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**LEGAL CONTROL
OF
ILLEGAL PAYMENTS BY MULTINATIONAL CORPORATIONS**

Dissertation submitted to the School
of Graduate Studies and Research in partial fulfilment
of the requirements

For

The Degree of
DOCTOR IN LAWS

Saleh Abdullah Al-Oufi

Supervised by
Professor André Jodouin

Faculty of Law
University of Ottawa

1988



Saleh Abdullah Al-Oufi, Ottawa, Canada, 1988.

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UNIVERSITÉ D'OTTAWA
UNIVERSITY OF OTTAWA

LEGAL CONTROL
OF ILLEGAL PAYMENTS BY
MULTINATIONAL CORPORATIONS

by

Saleh A. Al-Oufi

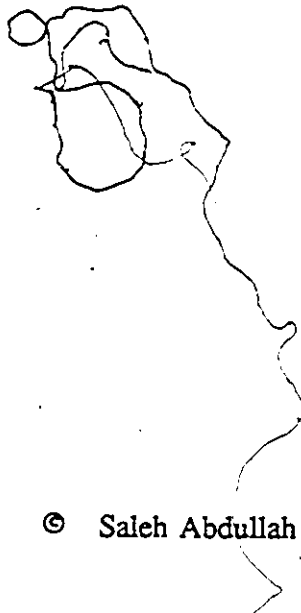


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VITA

Saleh Abdullah Al-Oufi was born in a small farming town near the city of Al-Taif, west of the Arabian Peninsula in Saudi Arabia. He attended elementary school in this town for five years, then intermediate and high school in the school of Dar Al towheed in Al Taif for six years. In 1972 he graduated and attended Islamic Law (Sharia) College of the King Abdulaziz University in Makkah, now Um Al Qura University. During his undergraduate years he was one of the top five students in his field. He graduated with the degree of LL.B. in Islamic Law in 1976. He was subsequently admitted to the program of legal studies at the Institute of Public Administration. He spent two years there and graduated in 1978 with highest distinction as the first in his group that year. As partial fulfilment for his diploma he wrote a thesis entitled "Arbitration and Conciliation as a Means of Solving Commercial Disputes: A Comparative Study. He worked as a legal advisor for the Saudi Arabian government for two years, then in 1981 was awarded a scholarship to complete his higher education. He studied English as a second language for almost a year before entering the Masters program at Tulane University School of Law, U.S.A. In 1983 he obtained his LL.M. in common law, with research in legal problems of foreign investment in developing countries. As a result of the encouragement of Dean Thomas J. Schoenbaum, he continued his LL.M. in admiralty law and graduated in May 1984, with research in liability of oil and shipping companies for pollution of the sea. In 1985, he was accepted as a doctoral candidate in the Faculty of Law at the University of Ottawa, for which he presents this thesis, Legal Control of Illegal Payments by Multinational Corporations. At the same time, he participated in a series of conferences offered by the Quebec National and International Commercial Arbitration Centre.

DEDICATION

I dedicate this dissertation to my beloved mother, who supported me with love throughout my childhood and student years and encouraged me to complete my higher education, and who worked hard to raise me and the rest of my brothers and sisters. I also dedicate it to my beloved father, who passed away before I came to North America for my higher education. God's peace be upon him.

I will always cherish my younger brother Eidah, not only for his incredible display of love for me, but also for his absolute insistence that I successfully finish my doctorate. His taking on the responsibility of helping my mother raise my younger brothers and sisters is an expression of family unity that is greatly appreciated. His sense of singular purpose will be a source of inspiration to me in all my endeavours.

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The photocopies of journal material given me by Professor Antaki have greatly benefited my research and saved me valuable time. Also, I have benefitted from books and case citations that have been made accessible by my supervisor, Professor André Jodoiun. He also lent a great deal of strength, energy, and encouragement to my creative work.

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ABSTRACT

This dissertation deals with the issue of illegal payments by multinational corporations. It is particularly concerned with possible and effective ways to control such illegal activities. The dissertation consists of four parts, seven chapters, with the introduction and conclusion.

Chapter 1.0 describes the myth and reality of this method of conducting business, the ethical dilemma of the parties involved, and the consequences to them. Chapter 2.0 is a description of the various types of illegal payments and the methods and techniques used by corporations to cover up such practices. Chapter 3.0 is a discussion of the MNC legal advisor's duty to control illegal payment through his role in shaping corporate behaviour. Chapter 4.0 looks at intracorporate remedies to control MNC illegal payments and the shareholders' role in the form of derivative suits in halting illegal practices by managers and directors that have a detrimental effect on the corporations' future business dealings abroad. Chapter 5.0 is a survey and a comparative analysis of legal sanctions to control MNC illegal payments in Saudi Arabia and the U.S. Chapter 6.0 is a study of the jurisdictional basis for controlling illegal payments abroad by applying local laws to the activities of national corporations beyond national borders, and of the policy dilemma that would accompany this extraterritorial application. Finally in Chapter 7.0, the writer reaches the conclusion that the best method of control of illegal payments and bribery in transnational transactions is through the cooperative efforts of the whole international community, thereby avoiding the problem that arises in applying national law to activities that occur in another sovereign's territory, and at the same time activating the law of other nations that seek to control such illegal practices. The research has revealed that almost every country has laws against bribery and illegal payment, but that the corrupt system and official

selective application of these laws make it useless to control such activities. However, efforts by regional and international organizations will not be effective unless they are enacted and mandated by a treaty adhered to by all national concerns.

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INTRODUCTION

The writer's purpose in studying illegal payments by multinational corporations is to expose the problem and its legal control from the lawyer's perspective. The writer attempts to do this without indulging in judgment of the political and social behaviour of the actors involved, although the conscious and premeditated corruption of the processors of the law or, more generally, the custodians' behavior needs to be examined briefly to make the picture clearer and to pave the way for our study.

Deviation from prescribed norms and appropriate social values by certain groups contributes to the development of deep ambivalences about the law and its practitioners in particular, and about the political system in general. Paradoxically, where government has emerged as custodian of the law, proclaiming its honest intention to preserve justice and work for the well being of society, the uncovering of operational corruption leaves citizens with no reason to assume improvement. Consequently, the impeachment of a public official for a fundamental violation of the trust of the general public is almost expected, and meets society's expectations and perception of justice.

Undoubtedly, when a political leader deviates from the general expectation of the public, resentment increases, as does the erosion of civilized principles. However, from a professional viewpoint, this dissertation is seen not as a political study but as a conventional legal one, with meticulous analysis of legal definitions, review of statutes and rules, discussion of past precedents and a comparative look at the enforcement problems that might be encountered by those in charge of prosecuting and convicting these violators. It is hoped that the content of this dissertation will be a modest contribution towards exploring the problem of illegal

payments and bribery, and towards activating efforts to efficiently control such illegal behaviour by both actors. Nonetheless, it shall be recognized that the study of the legal control of illegal payments by multinational corporations is rather complicated as a field of legal study, because of its clandestine nature and the lack of analytical tools available to examine the problems and suggest solutions.

Thus, in Chapter 1.0, the reader is given an overview of the myth, reality and consequences of the issue of bribery and the epidemic of corporate corruption. The corrupt activities of corporations that surfaced in the early 1970s virtually drew the attention of the world to the role of corporations in society. The thunderclap that accompanied the Watergate scandal sharpened the need for effective control of corporate behaviour to correspond to its legitimate creation in society. The extent of corporate bribery and illegal payment that was disclosed indicated factual links and established sufficient evidence to prove complicity between corporations and political actors. Evidently, in business government relations, a loose system of control will permit wide spread corruption, especially when there is evidence that the leaders are themselves corrupt. This corrupt behaviour of leaders and public officials is a distinct feature of the exercise of authoritarianism, especially in developing countries. The control of illegal payments in transnational business transactions requires the will of political leaders, the business community and the legal profession.

Chapter 2.0 examines illegal payments and bribes that are deemed authoritatively unlawful, and other exceptional payments that have the operative effect of bribery. Although methodological problems arise in labelling payments illegal, a designative and evaluative approach should be employed to arrive at a conclusion about the payments' appropriateness and legitimacy. Examples of these problems are sensitive political contributions and facilitating payments, the actual purpose of

which is to gain some favourable and sympathetic treatment from the taker of these payments and to ensure his subservience to the giver. Yet, one must examine the purpose and the motive behind the payment to distinguish a bribe from a legal political payment by a business organization. In addition it shall be recognized that a "facilitating payment" a neo-euphemism for the term "bribe" shall be considered illegal in the final analysis because its clear purpose is the corruption of the recipient to modify or influence his decision in favour of the giver. The legalization of this type of payment can lead to the concealment of other illegal practices and might discourage the recipient from executing his duty unless he receives some facilitating payment. Several methods and techniques are employed by big corporations to conceal the purpose of the payments, secure anonymity and protect the recipient.

This leads us to examine in Chapter 3.0 the extent of corporate legal advisor responsibility of any business organization to control illegal payments. The legal professional faces a bewildering dilemma as he assesses his responsibilities when he has had previous knowledge about illegal payments by the organization that employs him. Several questions must be answered in order to determine the legal advisor's liability: To what extent is the legal advisor legally or morally obligated to reveal information to which he is privy with respect to illegal payments? Does complying with this legal and moral obligation to reveal information contradict the principle of confidentiality of the attorney client relationship? If not, in what circumstances does the attorney client privilege apply? Consequently, what role should the legal advisor play in the business organization and in the shaping of its behaviour?

We subsequently in Chapter 4.0 examine the internal remedies employed by corporations to control illegal payments. Although these remedies were initiated

by corporations to shield the public and the shareholders from the glare of publicity that surrounds the revelation of illegal payment, as in the Watergate scandal, they are a positive step toward eliminating the practice. The first of these measures is the publication of a corporate code of conduct to guide corporate employees in conducting business in accordance with ethical and lawful principles. The second measure is bringing about a change in attitude toward the composition of corporate boards of directors. This can be achieved by the installation of independent outside directors who would monitor against any wrongdoing. Such a measure narrows corporations' latitude, under the traditional composition of the board of directors, to define and assess responsibility and consequences for future action. Besides, it also exhorts corporations to be more cautious about questionable activities and to earnestly admonish any possible illegal conduct. The third measure is the creation of an audit committee to prevent any misuse of corporate funds by management, and to provide a mechanism by which outside directors can investigate corporate accounting and monitor its financial practices without managerial pressure. The fourth measure is an intermittent internal investigation by the corporation to make certain that all business activities are being conducted in accordance with ethical standards and legal principles. However, this measure may be used to advantage by shareholders when the internal investigation reveals bribes or questionable payments. Corporations often block shareholders who bring derivative suits against the directors involved by asserting the business judgment rule. Indeed, this power in the hands of corporate boards to terminate a derivative suit, without any monitoring device for the abuse of the rule, increases the possibility of the board's covering up illegal activities on the ground that the suit is not in the best interests of the corporation. Nevertheless, considering the link between bribery and illegal payment in international business, and corrupt activities of both MNCs and local foreign officials, these internal voluntary measures might not

deter corporations from devising ways of circumventing their professed policies. These policies are too often used for public consumption and image making rather than to conduct business in accordance with ethical and legal principles.

In Chapter 5.0 we examine legal sanction of illegal payments. One should remember that most if not all illegal payments were and perhaps are still being made in countries that have laws prohibiting such practices. Indeed, these practices flourished as a result of giant corporations striving to maintain their economic power in developing countries. To accomplish this goal and generate exorbitant profits, they went beyond reasonable business practices and invested their efforts in exploiting foreign officials who were motivated by greed and personal enrichment to the detriment of their fellow citizens. The national economy, after all, finally bears the cost of bribery and illegal payment and not the payee, and the receiver official is supposedly the enforcer of the laws.

Admittedly, the effectiveness of the law to squelch corrupt practices by giant corporations in international business depends on its equal and impartial enforcement. Concurrently, intergovernmental cooperation is needed for mutual judicial assistance, gathering evidence, extraditing the accused, and settling any disputes that may emerge as a result of prosecution and indictment. We will examine first the Saudi Arabian dual legal system the *Shari'a* or Islamic law and the regulation against bribery which regulate in detail the subject matter in accordance with the Islamic concept of justice and preservation of the community. Secondly, we will look at the efforts of the U.S. to rebuild its image after the revelation of the Watergate scandal. This image making, however, took the form of enacting appropriate rules of criminal law to prevent corporations from using bribery and illegal payments in their dealing overseas, and thus gaining access to foreign countries for the purpose of conducting business. In addition to the image making

impetus, the development of U.S. law to control its corporations' illegal payments abroad was also spurred by a will to curb the practice of these corporations and their subsidiaries of laundering money for illegal political contributions in the U.S. itself. Nonetheless, the effectiveness of such a unilateral action is hindered by its extraterritorial consequences, and attendant upon such a law are many difficulties associated with its application.

This leads us to Chapter 6.0, where we will examine the basis that may be asserted for criminalizing corporate activities, and the theories that may be advanced to establish the jurisdiction of a country over the activities of its national corporations abroad. We will also examine the political dilemma attending the application and enforcement of such legal control. While acknowledging these difficulties and dilemma, we will in Chapter 7.0 of this dissertation present the efforts by regional and international organizations to control the problem of illegal payments by giant corporations as the only way to overcome the difficulties associated with the application of unilateral action, and we advocate the need for the concurrent cooperation of countries that possess economic power and those in need of development.

Note 1. Except where indicated, Arabic materials (statutes, regulations, newspaper articles, etc.) have been translated by the author of this thesis, who takes full responsibility for the translation.

Note 2. Most of the Arabic language materials are dated from the Hidirah, that is the date of the departure of the Prophet Muhammed, peace be upon him, from Makkah to Madinah, where he publicly announced his message from God. This date is know as "After Hidirah" (A.H.).

PART ONE: AN OVERVIEW OF THE EXTENT OF CORPORATE
BEHAVIOUR IN WORLD BUSINESS AND A CATEGORICAL ANALYSIS OF
ILLEGAL PAYMENT TO PUBLIC OFFICIALS

CHAPTER 1.0

MYTH, REALITY AND CONSEQUENCES OF MULTINATIONAL
CORPORATIONS' ILLEGAL PAYMENTS

1. General Remarks

The epidemic of corporate corruption that beset multinational corporations (MNCs)¹ in the early 1970s drew attention virtually around the globe. MNC activities were a daily focus of the business pages of newspapers, with several scandals reaching front page proportions. The activities involved not only "reputable" businessmen but also large corporations. A prime example was Lockheed's spectacularly indiscreet millions in bribes to high ranking government officials of Japan and of certain European and Middle Eastern countries. In the U.S., government contractors entertained Pentagon procurement officials² and employed retired high ranking military officers to perform a variety of sensitive and in some cases secret tasks for the company.³

¹ A multinational corporation has been defined as "a related group of companies operating simultaneously in different countries and therefore subject to different national jurisdictions, but under the corporate control of one parent company. See Litvak Smoule, *The Multinational Corporation: Some Economic, Political and Legal Implications* (1971), 5 *Journal of World Trade Law*, at 631-632. For our purposes in this thesis, MNCs are those corporations transcending the national boundary and doing business abroad, whether or not they have a subsidiary or plant abroad.

² Ralph Nader and Mark Green, "What to Do About Corporate Corruption," *Wall Street Journal*, March 2, 1976, at 8, col. 4.

³ See Michael C. Jensen, "Retired Generals Employed by Northrop in Varied Jobs," *New York Times*, June 26, 1975, at 55, col. 5. Also see Jerry Landauer, "Northrop Hired Many High Level Agents to Help Foreign Sales, Documents Show," *Wall Street Journal*, June 9, 1975, at 4, col. 2.

To begin this rather complicated study of the problem of illegal payments, we shall, beforehand, be cognizant of the fact that the area of illegal payments by MNCs is somewhat difficult as a field of legal study, since these payments are for the most part clandestine. Moreover, the usual analytical tools of the lawyer are not sufficient to deal with the phenomenon itself or with some of its social and economic implications.

Nonetheless, in order to understand those rules of law which have evolved as a reaction to the practice of illegal payments, as well as the traditional rules of law that could have a bearing on them, it is necessary to have an idea of the extent of these payments in the world of business and to understand their operation in order to establish factual categories that correspond to the applicable legal categories.

In order to achieve this objective, we have tried to describe the phenomenon, on the basis of the literature of business and journalistic writings. However, this description may paint a picture of American businessmen and corporations as the instigators of corruption in the world. In fact, other giant corporations both in East and the West use the same methods to do business and are not mentioned. The reason for this is mainly the extent of freedom enjoyed by the press in the U.S.A. which enables it to bring to public notice a number of instances which would escape such notice in other countries. More-over, the publicity associated with illegal payments by MNCs has generated strong interest in the U.S. Congress and in the academic legal community, with the result that there is a considerable body of legal materials (both legislative and scientific) which exists in the U.S. and not in other countries.

2. Corruption in Business-Government Relations

It is true to say that corruption lies at the heart of irregularities in business government relationships around the world. Such payments by businesses and business organizations are widespread in poor as well as in rich countries,⁴ in developed and underdeveloped nations regardless of political and social ideology,⁵ although there are indications that a stable legal and political climate acts as a deterrent to these practices. There is no nation in the world that can claim absolute immunity from corruption. However, even if a particular nation is corruption free, it may still, in the course of pursuing its own interests, be the inspirer of corruption in another nation. A halt to corruption cannot be accomplished by one individual or one administration, but must emerge from the will of the nation to clean its house before it incurs the indictment of other nations. For example, if U.S. MNCs stop initiating illegal payments and responding to officials' requests for bribes, thus raising the issue of illegal payments to the level of a political stand, the accused officials in other nations will be challenged in any forthcoming illegal payments or requests. Further, when MNCs have the confidence in their products to compete in the world market, there is no need for illegal payments. For example, if Lockheed did not have a problem in marketing its Jet Star, it would not have resorted to bribing officials throughout the world to secure the sale

⁴ It was estimated that corruption in the form of bribery, kickbacks and extortion in the U.S. amounted to \$5 to \$8 billion annually, especially in the retail and building industries. See Neil H. Jacoby, Peter Nehemkis and Richard Eells, *Bribery and Extortion in World Business* (1977), at 42.

