign subsidiary out of the subsidiary's operating budget, or where off-the-book accounts are kept, no such duty of inquiry should necessarily arise.⁵⁶ Thus, if a single foreign subsidiary uses fictitious invoices to withdraw \$1,500,000 within a two year period to pay foreign government agencies for sales contracts, constructive knowledge should be imposed. On the other hand, if seven different subsidiaries in different countries make payments to foreign government officials totaling \$900,000, the case for constructive knowledge may not be as clear.⁵⁷

A third situation in which a parent corporation could be held liable for its subsidiary's foreign activities is that in which a principal-agent relationship exists. A subsidiary is not ordinarily considered the agent of the parent company merely because a majority of its voting shares are held by the parent.⁵⁸ In some cases, however, a subsidiary is considered the agent of its parent, as for example, when it enters into a contract on the parent's ac-

54. *Id.*

55. In disclosures made pursuant to the Voluntary Compliance Program, *see* notes 65-68 *infra* and accompanying text, Exxon reported that some questionable payments made by its Italian subsidiary in order to secure oil sales contracts were either known or authorized by the corporation's directors and management. Similar disclosures were made by General Telephone Electronics Corp., Cities Service, and Gulf. SEC, REPORT ON QUESTIONABLE AND ILLEGAL CORPORATE PAYMENTS AND PRACTICES, exhibit A (Comm. Print 1976) [hereinafter cited as SEC REPORT].

56. Thus the test for determining whether a corporation has constructive knowledge of its subsidiary's activities is not as strict as that used when the questionable activities are those of a domestic agent. *See* notes 47-49 *supra* and accompanying text.

57. These hypotheticals are based on disclosures made by the Burroughs Corp. and Johnson & Johnson. SEC REPORT, *supra* note 55.

58. RESTATEMENT (SECOND) OF AGENCY § 14M (1957).

count.⁵⁹ If a foreign subsidiary *is* the agent of the parent corporation, the parent would be liable for all questionable payments made by the subsidiary in the exercise of its agency authority.⁶⁰ In some cases, even though a subsidiary is not technically an agent, the parent is held liable for the actions of its subsidiary. This view is commonly referred to as "piercing the corporate veil": the separate corporate existence of the subsidiary is disregarded because it is so dominated by the parent as to be only its instrument.⁶¹ If, therefore, a foreign subsidiary's activities are substantially under the control of the parent corporation, the parent corporation would be chargeable with the subsidiary's wrongs. An example of such a situation would be the use of a foreign subsidiary to "launder" money eventually used for the payment of foreign bribes.

C. WHAT SANCTIONS SHOULD BE IMPOSED?

The FCPA has not significantly changed the SEC's "basic enforcement program" in the area of foreign bribery.⁶² Actions instituted against corporations making questionable foreign payments have emphasized violations of the disclosure requirements of the Securities Exchange Act of 1934⁶³ rather than FCPA charges.⁶⁴ This enforcement scheme differs little from that adopted in the now defunct Voluntary Compliance Program.⁶⁵ That

59. A true agency relationship was found in *National Plumbing Supply Co. v. Torretti*, 237 Mo. App. 570, 175 S.W.2d 947 (1943). Essentially all the shares of both the parent and subsidiary were owned by the same person. The expenses of the subsidiary were sometimes paid by the parent. When the subsidiary did pay its own expenses, it was immediately reimbursed by the parent. Furthermore, the parent company had told a third party that it would pay all of the subsidiary's bills. Another case of a subsidiary agent is *Whitehurst v. FCX Fruit & Vegetable Serv., Inc.*, 224 N.C. 628, 32 S.E.2d 34 (1944), in which the parent and subsidiary had common employees with whom a third party dealt. Shipments sent to the parent by the third party were paid for by either the subsidiary or parent.

60. The FCPA specifically provides that a corporation is liable for the corrupt payments made by an agent acting on the corporation's behalf. 15 U.S.C.A. §§ 78dd-1(a), -2(a) (West Supp. 1979). Therefore, actions undertaken for the personal enrichment of the foreign subsidiary agent would not subject the parent to FCPA liability.

61. The Reporter's Notes to § 14M of the Restatement (Second) of Agency explicate the difference between a true principal-agent relationship and relationships where the separate corporate entity of the subsidiary is disregarded for policy reasons. RESTATEMENT (SECOND) OF AGENCY § 14M, Reporter's Notes (1957).

62. 466 SEC. REG. & L. REP. (BNA) A-4 (1978). The Department of Justice has been equally cautious in implementing the FCPA. *Id.*

63. *See, e.g.*, SEC v. McDonnell Douglas Corp., 484 SEC. REG. & L. REP. (BNA) A-6 (D.D.C. Dec. 14, 1978); SEC v. International Tel. & Tel. Corp., 477 SEC. REG. & L. REP. (BNA) A-1 (D.D.C. Nov. 1, 1978); SEC v. Katy Indus., Inc., 469 SEC. REG. & L. REP. (BNA) A-1 (N.D. Ill. Aug. 30, 1978); SEC v. Boeing, 464 SEC. REG. & L. REP. (BNA) A-16 (D.D.C. 1978); SEC v. Page Airways, Inc., [1978 TRANSFER BINDER] FED. SEC. L. REP. (CCH) ¶ 96,393 (D.D.C. Apr. 12, 1978).

64. 466 SEC. REG. & L. REP. (BNA) A-4 (1978).