⁵ Corruption is not a feature of developing countries only, but has been practised in many developed countries such as the U.S. and Japan; however, it was practised covertly. The revelation of the Watergate scandal made it clear that payments by MNCs to domestic and political figures for political influence and special favours were widely prevalent. They were either offered or asked for to secure profitable opportunities to expand operations or to gain some leniency in any forthcoming change in the laws or regulations that might effect the MNCs' business. See Mamoru Iga and Morton Auerbach, "Political Corruption and Social Structure in Japan," (1976), 17 *Asian Survey*, No. 6, at 556-564. Also see N.Jacoby., *Id.*, at 172.

of its airplane.

Nonetheless, when the objective is the maximization of profit and return of investment, which is the goal of all MNCs in the world today, the moral issue is frequently ignored. The method used by MNCs is morally questionable: management usually has the mandate to meet the corporation's legal obligations to the extent that disclosure is compulsory to assure compliance with any laws or government regulations.⁶ The cost of compliance, however, is sometimes weighed against the prospective return of doing business.⁷

Ostensibly, in almost all governments throughout the world there are laws and regulations that prohibit corruption, bribery and illegal payments in conducting business, but the loose system of internal control permits such behaviour to continue, either covertly or overtly, especially when those in leadership are themselves corrupt. Under such conditions, the pervasive corruption is very likely to work its way through the chain of command right down to the lowest level employees.⁸

In any organization—either government or business—where bureaucracy is practised, there are two types of corruption. The first type is found in low level bureaucrats, where an individual employee disregards the relationship that links him with the organization by making a decision without assessing the effects on his agency's budget.⁹ For example, a private sector employee who takes a bribe ultimately causes an augmentation of the marginal cost in the agency's budget. Similarly, when a government official takes a kickback in return for approval of a

⁶ Edward C. Banfield, "Corruption as a Feature of Governmental Organization" (1975), 18 *J. of Law and Economic* No. 2, 587-605 at 601.

⁷ Jerry Landauer, "Rollins Inc. Says It Will Continue Payoffs Abroad; Other Firm Tells of Resistance," *Wall Street Journal*, March 3, 1976, at 3, col. 2.

⁸ See N.H. Jacoby, *supra*, footnote 4, at 147.

⁹ Susan Rose Ackerman, *Corruption: A Study in Political Economy* (1978), at 68.

government purchase of material, he is in effect adding this kickback to the price of the item by inflating the seller's price.¹⁰

The second type of corruption involves high level bureaucrats who try to maximize their personal gain. They will tolerate any corruption in any low level employees if that is necessary for their (the bureaucrats') survival, or they may buy the silence of those employees by recruiting them as subordinates.¹¹

Watergate-related investigation into domestic political contributions in the U.S. uncovered a raft of MNC illegal payments that astonished most of the world. Such illegal activities are derived from the influential power and financial strength that MNCs possess of their very nature, and that they use to perpetuate the need of other nations to rely on them. The methods MNCs use to execute these policies are varied; they range from lobbying the host country's legislators by bribing government officials,¹² to making political contributions to parties likely to help the MNCs to maintain and execute their policies,¹³ and in the extreme, to overthrowing unfriendly governments.¹⁴ The economic power and resources that MNCs possess and control contribute to the achievement of their policies,

¹⁰ Mr. Haughton, Lockheed Chairman, testified before the Senate Foreign Relations Committee of the U.S. in connection with \$106 million in agent fees paid to Mr. A. Khashoggi to facilitate the sale of the company aircraft to the government of Saudi Arabia. He said that payment to and allegedly through Mr. Khashoggi had not come out of Lockheed funds. Lockheed added the sale commission and alleged bribe to the price of its airplanes. See Robert Smith, "Lockheed Document Discloses a \$106 million Saudi Payout, Agent's Fees Cited in Testimony at Senate Panel," *New York Times* Sept. 13, 1975, at 31, col. 1. and at 33, col. 1.

¹¹ Susan Rose Ackerman, *supra*, footnote 9, at 68.

¹² Kenneth H. Bacon and Mary Bralove, "Buying Favor: United Brands Paid Bribe of \$1.25 Million To Honduran Officials," *Wall Street Journal*, April 9, 1975, at 1, col. 6.

¹³ Jerry Landauer, "Costly Concession: Gulf Oil Admits It Paid \$4.2 Million to Officials Abroad to Shield Assets," *Wall Street Journal*, May 2, 1975, at 1, col. 6. Also see Kenneth H. Bacon, "SEC Testimony Tells How Gulf Oil Gave \$300,000 a Year to Politicians in the U.S.," *Wall Street Journal*, November 17, 1975, at 30, col. 1. Also see Michael C. Jensen, "Gulf Oil and Millions for Politicians," *Wall Street Journal*, November 25, 1976, at 1, col. 3.

¹⁴ For example, IT & T attempted to pay the CIA \$1 million to aid in overthrowing Chile's president, Salvador Allende. See Susan Rose Ackerman, *supra*, footnote 9, at 81.

regardless of the means they are using in reaching their end.¹⁵

In many countries, the predisposition of public officials to respond to MNCs' avarice is much greater in certain arenas than in others. In major contracts such as defence, oil concessions and airlines, where the decision is more political than commercial, the temptation to utilize one's power to the advantage of the ruling political party is virtually unconquerable, especially in a government structure where there is no clear distinction between the wealth of the country and that of the ruling power.¹⁶ Accordingly, one would expect any decisions made by those politicians or rulers to be ones that would bring them the maximum personal benefit. This type of political authority's self-interested decision making always breeds corruption: When the law does not state explicitly and unambiguously the extent to which a leader's or a public official's power extends, nor delineate the scope of his personal rights and his duties to the public, the potential for abuse is unavoidable. For example, when a leader or a public official is entrusted to exercise his discretion over certain property rights or to make an important economic decision, the outcome of such a decision may intentionally be directed to the advantage of certain groups. This allocation of benefit engenders corruption and consequently procreates a distasteful attitude on the part of the public at large.¹⁷ Under such conditions the public official may easily violate the law undetected by concealing the transaction under a cloak of apparent legality.¹⁸ However, this use

¹⁵ B.R. Reich, "Global Social Responsibility for the Multinational Corporations," (1977), 8 *Tex. Int'l L.J.* 187-201, at 188.

¹⁶ D.V. Marsh, *Business Ethics* (1980), at 227-228.

¹⁷ Bruce L. Benson and J. Baden, "The Political Economy of Governmental Corruption: The Logic of Underground Government" (1985), 11 *J. Legal Stud.*, 391-410, at 395.

¹⁸ For example, a public employee in the Saudi Arabian government can run a business as an associate with a foreign company without being questioned on the legality of his act. The registration of a new company, published in various journals, occasionally if not always includes the name of a member of the government or associated official as founding member. Also sometimes as a covert procedure an official will use the name of a family member. So, the examination of the true ownership of many companies would reveal that the nominal owner is the wife or child of a prominent political leader or high ranking government official.

of public office and official authority for personal or family enrichment will inevitably have a negative effect on the country's economy, because the dominant feeling of those officials is a great insecurity about their ill gotten wealth.¹⁹ This insecurity impels them to transfer any capital formed through corruption outside their country for investment.²⁰

This type of corruption by political leaders or public officials is the outcome of the exercise of authoritarianism. There is no doubt that when the public has a chance to participate in a decision making process in a democratic manner, corruption will be lessened by the fact that there will exist channels for open discussion of any deviance by the leader from the public expectation. In addition, public influence will be transferred into pressure to bring in laws that would prevent any abuse by a public official of his power and authority and that would also monitor possible violations of this authority.²¹ So, in many underdeveloped countries where authoritarianism dominates, the discretionary powers of a public official are great, and in this juncture there is a chance of buying his favour.

The "buying" of such officials can be perceived from the practices of certain MNCs, especially those corporations that dominate the production of arms, food, oil and drugs. And when MNCs are closely associated with illegal payments, this

¹⁹ For example, the Iraqi government, by presidential decree, has recently executed five high government officials, among them a former mayor of the capital city of Baghdad, for their part in taking bribery from various MNCs and their cooperation in covering up for high commissions for the purpose of gaining business in certain countries, and for transferring those illegal payments or/and commissions into their accounts through foreign banks into foreign countries. See staff reporter, "Baghdad Executes Five People, Among Them a Former Mayor of the Capital," *Asharq Al-Awsat* (Arabic Newspaper), February 17, 1987, at 1, col. 6.

²⁰ Clear examples are the former Shah of Iran and Ferdinand Marcos, the former Philippine president. See Laurence Whitehead, "On Presidential Graft: The Latin American Evidence," in *Corruption: Causes, Consequences, and Control* (edited by Michael Clark, 1983), 146-162.

²¹ A prime example is the *Foreign Corrupt Practice Act of the U.S.A.* pub. Law. no. 95-213, tit. 1, 91 Stat. 1494 (1977) (Codified at 15 U.S.C. Secs. 78 dd-1, 78 dd-2, 78 ff[Supp. I, 1977]). For the complete text, see App. II *infra*, which was enacted as a result of corporate illegal contributions at home and abroad. This law prevents the type of illegal practices by MNCs that we will examine in Chapter 5.4 of this thesis.

is a clear indication of close government business relations.²² Such activities may be conceived and justified by officials from the MNCs home countries on the ground of securing governmental interests, which in the writer's view does not correspond to good moral and ethical standards. Furthermore, another perceivable indication of close government business dealings is the intervention by the MNC's home government in its business dealings for what is usually called "security reasons". A closer examination of this type of situation will frequently reveal a pattern of illegal payments by MNCs.²³ Although the practice of bribery is repugnant to basic ethical principles, in many instances one has strong reason to believe that a possible covert connection exists between MNCs and the intelligence agencies of their home countries,²⁴ and that this connection extends to a full blown system of illegal payments and granting of political favours.²⁵

There is convincing evidence that the United States government, through the Central Intelligence Agency (CIA), was involved in the approval of illegal payments,²⁶ or at least that there was an awareness of such illegal practices by MNCs, and little effort made to stop them.²⁷ In fact, on several occasions, the United States government, through the state department,²⁸ had interceded to stop

²² The Lockheed scandal is an example of this relationship. In 1975 Lockheed admitted it had made under table payments of \$22 million. Part of the payments were used to promote the sale of its L1011 airplanes. The company was in financial difficulty and at the edge of bankruptcy in 1971 when the U.S. congress bailed it out, agreeing to guarantee a \$250 million loan. At that time Congress established a Loan Guarantee Board with broad powers of supervision over Lockheed operations. This fact suggests that the U.S. government knew about the illegal payments that were given by Lockheed to foreign officials. See George C. Lodge, "The Connection Between Ethics and Ideology" (1982), 1 *J. Bus. Ethics*, 85-98, at 95.

²³ See Anthony Sampson, *The Arms Bazaar* (1977), 211-230. In such a case, some may consider this as a valid exemption, and a justification for making illegal payments to foreign public officials.

²⁴ W. Michael Reisman, *Folded Lies: Bribery, Crusade, and Reform* (1979), at 63.

²⁵ George Cabo Lodge, *supra*, footnote 22, at 93-94.

²⁶ A CIA connection was approved by Washington in the case of a Lockheed bribe to a Japanese official in the sale of Starfighter planes to Japan. See Anthony Sampson, *The Arms Bazaar*, Ch. 13, "Japan Behind the Black Curtain," 222-240 (1977).

²⁷ George C.S. Benson, *Business Ethics in America* (1972), at 253.

²⁸ After the revelation of corporate scandals in the U.S., documents revealed information

the disclosure of the names of foreign officials who were involved in bribery and who received some of those clandestine payments.²⁹ As a result of that intervention, the Security and Exchange Commission (SEC) dropped some of its foreign payments cases and the Justice Department of the United States did not prosecute top executives of those MNCs involved in bribery, because of fear of disclosure of national security secrets.³⁰ This action implies a cover up under the guise of security measures. This in the writer's view an elusive and evasive justification, because it tends to maintain and preserve the anonymity of the corrupt activities of public official, where the bribe was made, upon the expenses of his own people and his country economy. In one case, however, in which the U.S. government did not intervene, the company's chairman rationalized during the investigation that the illegal payments made by his company were for the purpose of protecting the company's investment, and an attempt to cover and protect the CIA connection.³¹ In Lockheed Corporation illegal payments abroad, one could easily figure

that linked many foreign nations to those scandals, and that would embarrass the U.S. government if the names of those foreign officials were revealed. The U.S. government, headed by Secretary of State Henry Kissinger, moved to prevent the disclosure of those names by writing to the Attorney General of the United States protesting that the Lockheed documents contained "uncorroborated, sensational and potentially damaging information, which would damage the foreign relations of the United States" (Quoted in Anthony Sampson, *The Arms Bazaar*, from H. Kissinger's letter to the Attorney General of the United States (1977), at 276.

²⁹ See *Security and Exchange Commission v. Lockheed Aircraft Corporation*, 404 F. Supp. 651, (D.D.C. 1975). The State Department opposed any efforts on the part of the Security and Exchange Commission, the government body investigating the illegal payment by MNCs, to release the names of recipients.

³⁰ See Jerry Landauer, "SEC Dropping Foreign Payoffs Cases Against Page Airways at CIA's Request." The SEC investigation revealed that the company paid \$7.5 million abroad from 1972 to 1977. When the CIA moved to cover up for those recipients whose identities were disclosed, the investigation revealed that several public officials were involved the president of Gabon, a government minister in Malaysia, the Ivory Coast's Ambassador to the U.S., and agents who helped the company win business in Saudi Arabia and Morocco. *Wall Street Journal*, April 8, 1980, at 8, col. 2.

³¹ The Gulf Oil chairman defended a payment of \$4 million to the Korean ruling party in 1970 as necessary to secure the continual favour of the regime. One member of the questioning committee of the U.S. Senate pointed out that the company's investments in Korea were fully insured against expropriation by the United States government, and that the U.S. assistance to and influence in South Korea were substantial, so that there was no reason for the payment. The chairman did not give a clear response, possibly because he was protecting his CIA

out the connection between the bribe made by the corporation and the U.S. government.³²

Every case of illegal payments and bribery made by MNCs is a case history of an illegal method of procuring business abroad and an acknowledgement of clandestine and sometimes overt connection between business activities of the MNCs and government officials.³³ Such dealings can take place either within or outside the MNC's home state, and without them the MNC would not achieve the amount of business it wished. The chairman of Lockheed later made the remark that the manipulation and manoeuvring utilized to procure business were worthwhile and that the halting of payments to foreign officials would have tied up their business.³⁴ In most of these cases, the bribes and illegal payments were instituted for the benefit of the MNCs and were made voluntarily. While the MNCs always claimed that they were victims of extortion,³⁵ these claims were made to evade public criticism and legal conviction for the violation of laws and moral obligations.

connection. See George Cabot Lodge, *supra*, footnote 22, at 93.

³² In Lockheed illegal payments of \$22 million in bribes to promote the sale of its L1011 Tri-Star, the awareness of the U.S. government of the payments is irrefutable for several reasons. The company is a major U.S. defence contractor, and was answerable to the U.S. Congress Guarantee Board, of which the U.S. Secretary of the Treasury was a chairman. See George C. Lodge, *supra*, footnote 22, at 93.

³³ In many cases MNC may justify the rendering of illegal payment to public official of the host country on the ground that it cannot do business unless it satisfies the corrupt officials demand; see *supra*, footnote 31, and accompanying text.

³⁴ William M. Carley, "Grease or Grit? Lockheed Payoffs to Indonesians were Difficult to Arrange," *Wall Street Journal*, November 17, 1975, at 1, col. 6.

³⁵ Anthony Sampson, *supra*, footnote 23, at 285.

3. Purchase of Influence and Gross Sale of National Trust

When a public official assumes office, he represents a public will, because a trust is being conveyed on him that he is expected to preserve. This trustee ship theory requires an official to maintain, to the best of his ability, a high standard of performance and integrity; thus he must disregard all considerations except those that are genuinely relevant to the public interest.³⁶ An MNC's purchase of a public official's influence is done for the purpose of securing favour and facilitating the sale of its product or services.³⁷ Some of these arrangements call for the influence purchase of very high ranking officials.³⁸ This black market sale of the entrusted authority and influence by a public official has no fixed price, but the effectiveness and value of the services and the function of the system of the selling partner will yield an estimated price for his services, especially when the seller of a decision has a monopoly. The MNCs may also take into account, when buying such authority, the prospective future opportunities for business in the country, the strengths and weaknesses of the law enforcement,³⁹ and the prevailing ethical standards.⁴⁰

³⁶ Daniel H. Lawenstein, "Political Bribery and the Intermediate Theory of Politics" (1985), 32 *UCLA Law Rev.*, 784-851, at 785.

³⁷ For example, Lockheed Aircraft Corporation admitted that in 1975 it had paid at least \$22 million to help secure a lucrative contract. See Sunswet, "Crisis at Lockheed," *Wall Street Journal*, February 13, 1976, at 1, col. 6.

³⁸ Yashia Kadomo, Japan's prime minister in 1976, was paid \$7 million by Lockheed for the purpose of promoting the sale of jet liners to All Nippon Airways. See Jerry Landauer, "Lockheed Aid to Militarist Japan Faction Blasted in Senate Study of Multinationals," *Wall Street Journal*, February 5, 1976, at 5, col. 1.

³⁹ Bribery is sometimes paid by MNCs to evade the imposition and enforcement of local laws in foreign countries, for example, the managing director of a Minnesota mining and manufacturing corporation admitted that one of the company's foreign subsidiaries paid a \$52,000 bribe to a foreign customs agent to avoid penalties for evading custom payments. See *Wall Street Journal*, November 18, 1975, at 6, col. 1.

⁴⁰ Neil H. Jacoby *supra*, footnote 4, at 42.

Bribery is the fee paid to a public official for prostituting the authority and power conveyed on him.⁴¹ The idea that a public official's authority is a commodity that can be sold and bought, that he or she would set aside public trust for private advantage, is repugnant to basic ethical standards, and also contrary to the official's legal responsibility to uphold human rights and dignity.⁴² Still, the subtle variations on this illegal and subversive practice are many.⁴³

Furthermore, the activity centred around the purchase and sale of public trust is usually in direct proportion to the amount of authority given to those in decision making positions. The granting of full and unlimited authority to a public official engenders a potential abuse of his power,⁴⁴ and becomes a decisive factor in increasing the illegal use of public authority for self benefit purposes. So when Lockheed Corporation submits a bid to sell aircraft to a state owned airline, the bid will get through so long as the president of the airline or the minister in charge is the one who possesses the authority to approve the contract, and so long as Lockheed has paid sufficiently to get his signature. This type of procurement policy, which leaves a decision in the hands of a single official rather than

⁴¹ Corruption of a public official would engender the demand for a public official's influence in making a decision, which then may create a new "political entrepreneur to purchase pieces of the authority, that is to bribe or otherwise influence the possessor of authority to use it as the purchaser requires." See Edward C. Banfield, *supra*, footnote 6, at 601.

⁴² Daniel H. Lawenstein, *supra*, footnote 36, at 800.

⁴³ For example, in the United States of America, many U.S. ambassadors to foreign nations previously made very large contributions to the political campaign of the president who appointed them. There could be many reasons for this but it is a bad practice because it generates many negative inferences. See Neil H. Jacoby *supra*, footnote 4, at 137.

⁴⁴ *Occidental Petroleum Corporation v. Buttes Gas & Oil Company*, 331 F. Supp. 92 (1971). This case was brought as an antitrust action in the U.S. by Occidental Petroleum Corporation against Buttes Gas & Oil Company. Occidental alleged that the defendant conspired with the ruler of Sharjah State (now united with other Gulf states to form the United Arab Emirates) by bribing him to pass a law to extend the territorial water to cover areas that previously had been considered part of the concession of Occidental Oil Company. The court in this case concluded that although the conduct of Sharjah's ruler was motivated by his own personal gain and benefit, the ruler of Sharjah acted at all times in his official capacity and on behalf of his state. The court dismissed the action by applying the act of state doctrine. At 113-114.

subjecting it to a competitive process, is deliberately maintained in order to generate opportunity.⁴⁵ It is worthwhile here to mention that such centralization of power and authority are the dominant policies and practices in many underdeveloped countries, especially those states dominated by certain political parties, or where strong family ties exist between the state and business. Any improvement in the legal system which does not apparently benefit or follow the policy line of those leaders nearly impossible to predict, so long as the result of any laws or regulations are being dictated by those in power or are based on former rules that were determined by personal fiat.⁴⁶

Consequently, when this state of affairs is present in the system, it is easier to purchase the influence of those holding public office, to have access to the system, and to rationalize the expenditures as a facilitating payment.⁴⁷

The claiming of superior social status by these officials, which usually accompanies the important public position they maintain, puts them, however arbitrarily, beyond any criticism and restraint.⁴⁸ The tendency among them is to have their discretionary authority increased as much as possible, which in turn reduces the chance of discovery and sanction of any corrupt activities.⁴⁹ Such a lack of restraint by any institution on a public official's activities will lead to the illegal augmentation of their personal income with little or no public pressure.⁵⁰ The

⁴⁵ Neil H. Jacoby, *supra*, footnote 4, at 137.

⁴⁶ *Id.*, at 144.

⁴⁷ Yerachiel Kugel and G.W. Gruenberg, *Selected Readings in International Payoffs* (1977), at 664.

⁴⁸ In most cases, the detection of corrupt practices by public officials or political leaders comes from outside observers, because bureaucrats usually maintain barriers between themselves and the public by rhetorical speeches and the recruiting of loyalists. See Bruce L. Benson and John Baden, "The Political Economy of Government Corruptions: The Logic of Underground Government," (1985) 14 *J. Legal Stud.*, 391-410, at 403.

⁴⁹ Morris S. Zefel, "Corruption and the Special System in Zambia," in *Corruption: Causes, Consequences and Control* (edited by Michael Clark, 1983), 163-185, at 183-184.

⁵⁰ See *supra*, footnote 20 and accompanying text.

tolerance of officials' abuses of public trust for their advantage, in general, has an opportunity cost for those officials. In addition it has a detrimental effect on the future of the country's stability, because with such abuses of responsibility, it is hard to believe that citizens are pleased to see their trusted agent get rich at their disadvantage.⁵¹

⁵¹ Harold L. Johnson, "Bribery in International Markets: Diagnosis, Clarification and Remedy," (1985) 4 *J. Bus. Ethics*, 447-455, at 447.

4. Consequences of Different Courses of Action for Business Executives and Political Leaders

We have discussed the myth of illegal payments by MNCs in the context of business government relationships. The reality of this relationship is the purchase of a public official's influence by the highest bidder among MNCs. We will now examine the consequences of this relationship, its future⁵² economical effect for MNCs and its political effect for public officials.

At the outset we shall mention that when economic power is separated from political power, corruption prevails on a large scale, because the psychological motive of wealth is to gain the support that is needed to increase and protect this wealth, and that can be done by soliciting the support of those in power.⁵² The MNCs, in seeking the support of political figures either in the home country or in the host state, put great efforts into lobbying for favourable treatment.⁵³ The dimensions and the cumulative effects of MNCs' solicitation of favours at home and overseas brought about the "censorship"⁵⁴ of this practice, which uses money to entice and lure a public official to sell his influence.

Some writers adopt the idea that illegal payments may be tolerated so long as there is a gesture of economic benefit to the public from any MNC business activities.⁵⁵ However, this seems to be a very elusive and evasive approach to the reality and the motives behind MNCs activities, for no one can be assured of the

⁵² Wladimir Eliasberg, "Corruption and Bribery," (1951-52), 42 *J. of Crim. L. & Criminology & Poli.Sci.*, 317-333, at 322.

⁵³ The big corporations always get such favourable treatment because of their influence in the political system, for example, Lockheed aircraft and Chrysler automobile companies were bailed out of their financial problems by the U.S. government. See Fred R.Harris, "The Politics of Corporate Power," in *Corporate Power in America* (edited by R.Nader and M. Green, 1973), 25-41, at 26.

⁵⁴ See Neil Jacoby, Peter Nehemkis and Richard Eells, *supra*, footnote 4, at 45.

⁵⁵ *Id.*, at 194.

benefit to the public as long as the corrupt official is motivated by self interest and is taking advantage of the position with which he has been entrusted. Also there is no reason, in the writer's view, why an MNC would assert the benefit to the public, while pursuing its profit motivated action regardless of the effect on society.⁵⁶ It is important to remember that illegal payments contribute nothing to the well being of the ordinary citizen; in fact they have a very damaging effect on the economic and political structure of the country.⁵⁷

Moreover, illegal payments may cause embarrassment to the home country government when the host country's leader discovers that MNCs resorted to bribery to do business with his government,⁵⁸ or in many situations the discovery can become a trigger for a radical change in the political system.⁵⁹ In fact it was a basis for a successful overthrowing of regimes in many countries such as Nigeria, Nicaragua and the Philippines, and may be the fuel for other insurrections in the near future in some of the Middle Eastern countries.

Let us turn our attention to the negative effects of these practices on the MNCs themselves. When discovered, they have a negative effect on business executives and political leaders.⁶⁰ The miscalculation by MNCs of the size of future payments and the consequences of illegal payments might jeopardize the company's business⁶¹ or expose its personnel to prosecution in the country where

⁵⁶ There is no tangible benefit to the ordinary citizen when a government official is bribed to procure a contract or secure a sale of a product to a particular country, actions which add the amount of the bribe to the contract cost. See the discussion *infra*, at footnote 167 and accompanying text.

⁵⁷ D.V.Marsh, *supra*, footnote 16, at 231.

⁵⁸ Robert M. Smith, "Northrop Apologizes on Saudi Bribes," *New York Times*, June 10, 1975, at 55, col. 5. An official of the Northrop Corporation apologized in U.S. Senate testimony to the government of Saudi Arabia for having paid \$450,000 in bribes to two Saudi generals in 1972.

⁵⁹ George C.S. Benson, *supra*, footnote 27, at 252.

⁶⁰ *Id.*, at 21.

⁶¹ For example, the government of Saudi Arabia banned a South Korean Corporation, Hyundai Construction Company, from doing business in Saudi Arabia for two years, fined Hyundai

the payment was made.⁶²

\$90.9 million for trying to bribe government officials, and sentenced a Hyundai executive to 30 months in prison for his role in breaking the country's anti-bribery law. Also, the Saudi government warned the company that the fine would be doubled if Hyundai tried in the next two year period to circumvent the ban. See *Al-Riyadh* (Arabic newspaper) May 1, 1980, at 1. Also see *Wall Street Journal*, May 5, 1980, at 16, col. 3.

⁶² For example, the gift made by Gulf Oil to a former Bolivian president in the form of a helicopter for his personal use proved to be counter productive to the purpose anticipated by the company, because after the death of the president in a helicopter crash, the company's property was nationalized and the new regime threatened to withhold a \$57.2 million indemnity payment to the company. See Jonathan Kandell, "Bolivians Discuss Gulf Gift in Cynicism and Resentment," *New York Times*, May 27, 1975, at 39, col. 1. Also, the Chilean government investigated a charge that General Tere bribed an associate of Salvador Allende in hopes of saving the company properties from expropriation when the Allende government took over. See Jerry Landauer, "General Tere Allegedly Made Payoffs to Political Figures in Three Countries," *Wall Street Journal*, December 11, 1976, at 7, col. 1.

5. Ethical Dilemmas

While we are aware of the remarkable contribution of MNCs to the advancement and promotion of our standard of living, we are very much concerned about the negative effect of some of their activities and practices, and by the level of their executive morality. While several dubious practices are seemingly acceptable to the MNCs themselves, the public generally condemns the bribery of public officials. At the outset, it is important to state that the existence of an MNC is not defensible by the mere fact that it is an economic institution. While its primary concern is profit, it must also be expected to bear its share of social responsibility.⁶³ A corporation has value in our society only when it serves the interest of the general public,⁶⁴ or when it at least minimizes the damage to those exposed to or affected by its activities.⁶⁵

So any economic decision by an MNC should be the result of an extensive analysis and evaluation of any negative social or moral consequences that may arise as an outcome of the implementation of that decision.⁶⁶ The exercise of MNC moral responsibility, which goes beyond legal responsibility,⁶⁷ should be carried out in many contexts.

This concept of moral responsibility can be understood by examining its two main components, rationality and respect.⁶⁸ When an MNC makes a business

⁶³ Theodore V. Purcell, S.J., "A Practical Guide to Ethics in Business," in *Selected Readings in International Payoffs* (1977), (Kugel, Yerachiel and G.W. Gruenburg, ed.), 34-37, at 34.

⁶⁴ D.V. Marsh, *supra*, footnote 16, at 13.

⁶⁵ The Bhopal accident in India is an obvious example of an MNC's ignorance of the effect of its operations on society and the environment.

⁶⁶ Matthew Lippman, "Transnational Corporation and Repressive Regimes: The Ethical Dilemma" (1985), 15 *Cal. W. Int'l. L.J.*, 542-551, at 551.

⁶⁷ K.E. Goodposter, "The Concept of Corporate Responsibility" (1983), 2 *J. of Business Ethics* 22, at 5.

⁶⁸ *Id.*, at 7.

decision, the rationale behind this decision reveals its motive and purpose, and if this decision is to be acceptable to the general public, the MNC must first consider the alternatives and the consequences. At the same time, when making such a decision the MNC's executives must give full consideration to the perspective of those who will be affected by the decision.⁶⁹

Although MNC executives are more concerned with profit oriented manoeuvres,⁷⁰ they must choose a means that is morally and legally acceptable, and that can be achieved without effects that are deleterious to the public interest. This concern about the implementation and execution of business decisions has increased in recent years. There is a particular focus on the dichotomy between the MNC executives' opinion of what is justifiable practice and the general public's view of many of these practices as being corrupt and immoral.⁷¹ Illegal payments and political payoffs are unjustifiable business practices in the public's opinion; they raise many provocative moral issues and arouse resentment against MNCs and questions about their integrity and their actual role in the national economy.⁷²

So the MNCs' existence in society and the decisions they make can only be justified to the extent that their existence and the business they do serve a general interest of society.⁷³ It is therefore unacceptable for society's needs to be subjugated to the main goal of MNCs, which is profit making.⁷⁴ The principle that

⁶⁹ Thus, when an MNC gathers the information for the procurement of a contract or sale of a product, prevision becomes crucial. It shall be perceived that the manner used will not be morally unacceptable or have any potential negative effects on the interests of the general public.

⁷⁰ Matthew Lippman, *supra*, footnote 66, at 545.

⁷¹ George Cabot Lodge, *supra*, footnote 22, at 85.

⁷² Arnold Berleant, "Multinationals: Local Practice and the Problem of Ethical Consistency" (1982), 1 *J. Bus. Ethics*, 185-193, at 185.

⁷³ Robert A. Dahl, "Governing the Giant Corporation," in *Corporate Power in America* (edited by R.Nader and M. Green, 1973), 10-24, at 10.

⁷⁴ *Id.*, at 11.

should guide MNCs in the conduct of their business is maintaining an absolute concern for the public expectation, and they should choose the legal means to achieve that end. In society's view, adopting these guidelines would achieve an ethically acceptable result.⁷⁵

The argument that an action can be right or ethical to the extent that it promotes a net happiness in relation to all of society⁷⁶ has no solid ground,⁷⁷ and anyway, it could not be justified in individual cases.⁷⁸ Neither can it be rationalized by MNCs that without bribery or payoffs to obtain overseas contracts there would be no sales, and that would in turn result in the closing of the plant and then unemployment.⁷⁹ This rationale ignores the fact that, although in one situation net happiness may be achieved through paying bribes and thus gaining successful contracts, in an opposite scenario the payment is discovered and the company gets convicted of bribery, which may also result in the loss of future opportunities of entering or doing business in the country where the bribe is discovered.⁸⁰ One must observe that the secrecy within which the payment is made is by intuition evidence of the illegality of the payment and of the general

⁷⁵ Several philosophical theories have been advocated by MNC executives to justify their business decisions. The machiavellian activist says that "expediency must take precedence over virtue," so that there are no moral imperatives in doing business. Moral actions are only those that are effective in accomplishing some purposes. Thus this theory is amoral in the sense that the end, which is usually winning, is sufficient justification for the means. The second theory is the objectivism theory. The proponents of this theory say that the MNC "has no ideology or sets of values other than economic growth, profit, and efficiency." See Paul Niesing and John F. Preble, "A Comparison of Five Business Philosophies," (1985), 4 *J. of Business Ethics*, 465-476, at 467.

⁷⁶ When MNCs adopt the end justifies means theory, as we have witnessed in recent times as with the Watergate, Lockheed and IT&T scandals and bribery, the moral conflict arises. The question is: Does the preservation and maintenance of MNC strength justify resorting to deception or the payment of bribery?

⁷⁷ Bartley, A., Breman, "Amending the FCPA of 1977: 'Clarification' or 'Gutting a Law?'" (1984) 11 *J. Legis.*, 56-89, at 79.

⁷⁸ *Id.*, at 80.

⁷⁹ See *supra*, footnote 61 and accompanying text.

⁸⁰ Arnold Berleant, *supra*, footnote 72, at 187.

disapproval of society. Investigations show that in all the illegal payments made by MNCs, there were different methods of concealment used by those involved.⁸¹

Further, it is logical to suggest that when a country prohibits illegal payment and bribery of its own citizens,⁸² it has a moral obligation not to involve members of another nation in such bribery simply because it is an apparent practice in that nation.⁸³

⁸¹ Neil H. Jacoby *supra*, footnote 4, at 173.

⁸² The U.S. Amendment of Sec. 162(c)(1) of the Tax Equity and Fiscal Responsibility Act of 1982 preserves that illegal payments to foreign officials are deductible so long as those payments are not illegal under another law, namely The FCPA, which allows "grease payments" paid to foreign officials to be detected, notwithstanding that such payments, if given to U.S. officials, are treated as bribery. K. F. Brikey, *Corporate Criminal Liability*, Vol. 3 (1984), at 3

⁸³ George C.S. Benson, *supra*, footnote 27, at 249.

CHAPTER 2.0

CHARACTERIZATION AND CATEGORICAL ANALYSIS OF MNCs' ILLEGAL PAYMENTS

1. General Remarks

In this chapter we will discuss the features of the various methods MNCs use to make illegal payments, both domestically and abroad. We will at the same time shed some light on payments that are in accordance with the law.