65. The SEC instituted the Voluntary Compliance Program in 1976. The purpose of the

program required corporations to make disclosure of all material facts relating to foreign payments. Difficulties arose in complying with the program, however, because the standards for disclosure it endorsed departed from traditional concepts of financial materiality.⁶⁶ In addition, because it did not require that the names of the foreign countries and parties involved in the questionable transactions be disclosed, the effectiveness of the program in preventing foreign bribes was questioned.⁶⁷ The program was ended apparently because of this latter criticism.⁶⁸

Congress in enacting the FCPA recognized that criminalizing foreign payments would be more of a deterrent to foreign bribery than disclosure. Furthermore, it sought to avoid the administrative burdens necessarily involved in liberal disclosure requirements.⁶⁹ Thus the lack of FCPA prosecutions by the SEC is unwarranted except to the extent that it avoids retroactive application of a criminal statute.

The optimal approach to implementing the FCPA in light of the disclosure requirements of the securities laws would recognize and balance the interests sought to be protected by each. By criminalizing foreign corrupt practices, Congress wanted to ensure that the public interest in conducting foreign business transactions in an ethical and competitively healthy manner would not be overlooked by profit-motivated corporations.⁷⁰ The disclosure requirements, on the other hand, were designed to protect the economic interests of the investing public.⁷¹ Deterrence of foreign bribery is not necessarily beneficial to investors; disclosure of financially significant payments is.

An optimal balance would require all financially significant foreign payments to be disclosed. For example, payments to customs officials made on a regular basis, although not covered under the Act, might still be a

Program was to encourage corporations to disclose questionable payments voluntarily and thus ease the investigative burden of the SEC. Statement by SEC Chairman Roderick M. Hills before the Subcomm. on Priorities and Economy in Government of the Joint Economic Comm., reported in [1975-1976 TRANSFER BINDER] FED. SEC. L. REP. (CCH) ¶ 80,364 (Jan. 14, 1976); see SEC REPORT, *supra* note 55, at 8-11.

66. Henderson & Sommer, *Sensitive Corporate Payments: The SEC's Voluntary Disclosure Program*, in EIGHTH ANNUAL INSTITUTE ON SECURITIES REGULATION 423, 442-43 (1977).

67. SEC REPORT, *supra* note 55, at 32-33.

68. Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 VA. L. REV. 1099, 1255 (1977).

69. H.R. REP. NO. 640, *supra* note 9, at 6; S. REP. NO. 114, *supra* note 11, at 10. See note 13 *supra* and accompanying text.

70. H.R. REP. NO. 640, *supra* note 9, at 4-5 (foreign bribery "rewards corruption instead of efficiency and puts pressure on ethical enterprises to lower their standards"); S. REP. NO. 114, *supra* note 11, at 4 (foreign bribery affects domestic competition by acting as a "substitute for healthy competition").

71. See note 4 *supra* and accompanying text.

material fact required to be disclosed to the investing public. The same argument could also support disclosure of goodwill payments constituting a financially significant expenditure of corporate funds.⁷² On the other hand, only payments that are truly egregious and violative of public policy would be subject to the severe criminal sanctions of the FCPA. Of course, some payments will be subject to both the disclosure requirements and the criminal sanctions of the FCPA. For example, a \$2,000,000 payment to a foreign official who then awards a government contract is both a bribe, violative of the FCPA, and a payment significant enough to require disclosure. There is, of course, no reason to demand exclusivity, since no double penalization occurs; failure to disclose material facts results in the entry of a civil consent decree, not criminal penalties.

In addition, as suggested by the House Report⁷³ and the SEC,⁷⁴ a private right of action should be available to all those injured by violations of the FCPA.⁷⁵ A private right of action can be implied "in favor of the intended beneficiaries of a statute where necessary to implement the statute's underlying purposes."⁷⁶ To implement the FCPA's policies, a private right of action should extend to the general public, as well as to shareholders.⁷⁷ The liability to which corporations would be exposed would not be catastrophic since, as the General Counsel for the SEC stated, a "lack of pecuniary harm will be the real impediment to such actions."⁷⁸ Violations of section 102, the internal accounting controls provision, will probably only injure shareholders. Violations of sections 103 and 104, on the other hand, would very probably result in economic loss to business competitors.

CONCLUSION

The FCPA encourages corporate accountability in two ways: by requiring the establishment of internal accounting controls and by criminaliz-

72. See notes 36-40 *supra* and accompanying text.

73. H.R. REP. NO. 640, *supra* note 9, at 10.

74. Opinion of Office of the General Counsel on the Existence of a Private Right of Action Under the Foreign Corrupt Practices Act of 1977, [1978 TRANSFER BINDER] FED. SEC. L. REP. (CCH) ¶ 81,701.

75. *But see* Cort v. Ash, 422 U.S. 66 (1975), in which the Supreme Court allowed a private right of action only when four factors are present. (1) The plaintiff must be "one of the class for whose *especial* benefit the statute was enacted." (2) There must be "legislative intent . . . to create such a remedy." (3) The remedy must be "consistent with the underlying purposes of the legislative scheme." (4) The cause of action must not be "one traditionally relegated to state law." *Id.* at 78 (emphasis in original).

76. Abrahamson v. Fleschner, 568 F.2d 862, 872 (2d Cir. 1977), *cert. denied*, 436 U.S. 913 (1978); *see* Superintendent of Ins. v. Bankers Life & Cas. Co., 404 U.S. 6, 13 n.9 (1971); J.I. Case Co. v. Borak, 377 U.S. 426 (1964).

77. Opinion of General Counsel, *supra* note 74.

78. 452 SEC. REG. & L. REP. (BNA) A-6 (1978).

ing questionable payments made in particular circumstances. This approach ensures that the public interest in ethical foreign business transactions will not be circumvented by self-serving corporations. The pre-Act materiality doctrine, however, is still viable and should continue to require disclosure of financially relevant information to the investing public. In general, to solve the problems of FCPA interpretation, one must consider the policies of the Act and balance them against the potential burdens to the corporation.

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