Needless to say, there are payments that are legal in almost every country, such as wages and reasonable commissions for services rendered by MNCs,⁸⁴ and hardly ever is the question of the legality of these payments raised. Apart from these, however, there are other payments by MNCs that are clearly illicit and prohibited by the law, or are morally reprehensible. And in between these two types lie an array of payments of questionable legality, depending, in the final analysis, on the situation and the environment in which they are being made and the motive behind them. Political contributions would be an example of questionable motivation.⁸⁵ However, the MNC's illegal payment generally means a transfer of money or some thing of value, or services made with the intention of having some influence on politicians, political parties, candidates, government officials or employees in their legislative, administrative or judicial action. The motive is to secure favour for the giver by the party, who will benefit from the

⁸⁴ Yerachiel Kugel and G.W. Gruenberg, *Selected Readings in International Payoffs* (1972), at 7-12

⁸⁵ Hunt, "Special Interest Money Increasingly Influences What Congress Enacts," *Wall Street Journal*, July 26, 1982, at 1, col. 6. The sale of ambassador ship for campaign contributions is a particularly well known and apparently still current practice involving a relatively explicit *quid pro quo* arrangement.

payments either directly or indirectly. The profit motive is the driving force behind the making of the payments, and that, in many cases, receives the approval of the company shareholders,⁸⁶ though there are differences in corporations' attitudes in this regard.⁸⁷

Payments that are clearly illegal do not cause any problem for policy makers when discovered. However, payments that are of questionable legality pose some difficulty in the assessment of their legitimacy. Some authorities on the subject suggest the use of the following criteria to assess the legitimacy of these types of payments:

- (a) The payment must, clearly, be offered and accepted for services rendered, or be a reasonable market price for goods purchased. This condition eliminates gifts and other payments to persons and institutions not clearly involved in the transaction.
- (b) The payment must be in accordance with the law and not in violation of ethical and moral principles. So a payment might be considered illegal because it violates some aspects of the legal structure, particularly when the payee, or taker of this money, is a political actor.⁸⁸

The operation of these two criteria can be shown clearly in the payments made to an MNC's agent who has local connections in the country where he operates. Although the agent has some freedom and discretion to choose the paths to facilitate his principals' business, this freedom and discretion are governed by

⁸⁵ In a United Brands shareholders meeting the stockholders applauded their company and the chairman for advancing the profitability of the corporation. See *New York Times*, August 19, 1975, at 51, col. 4.

⁸⁷ E.D. Herlihy and Theodore A. Levine, "Corporate Crisis: The Overseas Payment Problem" (1977), 8 *L. & Policy in Int'l Bus. J.*, 547-629, at 568.

⁸⁸ Yerachiel Kugel and G.W. Gruenberg, *supra*, footnote 84, at 60. See also Anthony Sampson, *supra*, footnote 23, at 150-151.

ethics and principles. If the agent violates the legal structure, he is considered to be "officially corrupt," and then liable for the violation of the law of the country where he operates.⁸⁹

The attempts by MNCs to use money or any thing of value to influence a government official is a blatant form of corruption, which reflects the common conception that the crime of bribery is the black core of a series of concentric circles representing the degrees of impropriety in the dealings between government officials and MNCs.⁹⁰

In the following pages we will discuss the various types of payments made by MNCs that are either clearly illegal or of questionable legality. Also we will examine the ways these payments are made and the methods that are being used to transfer them into the hands of their final recipients.

⁸⁹ Edward C. Banfield, supra, footnote 6, at 591.

⁹⁰ Daniel H. Lawenstein, supra, footnote 36, at 786.

2. Sensitive Political Contributions by MNCs

One might think that the reason why MNCs contribute to political parties or to the election funds of certain politicians is to ensure freedom of decision making and to protect and maintain a private business system.⁹¹ However, the actual purpose is to gain some favourable and sympathetic treatment from the elected party or official in the exercise of the prospective authority that official will have after the election. This is considered to be a planned interference with the elected official's decision.⁹²

Despite the fact that a political payment and a contribution to a domestic or foreign official by an MNC are similar in nature, one can characterize a sensitive political payment by its purpose and by the motive behind it. A payment is considered illegal if it is made for the intention of having some influence on the outcome of a public election, such as in the case of the payment of about \$46 million made by Esso Italiana to various Italian political parties in order to help secure favourable treatment for the company's interests in Italy.⁹³ Regardless of the legal status of MNCs' political contributions, the instinctive motive is to subvert the intention of the receiver of the benefit from doing what is in the best interest of the electing public, and to impel the political leaders to enrich themselves at the public cost.⁹⁴

Yet, the legality of political contributions by MNCs differs from one country to another and sometimes even within the various jurisdictions in one country.⁹⁵

⁹¹ J. Patrick Boyer, "Legal Aspects of the Corporate Political Contribution in Canada" (1978-79), 3 *Can. Bus. L.J.*, 161-192, at 173.

⁹² N.H. Jacoby *supra*, footnote 4, at 102-110.

⁹³ William M. Carley, "Fiasco in Italy: A Political Slush Fund Hid Other Spending, Cost Exxon Millions," *Wall Street Journal*, November 14, 1975, at 1, col. 6, and at 24, col. 1.

⁹⁴ N.H. Jacoby *supra*, footnote 4, at 181.

⁹⁵ *Id.*, at 175.

In the international sphere, one may find it difficult to distinguish a legal political payment by an MNC from a bribe, such as in the case of the Gulf Oil contribution in South Korea,⁹⁶ or the Esso Italiana contribution in Italy,⁹⁷ or from a defensive payment, such as that alleged by United Brands in Honduras.⁹⁸ Whether legal, illegal or of questionable legality, the general purpose of a political contribution is to obtain a good stand and to have some assurance in the event of any future problems, in other words, to have access to political decision makers in a future crisis. It is, as one writer puts it, an "insurance premium" for the contributor in case of a major exposition to any liability.⁹⁹

The argument that many MNCs' political payments are made in countries where such payments are not illegal, ignores the fact that those payments are still viewed as improper or of questionable legality. This is supported by the fact that MNCs falsify their documents and records in order to conceal the amount of the contribution and the identity of those who have received it.¹⁰⁰ In common law this type of contribution, regardless of its legality, could be challenged by a shareholder derivative suit on the grounds that such payments by the corporation to politicians or political parties are "outside the range of the legitimate purposes of the corporation."¹⁰¹ For one thing, one cannot ascertain the benefit to the corporation. Moreover, such a contribution may constitute the infringement of the fundamental values of ethics and justice. The notion that there must be a balance between the

⁹⁶ *Id.*, at 107.

⁹⁷ *Id.*, at 108. 109.

⁹⁸ *Id.*, at 105.

⁹⁹ John C. Coffee, Jr., "Beyond the Shut Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response" (1977), 63 *Va. L. Rev.*, 1099-1278, at 1224. See also William M. Carley, "Fiasco in Italy: Political Slush Fund Hid Other Spending, Cost Exxon Millions," *Wall Street Journal*, November 14, 1975, at 1, col. 6 and at 24, col. 1.

¹⁰⁰ E.D. Herlihy and Theodore A. Levine, *supra*, footnote 87, at 568.

¹⁰¹ Marc Epstein, "Civil Responsibility for Corporate Political Expenditures" (1972-73), 20 *UCLA L.Rev.*, 1327-1351, at 1329.

benefit to the public and that to the corporation, and that problems arise when a corporation is competing in a business world dominated by government regulations,¹⁰² may be true to the extent that there is no existing nationwide public policy against corporate political contributions. Yet, when public policy exists, it must be given effect, and corporate activities will be judicially approved so long as there is no violation of such policy.¹⁰³

¹⁰² Notes, "Corporate Political Affairs Programs" (1961), 70 *Yale L. Rev.*, 821-862, at 853.

¹⁰³ Marc Epstein, supra, footnote 101, at 1331-1339.

A. MNCs' Political Contributions in Canada

Canada is one of the major countries in the Western world in which political contributions by MNCs are legal.¹⁰⁴ The history of political contributions by business interests to political parties in Canada started soon after Confederation. The sensitivity, however, of MNCs' contributions to politicians has been illustrated by several scandals. First, there was the Pacific scandal in 1873, which triggered the enactment of the 1874 Dominion Election Act.¹⁰⁵ Secondly, there was the McGreevey scandal of 1891, during the federal election in the province of Quebec, where some government contractors were given kickbacks to help the election of that province's candidate. This resulted in the 1891 amendment to the 1874 act.¹⁰⁶ This amendment made it illegal to contribute to any candidate's campaign with the expectation of valuable rewards. In 1908, the Dominion Election Act¹⁰⁷ was amended to prohibit any corporation from giving anything of value, either money or services, to a candidate for election. But the inadequacy of the enforcement of the law gave corporations the capacity to defy the law by directly or indirectly making contributions.¹⁰⁸ By 1930, under the pressure of some interest groups, the law prohibiting political contributions was removed.¹⁰⁹ In 1970 Canada Election Act¹¹⁰ was enacted, however, a special committee on election finances was set up to study the issue. This study served as the basis for the

¹⁰⁴ MNCs' political contributions in Canada and Italy are perfectly legal and considered ethically proper as well. See *Wall Street Journal*, May 19, 1975, at 1, col. 6. Moreover, IBM revealed that its Canadian subsidiary, IBM Canada Ltd., has contributed an average of \$36,000 a year to federal and provincial election campaigns since 1971. See *Wall Street Journal*, August 4, 1975, at 2, col. 4.

¹⁰⁵ Dominion Election Act. S.C. 1874, C. 9.

¹⁰⁶ See R.S.C. 1891, C.19. s.14 as am. by R.S.C 1908.C.26. See also J. Patrick Boyer, *supra*, footnote 91, at 164-165.

¹⁰⁷ See R.S.C 1908.C.26, as am. by R.S.C. 1920, C.46.

¹⁰⁸ See J. Patrick Boyer, *supra*, footnote 91, at 166.

¹⁰⁹ *Id.*, at 167.

¹¹⁰ See Canada Election Act R.S.C. 1970, C.49.

Election Expenses Act of 1974, which regulates contributions to political parties. The Act was amended in 1977¹¹¹ to allow payment to political parties in accordance with the Income Tax Act.¹¹²

Nonetheless, this is the state of the law today: Not all payments or contributions by corporations are lawful, and any payment resulting from a corrupt motive will be illegal under another law, namely the criminal code.¹¹³ Payments that are sensitive or imply a corrupt motive are prohibited. The distinction between the two types of payments, however, is extremely subtle and difficult to detect.¹¹⁴ This applies only to contributions in Canada, but there is no law, to the best of the writer's knowledge, that prohibits Canadian MNCs from paying foreign officials abroad, regardless of the motive of the payment.

¹¹¹ See Election Expenses Act, S.C. 1973-74, C.51, as am. S.C. 1977, C.4. John McClay, "From the Boardroom: On Corporate Payoffs" (1976), *54 Harv. Bus. Rev.*, 14-28, at 15.

¹¹² See *Canada Income Tax Act*, S.C. 1970-71-72, C.63, as am. by S.C. 1987, C.46. Also see J. Patrick Boyer, *supra*, footnote 91, at 168. Also see generally Ronald G. Atkey, "Corporate Political Activity" (1985), *23 U. Western Ont. L. Rev.*, 129-143.

¹¹³ Canada Criminal Code, R.S.C. 1970, C.34, sections 423, as am. by S.C. 1975, c.93, S.36 by adding sub sections (3)(4)(5)(6). Also see Sharon Williams and J.G. Castel, *Canadian Criminal Law, International and Transnational Aspects*, 1981, at 270.

¹¹⁴ For some campaign contributions, one may find it difficult to differentiate between bribery and permissible political contributions. Although legally the crime of bribery requires the involvement of persons that possess the power under the law to give what is sought by bribery, one should ignore this legal fiction to draw a realistic view.

B. MNCs' Political Contributions in the United States

Despite the fact that MNCs' political contributions, either at home or abroad, aim at having some influence on elected government, and at gaining favours from the politician they support, one writer claims that if such contributions were illegal, their illegality would not be equivalent to the illegality of bribery, and in countries where they are illegal, their illegality lies in "their own right."¹¹⁵

However, from the early days of the American political system, corporations and other business related interests such as labour unions and the American Medical Association were a major source of financing for federal and state elections.¹¹⁶ The large scale of influence by those contributors appeared after the revelation of the Watergate scandal in 1973. Since then the Watergate Special Prosecution Force has been established to investigate numerous allegations of corruption and fraud in the election process. Also, the Campaign Contribution Task Force has been established to investigate the violation of the campaign law that involved illegal contributions by corporations and other related business interests. The investigation uncovered the concealed nature of the violation, by which corporate records were falsified, and contributions were not reported in accordance with the law. This investigation resulted in criminal convictions of several companies and their officers under the federal criminal code.¹¹⁷

In 1974, the U.S. Congress enacted the Federal Election Campaign Act,¹¹⁸ which prohibits contributions by private interests to presidential elections and mandates that presidential elections be financed by public funds. On the other

¹¹⁵ N.H. Jacoby *supra*, footnote 4, at 175.

¹¹⁶ K.F. Brickey, *Corporate Criminal Liability* (1984), Vol. 2, at 290.

¹¹⁷ *Id.* at 291.

¹¹⁸ U.S. Federal Election Act of 1974. Public Law No. 93-443, Sec. 201, 88 Stat.

hand, congressional campaigns can be financed by private funds. The law allows the government contractors to establish a Political Action Committee (PAC), through which money is spent on the election of a member of Congress or the House of Representatives. However, allowing corporations and other business related interests to establish PACs does not dispel the likelihood of corruption, because this method preserves the power of big business, which may threaten the neutrality of the congressmen and senators when they are making decisions and voting for or against any law that would have a negative effect on the contributor's business. Such a situation is naturally at odds with the public interest.¹¹⁹

Such a contribution by an MNC through a PAC is "merely a new source of old concerns,"¹²⁰ because this method conceals benefit to the contributors. Its role is to concentrate its benefit and to help a few who can often "afford favored access on matters involving direct economic benefit to the giver."¹²¹ PACs channel money collected from employees and stockholders into the campaigns of candidates whose policies are favourable to corporations and other business related interest groups.¹²²

While PACs have supporters who have described them as a "healthy addition to the American political process,"¹²³ the critics of PACs are concerned about increased control by these special interest groups, which threatens the integrity of

¹¹⁹ Fred Wertheimer, "The PAC Phenomenon in American Politics" (1980), 22 *Ariz. L. Rev.*, 603-626, at 625.

¹²⁰ David Adomany, "PACs and the Democratic Financing of Politics" (1980), 22 *Ariz. L. Rev.*, 569-602, at 569.

¹²¹ *Id.*, at 597.

¹²² Bernadette A. Budd, "The Practical Role of Corporate PACs in the Political Process" (1980), 22 *Ariz. L. Rev.*, 555-567, at 555.

¹²³ Loe Ann Elliott, "Political Action Committees: Precincts of the '80s" (1980), 22 *Ariz. L. Rev.*, 539-554, at 539.

the political process.¹²⁴ The rationale is that this institutionalized pattern of MNC contributions would generate incumbent bias on the part of the politicians who receive the PAC contribution, even though there is a limit on the contribution.¹²⁵

¹²⁴ Id., at 541.

¹²⁵ Henry C. Kenski, "Running With and From the PAC" (1980), *22 Ariz. L. Rev.*, 627-651, at 640.

3. Aggressive Payments Initiated by MNCs to Secure Business Abroad

In the writer's view it is offensive enough to hear: "In our sophisticated society today, whenever money talks, people listen," or, as the pragmatists say, "you get what you pay for."¹²⁶ Or, as one commentator put it: "Payoffs are an institutionalized fact of international business."¹²⁷ Aggressive payment is a euphemism for the offensive words "bribery" and "kickback."¹²⁸ This type of payment is usually made directly in exchange for new business.¹²⁹ It is, therefore, a bribe, which has been legally defined as "the offering, giving, receiving or soliciting of anything of value in order to influence the action of a public official."¹³⁰ Corruption and kickbacks are taken to have a similar meaning, as long as the purpose of the payment and intention of the giver is to influence another to act in favour of the giver or his employer. In legal terms, this condition is called a "business purpose test".¹³¹

Those who advocate bribery in international business equivocate by referring to the purchase of influence as "trade," and in their opinion both parties, the MNC and the public official, benefit from such transactions.¹³² These are the same

¹²⁶ Henry W. Lane and Donald G. Simpson, "Bribery in International Business: Whose Problem Is It?" (1984), 3 *J. Bus. Ethics*, 35-52, at 35.

¹²⁷ N.H. Jacoby *supra*, footnote 4, at 4.

¹²⁸ "Bribery" is frequently used as a synonym for "corruption." In modern French, "to bribe" is "corrompre," and "bribery," "la corruption". See Roger J. Steiner, *The Bantam New College French & English Dictionary* (1972), at 103. In Arabic, "bribery" is "Rishwah." "Rishwah" has been used since the time of early Islam and throughout Islam jurisprudence and by Islamic jurists in their writing. The word "backshesh" is commonly used as the equivalent of "payoffs" in almost all Arabian countries. However, in recent years many new euphemistic terms have been invented to avoid the word "bribery," such as "tea money" and "service expenses".

¹²⁹ John C. Coffee, Jr., *supra*, footnote 99, at 1118.

¹³⁰ *Black's Law Dictionary* (5th ed., West Publishing Corp., St. Paul, Minn., 1979), at 173.

¹³¹ Philip J. Suse, "Questionable Payments in the Middle East: Potential Liability of American Corporations" (1982), 4 *J. Comp. Corp. L. & Sec. Reg.*, 101-142, at 114.

¹³² Harold L. Johnson, "Bribery in International Markets: Diagnosis, Clarification and Remedy" (1985), 4 *J. Bus. Ethics*, 447-455, at 447.

people who are more reluctant to use the word "bribery" to refer to the payments they give to public officials, opting for terms such as "aggressive commission" or "consultant fees."¹³³ But whatever their vocabulary, their rationale attempts to ignore the fact that an economic system is not devoid of morality, but must operate within a social context, and cultural relativity between societies is not an excuse for unethical behaviour.¹³⁴ Despite the inclination by some MNC executives to use bribery or aggressive payment to advance their business advantage, there are many others who view bribery and kickbacks with distaste. Kickbacks are simply a variation of bribery involving a percentage payment to a person who is in a position to influence a public official's or employee's decision.¹³⁵

The standard model of bribery in international business is as follows: When MNCs engage in business in foreign countries or secure a lucrative deal, they pay money to those officials or persons who are in a position to put their deal through.¹³⁶ For example, Lockheed payments in several countries to further the sale of its aircraft extended to high ranking officials in many governments such as the Netherlands, Japan and those in the Middle East.¹³⁷ In most cases the bribery payments made by MNCs helped to reinforce the MNCs' tendency to purchase a virtual assurance that persons taking bribes will carry out the MNCs' desire to complete the deal.¹³⁸

However, to distinguish bribery by MNCs from other related forms of pay-

¹³³ Lois R. Driscoll, "The Illegality of Bribery: Its Roots, Essence, and Universality" (1984), 14 *Cap. U.L. Rev.*, 42, at 35.

¹³⁴ Henry W. Lane and Donald A. Simpson, *supra*, footnote 126, at 35.

¹³⁵ Vincent E. Barry, *Moral Issues in Business* (1979), at 198.

¹³⁶ Sansweet and Blundell, "On the Give for U.S. Firms Abroad: Bribery Can Often Be Routine Business Cost," *Wall Street Journal*, May 9, 1975, at 1, col. 1.

¹³⁷ Jerry Landauer, "Lockheed Aid to Militarist Japan Factions Blasted in Senate Study of Multinationals," *Wall Street Journal*, February 5, 1976, at 5, col. 1.

¹³⁸ Kendall D'Ardrade, "Bribery" (1985), 4 *J.Bus. Ethics*, 239-248, at 239.

ments such as extortion, which might have some excusable rationale, we shall elucidate the elements of bribery that ought to be present in any indictable offence committed by an MNC in any international business transaction. In spite of the fact that secrecy is a feature of bribes by MNCs,¹³⁹ we shall not regard it as an element of bribery in international business, because to do so is to suggest that a favour with corrupt intent bestowed by an MNC on a public official, when done publicly, is exempt from the charge of bribery.¹⁴⁰

Common law courts have identified three major elements for bribery in international business transaction. First is the presence of a public official¹⁴¹ whose influence is sought; second, something of value¹⁴² must be given or done for him to adjust his official act to be in accordance with the bribe giver's desires; third, there must be the corrupt intent¹⁴³ that this thing of value intends to accomplish some benefit for the bribe giver.¹⁴⁴

¹³⁹ *Id.*, at 242-243.

¹⁴⁰ Daniel H. Lawenstein, *supra*, footnote 36, at 830.

¹⁴¹ Common law courts have given the term "public official" rather broad reading. It includes every employee who works for the government, notwithstanding the act he is bribed to perform is not an official act. See *United States v. G. Jeli*, 717 F.2d 968, 972-973 (6th Cir. 1983), Cert. denied, 104 S.Ct.1595 (1984). (An employee of the Bureau of Tobacco and Firearms was found to be a public official, notwithstanding that the proffered bribe was intended to influence him in a manner over which he had no authority.) In Saudi Arabia article 9 of the Regulations Against Bribery defines "public official" as any individual entrusted with public service, (translated by writer, See Appendix i) and this presumably includes any member of the royal family who holds a public position, since under the Islamic principle there is no difference in status between people in the Islamic government regardless of their position, title or status.

¹⁴² The phrase "anything of value" is a term contained in many statutes, and it has "consistently been given a broad meaning." See *United States v. Williams*, 705 F. 2d 603 (2nd Cir.), Cert. denied, 104S.ct. 524 (1984). It can be cash, services or pleasure, such as apartment rent, a resort vacation, the privilege to use company airlines, or scholarships for relatives.

¹⁴³ It must be a state of mind of corruption. This is the principal distinction between bribery and honest gratuity. It is essential to determine that the bribe giver "corruptly" gave or offered something of value to a public official with intent to influence his decision in his favour, or a public official corruptly solicited or accepted something of value in return for being influenced with respect to performance of duties associated with his official position. See *United States v. Johnson*, 621 F.2d 1973, 1076 (10th Cir.1980). However, it is not necessary to prove that the giver and the recipient of a bribe shared the same state of mind. See *United States v. Anderson*, 509 F.2d 312, 332 (D.C. Cir 1974), Cert. denied. 420 U.S. 991(1975).

¹⁴⁴ Daniel H. Lawenstein, *supra*, footnote 36, at 796-828.

In commercial bribery, a criminal act is completed when the agent or employee is given something of value for the purpose of influencing him to do something favourable to the briber, and the agent or employee is induced to improperly discharge a duty entrusted to him by a private concern or corporation where he is employed.¹⁴⁵ The cost is very high. The effect on the national economy is obvious, because it inflicts a higher price on the consumer.¹⁴⁶ International business bribery represents a market interference. The money used to bribe politicians is an extra burden on the national economy,¹⁴⁷ and also has severe adverse effects on international commerce, because it undermines the confidence in and integrity of multinational corporations.

¹⁴⁵ D. Dobbs, *Handbook on the Law of Remedies*, Sec. 10.6 (1973), at 70.

¹⁴⁶ Joan P. Weber, "Commercial Bribery: The Need for a Federal Criminal Statute" (1979), 21 *Ariz.L. Rev.*, 1147-1162, at 1148.

¹⁴⁷ Harold L. Johnson, *supra*, footnote 132, at 448.

4. Payments Made by MNCs to Avoid Economic Coercion, or "Defensive Payments"

There is a certain type of payment that is extracted through coercion, rather than being made on a voluntary basis. For example an MNC may receive a request from a foreign official that implies a threat to the economic future of the MNC. There may be a hint at harm to the corporation or to one or more of its officers. Such an act or implied threat is defined in the stricter legal sense as extortion, which is

...the obtaining of property from another, induced by wrongful use of actual or threatened force, violence, or fear, or under colour of official right.¹⁴⁸

So if a public employee, under colour of his office, demands and receives money or anything of value to which he is not entitled, he is guilty of extortion. This legal distinction between a payment made voluntarily by an MNC to obtain or retain business, and one that it is forced to make, operates to shift the focus of guilt from the MNC to the public official.¹⁴⁹

In *Wharton's Law Lexicon* this act of extortion includes not only the taking but also the withholding of action by a public official, or the causing of an official to take or withhold action, such as the demanding of more than a legal fee by colour of office.¹⁵⁰ However, to constitute the offence under common law, there must be a reasonable justification or excuse for the use of force, and the intention to gain or extort money or anything of value by using threats, accusations, menace or violence.¹⁵¹ Although criminal intent is a necessary element for conviction, the

¹⁴⁸ *Black's Law Dictionary*, (5th ed., West Publishing Co., St. Paul, Minn., 1979), at 525.

¹⁴⁹ N. Jacoby *supra*, footnote 4, at 90-91.

¹⁵⁰ *Wharton's Law Lexicon*, (10th ed., Stevens & Sons Limited, London, 1902), at 307.

¹⁵¹ See Canada Criminal Code, R.S.C., 1970, c.34, s. 305 (1). Also see *Regina v. Syrmalis*

court may incline to the view that economic coercion is not as complete a defence as duress for an MNC to avail itself of; the court may consider economic pressure as irrelevant, because in measuring intent, it does not matter whether the payments were made because of economic pressure, rather than the desire to create a pleasant environment for the corporation's business activities.¹⁵²

The distinction between bribery and extortion at the MNC level is somehow difficult to ascertain.¹⁵³ In bribery, the MNC employee initiates a payment to a public official to gain his favourable decision. An example is the payment made by Northrop to two Saudi generals to prevent their intervention with the purchase of its aircraft.¹⁵⁴ In extortion, on the other hand, the public official demands the payment in exchange for giving favourable treatment to the payer, or to invalidate the law that affects the company's future investments. A case in point is the payments made by United Fruit to an official of the Honduran government.¹⁵⁵ At a

and Syrmalis; R.T. Laurie (1981), 63 C.C.C. [2d] 453 (Que.C.A.), in which the court considered that the threat or menace need not be of such nature as to deprive the person of free exercise of his volition.

¹⁵² See *United States v. Barash*, 412 F.2d 26 (2d Cir. 1969). In this case the U.S. government brought an action against the defendant, a certified public accountant, for unlawful payments to several Internal Revenue Service agents in return for favourable adjustments in connection with audits of the personal income tax returns of the defendant's clients. The case was reversed on appeal and remanded for a new trial, because cross-examination was improperly restricted and the charge to the jury was in error in two respects, namely, a) threat of economic harm as an element of intent, and b) payment alone sufficient to establish intent. When the defendant argued that it was an error for the trial judge to exclude the defence of economic coercion from the jury's consideration of the counts under 26 U.S.C. Sec. 7214(a) (2) and 18U.S.C. Sec. 201(f), the provisions covering unlawful payment of gratuities, the appellate court stated:

We think that if a government officer threatens serious economic loss unless paid for giving a citizen his due, the latter is entitled to have the jury consider this, not as a complete defence like duress but as a bearing on the specific intent required for the commission of bribery...(at 29)

¹⁵³ V.O. Key, "Techniques of Political Graft," in *Political Corruption: Reading in Comparative Analysis* (edited by A.J. Heidenheimer, 1970), at 47.

¹⁵⁴ Robert M. Smith, "Northrop Apologizes on Saudi Bribes," *New York Times*, June 10, 1975, at 55, col. 5.

¹⁵⁵ According to documents revealed by United Brands, a former minister of the economy in Honduras had demanded \$5 million from United Brands Corp. in 1974 for a favourable tax concession on banana exports. The company acknowledged that it had paid unidentified Honduran officials \$1.25 million as the first instalment in meeting the bribery demands. See Special Report "Data in United Brands Case Could Convict Ex Honduran Official," *Wall Street*

certain point, bribery may be transformed into extortion. This happens when the official's capacity to withhold a decision or service, which is otherwise required by law, exceeds the MNC's capacity to sustain the loss of that service or benefit,¹⁵⁶ for example when a customs agent creates obstacles to the release of a shipment of perishable goods.

While bribery and extortion have many elements in common, they are distinguishable in common law by the element of duress: Any payment accompanied by duress is labelled as extortion.¹⁵⁷ But one might ask to what extent the distinction between extortion and bribery can be made and sustained. For example, in the Gulf Oil payments to the South Korean ruling party, if we put this payment in a time perspective, we would find it difficult to label it as extortion, because Gulf appears to have been from the beginning the sole initiator of the payments, with the purpose of entering into business activities in that country under preferred conditions. The subsequent demand for funds by the ruling party may be construed as a continuation of the old pattern of business practices between the two parties.¹⁵⁸ Whatever the range of distinction between bribery and extortion, in both cases both offences are repugnant, immoral, and detrimental to free market competition.

Journal, August 19, 1975, at 7, col. 1.

¹⁵⁶ W. Michael Reisman, *supra*, footnote 24, at 38.

¹⁵⁷ John C. Coffee, Jr., *supra*, footnote 99, at 1119.

¹⁵⁸ W. Michel Reisman, *supra*, footnote 24, at 38.

5. Payments Made by MNCs to Low-Level Foreign Employees, or "Facilitating Payments"

The term facilitating or "grease" payment is a neo-euphemism referring to a special species of bribe.¹⁵⁹ This type of payment is considered, in the final analysis, as illegal because its purpose is the corruption of a public official by enticing him and influencing his decision in favour of the giver.¹⁶⁰ Although the elements of bribery are satisfied in this type of payment to the degree of making it prohibited,¹⁶¹ under the United States Foreign Corrupt Practice Act,¹⁶² this type of payment is recognized as legal if paid to a foreign official,¹⁶³ on the grounds that the definition of the term "corrupt behaviour" varies from one legal system to another.¹⁶⁴ What is curious about the FCPA is that it defines grease or facilitating payments not in terms of their purpose, as are all other payments subject to the act, but in terms of the duties of the recipients of such payments.¹⁶⁵ The ambivalence of such characterization of this payment is allowed if paid abroad by an MNC to a foreign official, but considered illegal if paid in the United States,¹⁶⁶

¹⁵⁹ *Id.*, at 39.

¹⁶⁰ Philip J. Suse, *supra*, footnote 131, at 114.

¹⁶¹ See elements of bribery, *supra*, 2:3.

¹⁶² Public Law No. 95-213, 91 stat. 1494. The provisions of the act that are considered in this thesis are codified at 15 U.S.C. §§78dd 1 & 78dd 2(Supp. I 1977), §§78m (6) & 78FF (1976 & Supp. I 1977).

¹⁶³ Fredric Bryan Lener, "Corruption and the Foreign Corrupt Practice Act of 1977" (1979-80) 13 *U.Mich. J.L. Ref.*, 158-195, at 163. See also section(103) (a) of the FCPA, which defines "foreign official" as

agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical..

15. U.S.C. §§78dd 1 (b), 78dd 2 (d) (2) (Supp. I 1977).

¹⁶⁴ *Id.*, at 175.

¹⁶⁵ Hurd Baruch, "The Foreign Corrupt Practices Act" (1979), 57 *Harv. Bus. Rev.*, 32-50, at 46.

¹⁶⁶ See *supra*, footnote 82 and accompanying text.

thus bringing about a discrepancy in the United States' publicly acclaimed high ethical standards.

Although one might acknowledge that such quantitative limits of this form of bribery can be rationalized in some cases,¹⁶⁷ the legalization of this type of payment and the disguising of it in euphemistic terms can lead to the concealment of other activities and practices that are recognized as unlawful. It may also encourage public officials or employees to refrain from executing their duties unless they get some grease payment in return. As well, it may encourage public officials to discriminate between those who pay and other non-payers who are in need of service.

¹⁶⁷ For example, United Brands made payments in Italy reportedly to ensure that there would be no delay in unloading 15,000 tons of bananas, which otherwise would have constituted a worthless cargo. See Maidenberg, "New Rule, Harsh Life in Bananas," *New York Times*, May 11, 1975, Sec. 3, at 9, col. 1.

6. Methods and Techniques of Illegal Payments by MNCs

Most of the big corporations involved in doing business in the international arena employ several methods and techniques of securing a new contract or maintaining an existing one. Bribery, payoffs and the other related practices we have been discussing here are employed to influence public officials in charge of making decisions concerning the fate of the MNC's future business operations. When such illegal payments are made directly from a corporate fund in cash, several elaborate methods of concealment are used, such as false accounting, fictitious book-keeping entries and fictitious transactions.¹⁶⁸

The most visible MNC payment in cash was made by Gulf Oil Corporation to the political party of South Korea's president to gain favourable treatment. It totalled \$4 million.¹⁶⁹ There was also the cash payment made by United Brands in Honduras, totalling \$1.25 million.¹⁷⁰

To generate the cash needed for the big payments, the MNCs usually resort to legerdemain in transferring the money needed for the operation. As one of Gulf Oil's top officials explained it:

"The payment was made out of a Swiss bank account. It was charged to London. London billed it to Pittsburgh, and that got the thing out of any possibility of it being included in the U.S. tax return. So I replaced the funds in the Swiss bank account and removed the charge from the U.S. when I first found out about it."¹⁷¹

¹⁶⁸ Peter Nehemkis, "Business Payoffs Abroad: Rhetoric and Reality" (1975), 18 *Calif. Manag. Rev.*, 20, at 9.

¹⁶⁹ Jerry Landauer, "Costly Concession: Gulf Oil Admits it Paid \$4.2 million to Officials Abroad to Shield Assets," *Wall Street Journal*, May 2, 1975, at 1, col. 6.

¹⁷⁰ Kenneth H. Bacon and Mary Bralove, "Buying Favor: United Brands Paid Bribe of \$1.25 Million to Honduran Officials," *Wall Street Journal*, April 9, 1975, at 1, col. 6.

¹⁷¹ 167. Jerry Landauer, *supra*, footnote 169, at 25, col. 4.

Other methods used to disguise the purpose of illegal payments to foreign officials, is covering them under misleading headings such as entertainment expenses¹⁷² or exploration expenses,¹⁷³ or the receipt of fictitious invoices from the recipient of the payment.¹⁷⁴

Non-cash illegal payments take the form of expensive gifts such as the helicopter Gulf Oil Corporation gave to the former president of Bolivia for his personal use. (The helicopter subsequently crashed, killing the president.)¹⁷⁵ There was also the case in which Gulf Oil Corporation sold a very large crude oil tanker, the *Chun Woo*, to a Korean businessman, and then leased the vessel back for a long period of time on terms favourable to the owner, who in the meantime took care of the payments to the official.¹⁷⁶ The technique of the seller's inflating the price is also used as a subterfuge method of illegal payment. The MNC inflates the price of its products and then channels kickbacks to a secret numbered bank account in Switzerland or Singapore for those officials who help the contract go through.¹⁷⁷ There is also the technique of creating a special budget, such as Esso Italiana did for "advertising and public relations."¹⁷⁸

The employment of these different methods of payment usually benefits both the recipient of illegal payments--by securing anonymity and protecting him from

¹⁷² Edward D. Herlihy and Theodore A. Levine, *supra*, footnote 87, at 554.

¹⁷³ Byron E. Calame, "Lawyer for Gulf Oil Describes Operation of Secret Slush Fund," *Wall Street Journal*, November 17, 1975, at 3, col. 2.

¹⁷⁴ For example, when Esso Italiana made political contributions, it usually did so under the heading of "Newspaper and Journalistic Services" and the party receiving the payments provided the company with invoices. See W.M. Carley, "When in Rome: Oil Company Gifts to Political Parties Stir Inquiries: Companies Deny Any Wrongdoing," *Wall Street Journal*, May 19, 1975, at 1, col. 6.

¹⁷⁵ Jonathon Kandell, "Bolivians Discuss Gulf Gift in Cynicism and Resentment," *New York Times*, May 27, 1975, at 39, col. 1.

¹⁷⁶ N.H. Jacoby *supra*, footnote 4, at 10.

¹⁷⁷ Peter Nehemkis, *supra*, footnote 168, at 17.

¹⁷⁸ William M. Carley, "Fiasco in Italy: Political Slush Fund Hid Other Spending, Cost Exxon Millions," *Wall Street Journal*, November 14, 1975, at 1, col. 6, and at 24, col. 1.

any embarrassment in case of disclosure, especially for those officials whose countries have close ties to the United States--and the MNC, who avoids taxes on the payments by deducting them as business expenses.¹⁷⁹ Of the many variations mentioned, we will confine our attention to three visible methods of illegal payments, namely the creation of corporate slush funds, the utilization of an intermediary, and the employment of an agent or consultant.

¹⁷⁹ M.C. Ferguson, "Criminal Tax Cases Involving Large Corporations" (1979-80), 32 *The Tax Executive*, 112-119, at 117.

A. The Creation of Corporate Slush Funds

Slush funds¹⁸⁰ are created by MNCs to be used for questionable payments such as corporate sensitive political contributions, bribery, and kickbacks. The discovery of this phenomenon was the result of an investigation initiated by the IRS in the United States. A part of this investigation was the formulation of eleven questions to be answered by corporate principal executives.¹⁸¹ The investigation "disclosed intricate corporate schemes designed to generate large amounts of cash for illegal or improper use and to reduce taxable income unlawfully."¹⁸² Slush funds usually operate through foreign bank accounts,¹⁸³ foreign affiliates, or the establishment of foreign subsidiaries managed by someone trusted by the headquarters of the parent corporation.¹⁸⁴ Moreover, a study of corporate illegal payments conducted by the Investor Responsibility Research Center (IRRC) in Wash-

¹⁸⁰ Corporate slush funds are accounts or groups of accounts generally created through intricate schemes outside of normal corporate internal controls for the purpose of executing political contributions, bribes, kickbacks and other illegal activities. See Kathleen F. Brickey, *Corporate Criminal Liability* (1984), Vol.3, at 67.

¹⁸¹ Sherwin P. Simmon, "The Eleven Questions An Extraordinary New Audit Technique" (1976-77), 30 *Tax Law.*, 23-35, at 23-24. These eleven questions had earlier been the subject of judicial modification in *Richards v. United States*, 431 F. Supp. 249 (E.D. Va.1977). The court permitted a response to the eleven questions, limited only to payments deducted from gross income or otherwise related to the corporation's tax liability. As a result of their decision and the work of the ad hoc Committee on Sensitive Payments, the Internal Revenue Service has rephrased these questions and reduced their number to five. See *Report to Internal Revenue Service by the ad hoc Committee on Sensitive Payments*, Taxation Section, American Bar Association, and the proposed revisions to the "Eleven Questions" (1977-78) 31 *Tax Law.*, 9-14.

¹⁸² Report on the Internal Revenue Service "Slush Fund Investigation," by the special subcommittee of the committee on practice and procedure of the New York State Bar Association, Tax Section (1976-77), at 32 *Tax. Law. Rev.*, 161-237, at 167.

¹⁸³ *Id.*, at 168.

¹⁸⁴ The man who managed Bahamian Exploration, a Gulf subsidiary through which Gulf Oil Corporation funnelled about \$10 million for political contributions in the United States and abroad, said that he was underpressure to keep the arrangement quiet. In sworn testimony to the SEC, William C. Viglia recounted that Joseph Bound, a former Gulf financial vice-president, instructed him not to keep any records of his activities when he was assigned to the unit. See staff reporter, "Ex-chief of Gulf's Bahamian Unit says Silence was Ordered on Political Fund," *Wall Street Journal*, December 12, 1975, at 5, col. 1.

ington D.C. has indicated that most companies failing to disclose foreign illegal payments appear to have falsified corporate books and records.¹⁸⁵ Seemingly, the MNCs' accountants and auditors have tolerated the creation of slush funds, and the falsification of corporate books and records without notifying the board of directors,¹⁸⁶ even in instances where an audit committee existed to serve as a conduit by which such information could reach the board.¹⁸⁷ The creation of a slush fund is an adroit way of escaping the need to record the illegal payment in the corporate books.¹⁸⁸

¹⁸⁵ The *Wall Street Journal* quoted the IRRC as saying every one of the companies that has admitted illegal contributions or bribes to foreign officials also has conceded that those transactions weren't recorded accurately on corporate books, or to shareholders. Charles Elia, "Large Investors are Increasingly Concerned About Corporate 'Watergate', Study Says," *Wall Street Journal*, November 20, 1975, at 47, col. 5.

¹⁸⁶ A study done by the U.S. IRS of corporate slush funds found them to exist in 54% of the 896 corporations studied. See staff reporter, "SEC Forces Delay of Full Scale Brewing Stockholders' Meeting," *Washington Post*, June 7, 1977, at D 6, col. 5.

¹⁸⁷ In the Lockheed case, Arthur Young & Company discovered the payments in 1971 and brought them to the attention of the corporation's audit committee on two occasions, but senior management was able both times to prevent the audit committee from alerting the full board. Stephen J. Sansweet, "Lockheed Puts Foreign Payoffs Near \$38 Million: Two Former Executives Get Most of the Blame for Firm's Dubious Outlays," *Wall Street Journal*, May 27, 1972, at 4, col. 2.

¹⁸⁸ Edward D. Herlihy and Theodore A. Levine, *supra*, footnote 87, at 554.

B. Utilization of an Intermediary

The effectiveness of using an intermediary depends upon the position of the intermediary vis-a-vis the parties involved. It varies from one country to another. For example, in the United States the intermediary is usually an influential person who holds a government job. He is sometimes a former member of cabinet, or the former head of a regulatory agency. Some retired or resigned members associate themselves with one of the prestigious law or lobbying firms, and then use their former position to influence a former colleague to do what they want, of course with undisclosed benefit.¹⁸⁹ In doing business outside the United States, MNCs usually recruit those former public officials to do their mediation and to conduct the transfer of illegal payment to the right person.¹⁹⁰ For example, Northrop Corporation employed a retired chief of staff of the French Air Force and a celebrated former CIA station chief with access to the head of state in the Arabian Peninsula.¹⁹¹ An intermediary can also take the form of a dummy corporation¹⁹² through which the payment of unusual consultants' fees can be made and also concealed.

¹⁸⁹ N.H. Jacoby, Peter Nehemkis and R. Eells, *supra*, footnote 4, at 130.

¹⁹⁰ Lockheed Corporation admitted that it had paid approximately \$2 million through intermediaries to politicians in Japan, primarily to help sell the company's L 1011 Tri-Star aircraft to All Nippon Airways. See J. Landauer, "Damage to Government Friendly to U.S. is Seen in Disclosure of Lockheed's Bribes," *Wall Street Journal*, February 9, 1976, at 7, col. 1.

¹⁹¹ Peter Nehemkis, *supra*, footnote 168, at 14-15.

¹⁹² In Lockheed payments to an Indonesian air force official, the corporation resisted the demand by the Indonesian officer that his commission be deposited by Lockheed directly into a Singapore bank account. The company preferred the use of an intermediary dummy corporation or Lockheed subsidiary, fearing that direct payments would not be allowed as deductions by the United States IRS and that subsequent public disclosure of such payments would damage the company's reputation. See William M. Carley, "Grease or Grit? Lockheed's Payoffs to Indonesians Were Difficult to Arrange," *Wall Street Journal*, November 17, 1975, at 1, col. 6 and at 23, col. 1.

C. The Employment of an Agent or Consultant

The disclosure of illegal corporate payments to foreign officials reveals the extent to which MNCs used agents or consultants to divert money for the purpose of bribing foreign officials through the payment of excessive fees or commissions to the agent, who then takes on the task of channeling some of the fees or commissions to the appropriate official.¹⁹³ The use of a local agent is different from the use of an intermediary in that the agent may be accustomed to providing valuable technical and consultative advice to the foreign company for a fee or commission on a percentage basis of the amount contracted by the MNC or of the amount of sales he has arranged for his company. In fact, in many countries such as Saudi Arabia, an MNC cannot do business unless it has a local agent in the country. For MNCs, having an agent or consultant who is a native of the country makes good business sense,¹⁹⁴ because of his familiarity with his country's customs and the likelihood of his influence on his countrymen.

So MNCs usually know whom to go to for what services and on what occasion.¹⁹⁵ The selection of an agent sometimes does not depend so much on his knowledge as on his influence on the government and his close family ties to the influential leader in the country where he is being chosen to represent the MNC.¹⁹⁶ However, there is evidence that on occasion an MNC will consult U.S. government officials on whom they should employ as an agent in a particular

¹⁹³ Edward D. Herlihy and T.A. Levine, *supra*, footnote 87, at 554.

¹⁹⁴ Gerald T. McLaughlin, "The Criminalization of Questionable Foreign Payments by Corporations: A Comparative Legal System Analysis" (1978), 46 *Fordham L. Rev.*, 1071-1114, at 1093.

¹⁹⁵ Yerachiel Kugel, "Where We Are and How We Got There," in *Selected Reading in International Payoffs* (edited by Yerachiel Kugel and G.W. Gruenberg, 1977), at 13.

¹⁹⁶ Lindley H. Clark, Jr., "Innocents Abroad: How a Multinational Avoids Paying Bribes Overseas: Tip From U.S. Treasury," *Wall Street Journal*, April 14, 1976, at 1, col. 6 and at 15, col. 1.

country¹⁹⁷ and that sometimes U.S. government officials coach MNCs on whom to bribe, whom to refuse, and which agent or middleman to hire to represent the company.¹⁹⁸ Moreover, the retention of a particular agent is sometimes requested by the country where the MNC intends to do business. For example, in one of the Northrop Corporation deals "to sell military aircraft to Saudi Arabia, the Saudi Arabian Defence Minister directed Northrop's international consultant to retain a particular agent who had been employed in previous dealings with Lockheed and Raytheon corporations."¹⁹⁹

Notwithstanding the method of his selection, when the retaining of an agent or consultant is not regulated, a conflict of interest arises because of his relationship to the government entity and to contracting party. For example, when the agent has a member of his family in the department of the government that could award contracts to the company for which he is an agent, this relationship undoubtedly will give the agent leverage with those officials. Then the suspicion

¹⁹⁷ The Lockheed documents disclosed that the company consulted the American government about who had the most influence to be employed as an agent. In almost all cases the company hired consultants for their influence rather than their expertise. See Robert M. Smith, "Lockheed Documents Disclose \$106 Million Saudi Payout: Agent Fees Cited in Testimony at Senate Panel," *New York Times*, September 13, 1975, at L 32, col. 5.

¹⁹⁸ Reputable businessmen have reported that officials of the State and Treasury Departments of the United States have on many occasions carefully coached them as to whom to bribe, whom to refuse, and what sales agent to hire. See Robert M. Smith, "Lockheed Documents Disclose a \$106 Million Saudi Payout: Agent Fees Cited in Testimony at Senate Panel," *New York Times*, September 13, 1975, at L 31, col. 6 and at 33, col. 1.

¹⁹⁹ Michael S. Sinkeldam, "Comment: Payments to Foreign Officials by MNCs: Bribery or Business Expense and the Effects of U.S. Policy" (1976), 6 *Calif. West. Int'l. L. J.*, 360-381, at 366. Also, an obvious example is the case of *M. Habibe and Middle East Services v. Raytheon Company* 616 F.2d 1204 (D.C. Cir.1980). M. Habibe, an American citizen, brought an action against Raytheon for breach of contract on behalf of Prince Abdallah Al-Faisal (who did business under the name "Arabian Establishment for Trade, Shipping and Air Navigation" (AET-SAN)). According to Habibe's allegations, in 1971, the Saudi government decided to use AET-SAN as an agent for the shipment of the Hawk missile system. The prince's establishment entered into an agreement with M. Habibe and Middle East Services (MES), providing for MES to receive up to 20% of any commissions. This agreement was later cancelled after the visit of the chief executive officer of Raytheon to Saudi Arabia, when the SEC began an investigation into the legality of the payment made abroad by Raytheon.

of the agent as being a conduit of a bribe to those officials is inevitable. The bribe may sometimes be given to the agent by an MNC in the form of excessive fees or as commission, part of which is then channelled to the agent who helped in awarding the contracts to the corporation.²⁰⁰ However, the retention of a particular agent may sometimes be costly for MNCs because the agent may demand high fees, claiming that they are needed to pay bribes when in fact he simply pockets them.²⁰¹

Most of the Middle Eastern countries have enacted laws and regulations that forbid the use of agents in any public and mixed sector transactions at all,²⁰² while other countries allow the use of agents in some areas, but prohibit it for armaments procurement contracts.²⁰³ Further, in those sectors where an agent is permitted, he must be a citizen of the country,²⁰⁴ and a maximum percentage of contract value must be imposed on his fee.²⁰⁵ These prohibitions and restrictions

²⁰⁰ U.S. Representative Les Aspin has released Pentagon documents indicating the five foreign agents who had received \$18.7 million in fees, and \$500 million in military sales in Japan, Kuwait, and Saudi Arabia since mid 1973. The largest fee, \$8,886,000, was paid to the Triad Financial Establishment, owned by a Saudi Businessman, Adnan M. Khashoggi, in connection with an aircraft sale to the Saudi government. See *New York Times*, May 27, 1975, at 39, col. 1.

²⁰¹ For example, after the SEC investigation, the Northrop documents showed that it paid \$450,000 to A.M. Khashoggi, who, as the company alleged, claimed that the money was demanded by two Saudi generals during negotiations for a multimillion dollar sale of fighter aircraft. When Mr. Khashoggi testified before the U.S. congress Foreign Relation Subcommittee, he denied that he gave any money to Saudi generals, but he admitted that he pocketed the \$450,000 payment made by Northrop to "punish Northrop for thinking that the Saudis could be bribed." However, in the meantime nothing has been done by the Saudi government to investigate and clear such allegations to satisfy the general public. See Jerry Landauer, "Agents of U.S. Firms Abroad Are Termed Influence Peddlers by Ex Northrop Aide," *Wall Street Journal*, June 10, 1975, at 8, col. 2. See also Edward D. Herlihy and T.A. Levine, "Corporate Crisis: The Overseas Payment Problem" (1976), 8 *Law & Pol'y Int'l Bus.*, 547-629, at 562.

²⁰² For example, the Syrian government issued Decree No. 51/1979, which prohibits the use of an agent or mediator in any public or mixed transaction. See Fredrick W. Taylor, Jr., and Howard Weissman, "Middle East Agency Law Survey" (1980), 14 *Int'l Law.*, 331-359, at 353.

²⁰³ Paul C. Hamsy, "Legal Aspects of Doing Business in Saudi Arabia" (1982), 16 *Int'l Law.*, 51-66, at 59. The article discusses the Service Agency Regulations in Saudi Arabia, which have been promulgated by Royal Decree No. M/2 of January 20, 1978.

²⁰⁴ Article (5) of the Services Agency Regulations of Saudi Arabia. Promulgated by Royal Decree No. M/2 of January 20, 1978.

²⁰⁵ *Id.*, Article (8).

have followed the revelation of several scandals and briberies that occurred in the Middle East and that were uncovered as a result of the investigation of MNCs' misconducts following the Watergate scandal.

These restrictions and prohibitions are an attempt to enforce ethical business practice.²⁰⁶ Conversely, in the case where there is no restriction on the agent's fees in the country where he is employed, there is no way to find out how the agent spent his fees or commission, and the courts of the MNC's home country may be reluctant to require such accountability from the agent, on the ground of the common law tenet that a principal is not responsible for the act of his agent,²⁰⁷ when the agent is acting on his personal capacity for his personal benefit and outside the scope of his employment.²⁰⁸ However, the U.S. Foreign Corrupt Practice Act²⁰⁹ has established standards by which a corporation may on some occasions be held liable for bribes paid by its agent to foreign officials as part of his fee or commission, as we will see in Chapter 6.0 of this thesis.

²⁰⁶ Stanley Santire, "Participation and Registration in the Kingdom of Saudi Arabia" (1981), 15 *Int'l Law*, 561-570, at 564.

²⁰⁷ Peter Nehemkis, *supra*, footnote 168, at 15.

²⁰⁸ See *Egan v. United States*, 177 F.2d 369 (8th Cir. 1943), cert. denied, 88 L. Ed. 474 (1943), in which the court held that a corporation is criminally liable for the acts of its agents, officers, or servants who, in doing the act complained of, were engaged in exercising corporate powers for the benefit of the corporation while acting in the scope of their employment.

²⁰⁹ See U.S. Foreign Corrupt Practice Act, pub. Law. no. 95-213, tit. 1, 91 Stat. 1494 (1977). (Codified at 15 U.S.C. Secs. 78 dd-1, 78 dd-2, 78 ff [Supp. I, 1977].)

PART TWO : ADMINISTRATIVE AND CORPORATE METHODS OF CONTROL

CHAPTER 3.0

THE EXTENT OF CORPORATE LEGAL PROFESSIONALS' RESPONSIBILITY TO CONTROL ILLEGAL PAYMENTS

1. General Remarks

The disclosure of illegal payments by U.S. MNCs to domestic and foreign public officials creates a bewildering dilemma for professionals, particularly those of the legal profession. When an MNC's legal advisors have had prior knowledge about illegal payments, there is always the quandary of whether or not they are immune from liability. Several questions arise in this context: Are MNCs' legal advisors under a duty, either legal or moral, to reveal information to which they are privy with respect to illegal payments? And if there is legal or moral duty to reveal, will this breach the confidentiality principle of the attorney client relationship? Does a legal advisor have a responsibility to discover whether such payments have in fact been made by his client and to report them, and if so to whom? In what circumstances does the attorney client privilege not apply? We will try to answer these questions here, after exploring the role of a legal advisor in shaping corporate behaviour and his or her²¹⁰ duties and standards of personal conduct.

²¹⁰ For brevity, all further references by way of pronouns and possessives will be in the masculine gender.

2. The Role of the Legal Advisor in Shaping Corporate Behaviour

It is important to mention that while the MNC legal advisor was neglected for some time,²¹¹ his role has become more prominent in today's business world. Because a successful MNC executive needs sound legal advice, MNCs always seek to maintain a legal counsel with excellent knowledge of the MNC's sphere, who will dedicate his time and thinking to serving one entity with full independence and without any outside influences.²¹² However, the extent of public concerns and pressures have increased dramatically since the revelation in the early 1970s of MNCs' illegal payments, bribery, and illegal political contributions to many public officials in the United States and around the world. Public disclosure of these activities has brought into question the role of MNCs in society and the ethics of their contributions. This movement of public concern has brought about an increase in the involvement of regulatory agencies demanding MNC accountability. This in turn increases the MNCs' attention to the professional conduct of their advisors, and their need for sound legal advice as an important deterrent to any misconduct that might raise their accountability.²¹³ The significant factor that MNCs must monitor is public confidence, because the magnitude and dimension of corporate accountability lie within this confidence. If there was any indication that this trust was being ignored or neglected, it would raise the question of the integrity of the MNC's earnings, and whether it operates in the best long term interest of its shareholders, in particular, and of society at large.²¹⁴

²¹¹ John C. Tylor III, "The Role of Corporate Counsel" (1979), 32 *Rutgers L. Rev.*, 237-259, at 240.

²¹² Sylvester C. Smith, Jr., "The Lawyer in the Business and Commercial World" (1962-63), 36 *Aust. L.J.*, 385-388, at 337.

²¹³ Harold M. William, "The Role of Inside Counsel in Corporate Accountability" [1979 Transfer Binder], *Fed. Sec. L. Rep. (CCH)*, #82 at 369, #82 at 376.

²¹⁴ Harold M. William, "Corporate Accountability and the Lawyer's Role" (1978), 34 *Bus. Law.*, 7-17, at 7.

We must acknowledge that legal counselling of an MNC in today's business environment is not an easy job. The MNC legal advisor must assume a very active role in shaping the corporation policy and framing the standards of future corporate conduct.²¹⁵ Accordingly, this critical contribution to shaping the MNC's future conduct, and its essentiality for the effectiveness of MNC accountability shall be in conformity with public expectation.²¹⁶ The legal advisor's position gives him an increasing prestige, which consequently increases his responsibility to carefully and diligently observe the standards set up by the government's agencies for his ethical and professional conduct as well as society's expectation of him and of the role he plays.²¹⁷ Therefore, any deficiency of the legal counsel's role will incur the intervention of the regulatory agency, which we must acknowledge will be for the benefit of society, because such intervention by the regulator usually dramatizes the tendencies of the people to prevent any perceived abuses of their right.²¹⁸ Thus, to minimize the regulators' intervention, the MNC's legal advisor must discharge his responsibility in a manner consistent with both "the discipline of the market place and the non economic aspects of the public interest."²¹⁹ If this takes place, the gap between ethical guidelines and legal requirements will be closed.²²⁰ In the aftermath of the disclosure of several scandals involving MNCs the focus on the role and responsibility of MNC legal advisors has been so great as to urge one corporate lawyer to come forward to say that

²¹⁵ Marc I. Steinberg, "The Role of Inside Counsel in the Corporate Accountability Process" (1981), 4 *Corp. L. Rev.*, 22, at 4.

²¹⁶ As representative of the public, legal advisor deals with business enterprises in many fields and often has a better perspective from which to anticipate any problem and express reservations about a proposed course of action on ground that appears unfair or against the law or moral standards. Also see Harold M. William, *supra*, footnote 213, #82 at 370.

²¹⁷ Harold M. William, *supra*, footnote 214, at 14.

²¹⁸ Harold M. William, *supra*, footnote 213, #82 at 370.

²¹⁹ *Ibid.*

²²⁰ Harold M. William, *supra*, footnote 214, at 12.

this new mandate requires that "we lawyers reexamine our own role as advisors to corporations and to their executives and directors."²²¹ This revamping of the legal advisor's role requires him to take affirmative action when giving advice to his corporate client in the subject matter of any corporate misconduct, regardless of whether this advice may annoy and exasperate the client, and regardless of the fact that no constructive result may be perceived: He must discharge his duty in accordance with legal and moral principles.

It is worth while to maintain here that in the last few years, especially after the revelation of the illegal payments of the 1970s, the MNCs' executives' attitudes toward constructive legal advice has changed, and now more attention is being given to legal counsels' advice in so far as it will aid the executives to avoid any accountability²²² which may accrue as a result of a bad business judgment or activities of questionable legality. When the legal advisor gives advice, he exercises a preventive measure that contributes substantially to the avoidance of any violation of the law and consequent litigation,²²³ or at least reduces the increases in litigation and probable costs that would result therefrom. This also creates an internal discipline that is responding to the societal expectation.²²⁴ The unique position that a legal advisor has in a corporation gives him the opportunity to hear from all the corporation's constituents, therefore he is expected to be involved in an assessment of risks and consequences in situations that give rise to public concern and reaction.²²⁵ If, however, corporate counsel's advice is not appreciated by the corporate decision makers, the consequence would be a

²²¹ Whitney North Seymour, Jr. "A New Look at the Responsibility of Corporate Counsel" (1976), 31 *Bus. Law.*, 1271-1275, at 1271.

²²² John C. Tylor III, *supra*, footnote 211, at 248.

²²³ Sylvester C. Smith, *supra*, footnote 212, at 388.

²²⁴ George W. Coombe, Jr., "Multinational Codes of Conduct and Corporate Accountability: New Opportunities for Corporate Counsel" (1980), 36 *Bus Law.*, 11-43, at 11.

²²⁵ Harold M. William, *supra*, footnote 213, #82 at 371.

dramatic increase in public concern. This would ultimately lead to more involvement by the regulatory agencies in meeting the societal need by promulgating rules and regulations to be followed by the corporate concerns.

3. Comparative Outlook on the Effectiveness of Inside v. Outside Legal Counsel

As discussed previously, corporate counsel's unique position in a corporation makes him "the architect consciously or unconsciously of the accountability mechanism in the corporate structure".²²⁶ The profound future affect of the MNC legal advisor's advice upon the business affairs and the activities of the company either domestically or around the world has been felt in the significant augmentation of public censure in the wake of MNC transgressions associated with illegal payments. The multinational code of conducting negotiations perceives the role of MNC legal advisors as substantial in assisting the MNC's management to observe and address public expectation.²²⁷

The MNC legal advisor's role extends beyond strictly legal matters because of his daily role incorporate activities. This is especially true when the legal counsel is an employee of the corporation who participates actively in the formulation of appropriate ways and means to implement the corporation's policies.²²⁸ On the other hand, the effectiveness of the legal advisor's advice is not the same when he is an outside lawyer whose knowledge of the corporation's activities is limited, and who participates only when the corporation consults him on a limited legal question at a particular point in time. However, both methods of obtaining legal advice have their strengths and weaknesses. As we have stated earlier,²²⁹ the inside legal advisor's status as an employee of the MNC gives him a great deal of knowledge about what is happening in the corporation, which offers him a

²²⁶ Ibid.

²²⁷ George W. Coombe, supra, footnote 224, at 11.

²²⁸ Mendes Hershman, "Special Problems of Inside Counsel for Financial Institutions" (1978), 33 *Bus.Law.*, 1435-1451, at 1435.

²²⁹ See supra, 3:2.

chance to render sound legal advice, thus perhaps preventing possible misconduct by the corporation.²³⁰ The misconceived loyalty of the inside legal advisor may sometimes affect the objectivity of his advice. Moreover, the inside legal advisor may have reason to be concerned about his future and his job if he continues to challenge the legality of business goals formulated by management.²³¹ In contrast, the outside legal advisor may render more objective advice because of his independence from any influence by the MNC management, but owing to the nature of his relationship with the corporation, which usually arises when the legal problem has developed, his advice may not solve the problem or give guidance for the corporation's future activities.²³² Nevertheless, the retention of outside legal advice may be desirable in certain circumstances where there may be conflict of interest, such as the investigation of a possible bribery or any other illegal conduct by the corporation. It may also cause problems for the corporation, especially in the area of confidentiality and the invocation of the attorney-client privilege principle by the corporation.²³³

Meanwhile, the inside and outside legal advisors have the same duties, and are exposed to the same liabilities as their corporate clients.²³⁴ The corporate legal advisor's situation is very similar to that of the attorney representing an individual client, with the slight difference that the corporate legal advisor serves two clients simultaneously the corporate official or employee with whom he deals personally

²³⁰ Howard J. Aibel, "Successful Teaming of Inside and Outside Counsel to Serve the Corporate Client" (1983), 38 *Bus. Law.*, 1587-1603, at 1588.

²³¹ *Ibid.*

²³² *Ibid.*

²³³ Dennis J. Black and Nancy E. Barton, "Internal Corporate Investigation: Maintaining the Confidentiality of Corporate Client's Communication with Investigative Counsel" (1979), 35 *Bus. Law.* 53, at 8

²³⁴ Corporate legal advisor, as a lawyer, is exposed to Civil and Criminal constraints beyond the constraints of the Code of Professional Responsibility. He could be liable for assisting a client's wrongdoing or as a joint tortfeasor. Also he could be subject to criminal sanctions as accomplice or as co-conspirator.

and his ultimate client, the entity.²³⁵ Whether inside or outside, the MNC's legal advisor shall consider his advice to his client as a road map that will lead the corporation to a decision that is morally and ethically acceptable; in addition, MNC legal advisors must be sensitive to the conflict of interest considerations in the area of illegal payments by giving advice that will facilitate the implementation of MNC policy and prevent any potential abuses of power.²³⁶

²³⁵ William E. Knepper, *Liability of Corporate Officers and Directors* (3rd. ed., 1976), at 428.

²³⁶ Brian D. Farrow, "Special Problems of Inside Counsel For Industrial Companies" (1977-78), 33 *Bus. Law.*, 1453-1462, at 1458.

4. Legal Advisors' Duties and Standards of Personal Conduct

We have discussed the role of the legal advisor in shaping MNC behaviour and the effectiveness of his advice. However, we shall acknowledge that an MNC legal advisor is not only a citizen, but he is also an employee of the corporation where he maintains his job (if he is an inside counsel), a member of his own country's bar, and sometimes a member of the International Bar Association. By virtue of these associations, he owes a duty to his employer as well as to the court of justice.²³⁷ Congruently, he as

[A] lawyer shall not only discharge the duty imposed upon him by his own national or local rules, but he shall also endeavor when handling a case of international character to adhere to the rules of his code, subject necessarily to the rules existing in those countries in which he is native.²³⁸

The MNC legal advisor is therefore accountable on many quarters. He shall dedicate his loyalty and fidelity to the corporation where he maintains his job, as well as to his profession.²³⁹ Although he functions in a very hostile environment, he ought to give full consideration to ethical and moral obligations.²⁴⁰ Moreover, he should diligently promote effectiveness by preserving his professional independence.²⁴¹ However, if a code of ethics does not exist within the company, he

²³⁷ See Code of Professional Conduct approved by the Canadian Bar Association in 1920. C.F.C.B.A. 1(1); also see L.S.A., S.O., 1970, C.19, s.34. See also Mary Meechan, "More than a Mere Citizen: The Special Responsibilities of the Lawyer in Today's Society" (1980), 14 *The Law Society of Upper Canada Gazette*, 285-293, at 285.

²³⁸ 232. Article I of the International Code of Ethics. Adopted at Oslo on July 25, 1956, and amended by the General Meeting of the International Bar Association at Mexico City, July 29, 1964. Cited in, *Professional Ethics*, by Sir Thomas Lund, Director General of IBA.

²³⁹ Harold M. William, *supra*, footnote 213, at 14.

²⁴⁰ David S. Ruder, "The Corporate Law Department in Today's Corporation" (1978), 34 *Bus. Law.*, 819-823, at 821.

²⁴¹ Richard L. Fischer, "The Changing Role of Corporate Counsel" (1985), in *Corporate Counsel Annual*, 169-188, at 188.

should confine his activities in a manner appropriate and suitable to increasing public confidence in the integrity and efficiency of the legal profession to which he belongs.²⁴² Yet, MNC legal advisors might find it troublesome on some occasions to contend with ethical considerations, especially when it comes to questioning the activities of certain people in the corporation regarding some illegal and/or, unethical conduct such as bribery. These difficulties can be overcome by a "strong ethical imperative" which the legal advisor shall consider and take into account when asked for advice.²⁴³ He shall not give a swift answer, but take some time to evaluate the situation before him; this can be valued as an ethical responsibility related to competence.²⁴⁴ Furthermore, an MNC legal advisor shall strike a balance between cost and benefit before taking a step forward to forming legal advice; this, in the context of a particular corporation, can contribute to further responsibility.²⁴⁵

This high standard of professional responsibility may create a blockage of the flow of information to the corporate legal advisor, and it may even compel him to relinquish his job when faced with management's resistance to his advice.²⁴⁶ Sometimes such a dire step is necessary to avoid getting caught as an accomplice or participant in illegal conduct.²⁴⁷ In circumstances when the situation requires him to disclose illegal action by the corporation he shall do so, otherwise he would expose himself to disciplinary proceedings or possible disbarment.²⁴⁸

²⁴² Roger J. Gaebel, "Professional Responsibility Issues in International Law Practice" (1981), 29 *Am. J. Comp. L.* 58, at 58.

²⁴³ David S. Ruder, *supra*, footnote 240, at 821.

²⁴⁴ Brian D. Forrow, *supra*, footnote 236, at 1460.

²⁴⁵ Harold M. William, *supra*, footnote 213, at 14.

²⁴⁶ The resignation of counsel when the client is apparently in greatest need of sound legal advice is hardly helpful according to this view. See Robert J. Wilezek, "Corporate Confidentiality: Problems and Dilemmas of Corporate Counsel" (1982), 7 *Del. J. Corp.*, 221-250, at 235.

²⁴⁷ Samuel H. Gruenbaum, "Clients' Frauds and Their Lawyers' Obligations: A Response to Professor Kramer" (1979), 68 *Geo. L.J.*, 191-212, at 202-204.

²⁴⁸ Robert J. Wilezek, *supra*, footnote 246, at 226.

These obligations and duties of MNC legal advisors were affirmed by the case of *SEC v. National Student Marketing Corporation*,²⁴⁹ in which the administrative agency (SEC)²⁵⁰ asserted that the corporation attorneys had an obligation to stop the deal or reveal what in retrospect was held to be a material misrepresentation to the shareholders and the administrative agency. The SEC focused more, in the case, on the ethical responsibilities of the attorneys' connections with the securities transaction.²⁵¹ The facts of the case were that the SEC brought a legal action against two attorneys who prepared a legal opinion relied upon by the corporation's accountant to prepare a financial statement showing that the corporation had a sound financial standing in a merger transaction. The legal opinion concerned the effective date of the sale of one of the corporation's subsidiaries, which was, at the time, sustaining substantial losses and which the parent corporation wished to get rid of before the financial statement was prepared.²⁵² The allegations by the SEC were that attorneys failed to interfere in the closing of the merger, and that their inaction and silence constituted substantial assistance in this fraudulent transaction.²⁵³ The court agreed, stating that:

Courts have been willing to consider inaction as a form of substantial assistance when the accused aider and a better had a duty to disclose.²⁵⁴

²⁴⁹ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972). Hence, some of the cases that will be discussed in this thesis are securities cases relating to corporate counsel responsibility. The phenomenon, however, is not limited to this area, because the job of corporate counsel, whether it is an inside or outside counsel, is the same in so far as he advises on corporate conduct. The violation of the security law is comparable to the violation of any other law governing corporate misconduct.

²⁵⁰ In the United States, the Securities and Exchange Commission (SEC) is the agency authorized to handle cases of corporate fraud and misconduct. It is an independent regulatory agency consisting of five members appointed for staggered five year terms by the President with the concurrence of the Senate. Its primary responsibility is to administer or and enforce the U.S. Securities Laws. *Securities Exchange Act of 1934*, Sec. 4, 15 U.S.C. Sec. 78a(4)(a).

²⁵¹ Dennis J. Black and Nancy E. Barton, *supra*, footnote 233, at 44.

²⁵² *SEC v. National Student Marketing Corporation*, 45 F. Supp. 682 (D.D.C. 1972) at 692-696.

²⁵³ *Id.*, at 713.

²⁵⁴ *Ibid.*

The court analogized this case to other cases that concluded a duty to disclose and found that:

Although the duty to disclose in those cases is somewhat distinguishable, in that they contemplate disclosure to an opposing party and not to one's client, they are sufficiently analogous to provide support for a duty here.²⁵⁵

Then the court concluded that:

The attorneys' responsibilities to their corporate client required them to take steps to ensure that the information would be disclosed to the shareholders.²⁵⁶

So, the attorneys' silence was a breach of a duty to speak out and reveal the illegal action.²⁵⁷ The SEC also sought injunctive relief to prevent the attorneys from practicing securities law, but the court refused to grant such relief on the grounds that:

the Securities and Exchange Commission has not fulfilled its statutory obligations to make a "proper showing" that injunctive relief is necessary to prevent further violations of the law by these defendants.²⁵⁸

This case demonstrated that an attorney's knowledge of his client's non disclosure of illegal conduct may be equivalent to his knowledge that the client intends to commit a crime, a circumstance that is not protected under the traditional attorney client privilege doctrine.²⁵⁹ This obligation and duty of the legal advisor to speak out have been the issue of considerable debate within the legal

²⁵⁵ Ibid.

²⁵⁶ Ibid.

²⁵⁷ Ibid.

²⁵⁸ Id. at 717.

²⁵⁹ See infra, Chapter 3, 5.B.

profession,²⁶⁰ especially when the legal advisor is exercising his professional judgment, because the obligation of disclosure would erode the client confidentiality principle, and the result would be less flow of information from management to the legal advisor, thus impeding the preparation and rendering of sound legal advice.²⁶¹

The duty of disclosure pronounced in *National Student Marketing Corporation* suggested that MNC legal advisors had a duty to the shareholders and to the public as well as to their client. This duty to disclose requires the MNC legal advisor to take into account, when preparing a legal opinion or counselling his corporate client, the interest of a general public as well as his corporate client. This duty seems to present a conflict in many common law jurisdictions in which it is postulated that the legal advisor's client is the entity itself.²⁶²

These obligations and duties imposed upon the corporation's legal advisor bring about a dilemma as to who his true client is within the corporate hierarchy, with the understanding that the corporation cannot speak for itself, but only through those people who personify a corporation and make a decision on its behalf. Such a decision, and the execution of it, raises the corporation's responsibility before the law. So as to understand this dilemma, we shall ascertain the appropriate line of communication through which the MNC legal advisor must operate.

²⁶⁰ Samuel H. Gruenbaum, *supra*, footnote 247, at 211.

²⁶¹ Robert J. Wilezek, *supra*, footnote 246, at 235.

²⁶² Harry Frank, "A Higher Duty: A New Look at the Ethics of the Corporate Lawyer" (1977), 26 *Clev.St. L. Rev.*, 325-364, at 345.

5. The Framework Within Which MNC Legal Advisors Must Operate

In order to give the MNC legal advisor a clear opportunity to render maximum service to a corporation, it is crucial to ascertain his line of communication: Whom shall he advise, on what matters, and from what perspective? We can begin to answer these questions by determining with which group in a corporate hierarchy the decision making process lies. In many jurisdictions the by laws of incorporation invest this authority in the board of directors. However, while the board of directors may be the highest authority, the MNC legal advisor will find that a great majority of corporate decisions, on which he can have a significant impact, are made by management either with or without reference to the board of directors, or are based on management reasoning and recommendations.²⁶³ Accordingly, the MNC legal advisor shall maintain and preserve the relationship of trust with management, so as to ensure the acquisition of the information needed to render effective legal advice.

Acquiring such information will enable the legal advisor to make a balance between the management's confidence in him and the appropriate discharge of his obligations and duties to the director, the administration agency and the public.²⁶⁴

Meanwhile, management must realize that cooperation with the legal advisor is primarily in its own interest, because that would give management more assurance that any decision it takes will meet public expectation. The importance of this cooperative approach to decision making gained momentum in the wake of MNC activities that were found to be of questionable legality. Moreover, these open lines of communication will help to avoid situations which could lead to loss

²⁶³ See ABA Code of Professional Responsibility, EC 5-18(1977). Also see John C. Tylor III, *supra*, footnote 211, at 245.

²⁶⁴ *Id.*, at 246.

of jobs,²⁶⁵ or even loss of life. An example of this extreme type of situation was the suicide of the chief executive officer of the United Brand Corporation, which was precipitated by the SEC investigation of the corporation's \$1.25 million bribe to the president of Honduras.²⁶⁶ Such negative consequences may also reach the officers of the MNCs' subsidiaries abroad,²⁶⁷ and those acting as a conduit for illicit payments.²⁶⁸ Within this convoluted and covert web of negotiations, it is not surprising that the legal advisor often does not know exactly who his client is, whom he should be receiving orders from, or whom he shall advise or warn in the event of the discovery of wrongdoing. These are the questions that we shall try to answer in the following pages.

A. Who is the MNC Legal Advisor's Client?

The key to answering this question lies in the distinctive relationship between the corporation and the lawyer who works for it as one of its salaried employees a relationship different from the conventional lawyer client one. However, this complexity, generated by the fact that a corporation is an inanimate entity, derives its existence from the law. So, for a legal advisor to establish his direct client he must ascertain the identity of the person(s) authorized to speak on behalf of the corporation and to communicate with the corporation's legal advisor for the

²⁶⁵ Byron E. Calame, "Morality Play," *The Wall Street Journal*, January 15, 1976, at 1, col. 6. Gulf's Board ousted the corporation chairman, Bob. R. Dorsey, and three other top executives in the toughest corrective action taken up to that time by any corporation whose executives were caught making illegal political contributions and other illicit payment to foreign officials.

²⁶⁶ *Wall Street Journal*, April 9, 1975, at 1, col. 6. Eli M. Black, United Brand Chairman and chief executive officer, jumped to his death February 3 from his 44th floor office in mid town Manhattan.

²⁶⁷ *Wall Street Journal*, February 25, 1976, at 30, col. 2. When Lockheed Aircraft Corporation made illegal payments in Italy to promote sales of its aircraft, those payoffs prompted a police hunt for an Italian industrialist who resigned as a result of the discovery of illegal payments and disappeared. Also, in Japan the Japanese authorities raided the homes and offices of suspected participants in Lockheed payoffs there.

²⁶⁸ *Wall Street Journal*, February 25, 1976, at 30, col. 2. An Italian lawyer was arrested for his participation and role in serving as a conduit for illegal payments.

purpose of soliciting legal advice in matters involving a corporation.

The first case we will use to explore this question is that of *United States v. United Shoe Machinery Corporation*²⁶⁹ In this case the court held that the corporation was in itself the client,²⁷⁰ but the decision fell short of specifying who actually speaks for the corporation in the case where a legal advisor works on behalf of several authorized persons in the corporation, and in most cases of a

²⁶⁹ *United States v. United Shoe Machinery Corporation*, 89 F. Supp. 357 (D. Mass. 1950). The case was an anti-trust action initiated by the government against the corporation. The corporation refused to produce some of the documents made by one employee of the defendant to another employee on the ground of the attorney client privilege. The court classified the documents into four classes:

- a) those to or from independent lawyers,
- b) those to or from the defendant's legal department,
- c) those to or from the defendant's patent department, and
- d) working papers of persons in the patent department.

For the first group (which consists of letters to or from lawyers who worked as counsel to the corporation), if the letters

... were prepared to solicit or give an opinion on law or legal services, such parts of them are privileged as contain, or have opinions based on, information furnished by an officer or employee of the defendant in confidence and without the presence of third persons... However, in so far as the subject of these communications was the giving of facts disclosed to the attorney by a person outside the organization of defendant and its affiliates the communications are not privileged (at 359).

The second group of communications are those of a corporate inside legal advisor and his staff. These communications are privileged so long as the information did not come from persons outside the corporation or from a public document.

The third group of communications is not privileged,

Except where these communications are to or from outside counsel or the general counsel and his staff...(at 360).

The court found that most of this group's documents and communications were not privileged because they were made by persons who were not members of the bar of the court, although they were lawyers and members of other judicial bars. Also,

these patent department employees communicate usually directly (and only rarely through the head of the patent department) with many officers and employees of United [the defendant]. Thus these patent department employees are not protected by a privilege (at 360).

The fourth group of communications were the work products of the patent department employees, which the court found to be not privileged because (as aforementioned) those employees, though lawyers, were not acting in a legal capacity and thus were not attorneys within the attorney client privilege (at 361).

²⁷⁰ *Id.*, at 359.

group of related corporations, some of which are national and some foreign entities.²⁷¹ The notion that the entity is the sole client was also asserted by the American Bar Association in Ethical Considerations 5-18, which stated that:

A lawyer employed or retained by a corporation or similar entity, owes his allegiance to the entity and not to shareholders, directors, officers, employees, representatives or other persons connected with the entity.²⁷²

This makes it difficult to identify the legal advisor's proper relationship to the other players on the corporate stage, such as the board of directors, the chief executive and management. Some commentators say that a legal advisor's primary allegiance is to management and the board,²⁷³ others say that it is a positive ethical principle that one originally engaged on behalf of a corporation recognize the entity as the client and not a person(s), who may have a conflict of interest.²⁷⁴

In almost all jurisdictions, the board of directors personifies the entity and has the ultimate authority to manage the corporation's business; therefore, this makes a corporate legal advisor responsible to the person authorized to make decisions and to take action on behalf of the corporation.²⁷⁵ However, while the board is the highest authority in the corporation, one must acknowledge that in the complexity of today's business the primary professional relationship of the corporate legal advisor is usually with the chief executive officer (CEO), with whom the legal advisor has a close working relationship.²⁷⁶

The search for the direct client of the corporate legal advisor has also been

²⁷¹ Roger J. Gaebel, *supra*, footnote 242, at 3.

²⁷² 266. John C. Tylor III, *supra*, footnote 211, at 241.

²⁷³ *Id.*, at 243.

²⁷⁴ Roger J. Gaebel, *supra*, footnote 242, at 3.

²⁷⁵ John C. Tylor III, *supra*, footnote 211, at 241.

²⁷⁶ Stanley A. Kaplan, "Some Ruminations on the Role of Counsel for a Corporation" (1980-1981), 56 *The Notre Dame Lawyer*. 873-886, at 875.

complicated by the United States Court's decisions, as we have seen in the *SEC v. National Student Marketing Corporation* case,²⁷⁷ and as the fifth Circuit of the United States Court of Appeal held in the *Garner v. Walfinbrager* case,²⁷⁸ in which the court suggested that there is a direct relationship between the corporate legal advisor and the shareholders. It said that:

...in assessing management assertions of injury to the corporation, it must be borne in mind that management does not manage for itself and that the beneficiaries of its action are the stockholders... There may be many situations in which the corporate entity or its management, or both, have interests adverse to those of some or all stockholders. But when all is said and done, management is not managing for itself.²⁷⁹

These decisions by the courts prompted one commentator to say that "the statement that the board is the corporation's paramount authority is, of course, somewhat inaccurate, since the corporation's shareholders have even greater power than the board in some respects".²⁸⁰

²⁷⁷ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972).

²⁷⁸ *Garner v. Walfinbrager*, 430 F. 2d 1093 (5th Cir. 1970), Cert. denied., 401 U.S. 974 (1971). This was a class action brought by shareholders against the corporation and its officers, based on alleged violations of federal and state security laws. The plaintiff shareholders sought to see corporate books and communications between the corporation and its attorney, who then became the company president, and gave advice to the corporation about various aspects of the issuance and sale of the stock and related matters. The corporation refused access and disclosure of communications on the ground of attorney client privilege. The district court in an order reported at 280 F. Supp. 1018 (N.D. Ala. 1968), held the privilege was not available against the stockholders as plaintiffs. The appellate court stated:

... management judgement must stand on its merits, [and] not behind an ironclad veil of secrecy which under all circumstances preserves it from being questioned by those for whom it is, at least in part, exercised...[at 1101]. The corporation is not barred from asserting [the privilege] merely because those demanding information enjoy the status of stockholders. But where the corporation is in suit against its stockholders on charges of acting counter to stockholder interests, protection of those interests as well as those of the corporation and of the public require that the availability of the privilege be subject to the right of the stockholders to show cause why it should not be invoked in the particular instance (at 1103-1104).

²⁷⁹ *Id.* at 1101.

²⁸⁰ Stanley A. Kaplan, *supra*, footnote 276, at 875.

This broad interpretation of the attorney client relationship makes the MNC legal advisor responsible to several interested parties in the corporation and sometimes to the public. In the next section we will try to assess this relationship and the extent to which the legal advisor can protect his communications with those interested parties under the doctrine of attorney client privilege.

B. The Application of Attorney Client Privilege to MNC Legal Advisor Communications

The broad interpretation of a legal counsel's client can be troublesome for the MNC and for the legal advisor as well. Ostensibly it hinders the invocation of the doctrine of "attorney client privilege." This doctrine has been established essentially for the purpose of easing the flow of information from the decision makers in the corporate hierarchy to the legal advisor so as to enable him to render sound legal advice and also to preserve any facts from disclosure without fearing that the facts revealed to him will later be used against the client.²⁸¹ Moreover, this theory of confidentiality alleviates the client's fear of communicating with counsel, who is in the corporation context an individual employee.²⁸²

(i) The Proper Scope of Privilege for Corporations

As mentioned, the impersonal nature of a corporation as an inanimate entity mandates that it can only communicate through its agents. This again raises the question: Who is the legal advisor's client? In other words, the application of the privilege will vary, depending on who is the officer or employee authorized to personify and speak for the corporation.²⁸³ This designation is often so nebulous that MNCs will attempt to invoke the attorney client privilege for any communication with a corporate legal advisor in order to preserve the confidentiality of this information and prevent any disclosure that might jeopardize the corporation's business interests. However, commentators have conceded in recent years that the traditional concepts of privilege and confidentiality are difficult to handle when the

²⁸¹ John William Gergolz, "Attorney Corporate Client Privilege" (1982), 37 *Bus. Law*, 461-508, at 464.

²⁸² Michael W. Tankersley, "The Corporate Attorney Client Privilege: Culpable Employees, Attorney Ethics, and the Joint Defence Doctrine" (1980), 58 *Texas L. Rev.*, 809-843, at 830.

²⁸³ Dennis J. Black, *supra*, footnote 233, at 13.

corporation is a client,²⁸⁴ and must be cautiously drawn and narrowly applied.²⁸⁵ Furthermore, courts in the 1970s became increasingly protective of shareholders' rights in corporate decision-making.²⁸⁶ Although all courts in all common law jurisdictions have agreed to apply the concept of attorney client privilege to corporations as well as individual clients,²⁸⁷ they have developed distinctive applications of the privilege to corporations as clients. Accordingly, for a corporation to invoke the applicability of the privilege for communication between a legal advisor and another employee of a corporation, several conditions must be met:

- (a) The retention of the legal advisor must be for the purpose of furnishing legal advice.
- (b) The privilege attaches only to communication between the MNC as a client, speaking through an authorized person, and its legal advisor.
- (c) Confidentiality must be preserved by the legal advisor and MNC as a client.
- (d) There must be absence of waiver.²⁸⁸

In laying down these elements, courts have curtailed the application of the privilege to those instances where the preservation of the information is very important and in the best interests of the corporation, the shareholders and the

²⁸⁴ Robert J. Wilezek, "Corporate Confidentiality: Problems and Dilemmas of Corporate Counsel" (1982), 7 *Del. J. Corp. L.*, 221-250, at 239.

²⁸⁵ Julie Elizabeth Rice, "The Attorney Client Privilege in the Corporate Context: The Intersection of Federal and Illinois Law" (1984), *U. of Ill. Law.Rev.*, 175-202, at 179.

²⁸⁶ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972).

²⁸⁷ In *Radiant Burners, Inc. v. American Gas Association*, 320 F.2d 314 (7th Cir.), Cert. denied, 375 U.S. 929 (1963), the Seventh Circuit Court of the United States Court of Appeals reversed the district judge's decision that the attorney client privilege should not apply to corporations because the privilege is fundamentally and "historically personal in nature" [at 317]. The district court holding was such because the court could not identify which corporate agent should be deemed to speak for the corporate client [207 F. Supp. 771, at 773]. The Seventh Circuit Court of the United States Court of Appeals, when reversing the case, noted the long standing, implicit judicial recognition of the privilege for corporations (at 314-320). It rejected the contention that the privilege was essentially personal in nature. At 322-333.

²⁸⁸ *United States v. United Shoe Machinery Corporation*, supra, footnote 269.

public. In the following pages we will analyze these elements in the context of MNC illegal payments.

- (a) The communication must be for legal advice; however, since it is difficult to separate legal from non-legal or business communication, it is necessary for the court to apply a "but for analysis,"²⁸⁹ which means that the contact with the MNC legal advisor would not have existed but for the solicitation of legal advice.

The apparent relationship between a corporation as an employer and a salaried legal advisor may give rise to privilege, but not where the legal advisor is fulfilling a different function in creating a document for which the privilege is claimed.²⁹⁰ The leading authority on the subject of MNC illegal payments is *The Diversified Industries, Inc. v. Meredith* case,²⁹¹ in which the plaintiff shareholders sought the disclosure of a memorandum prepared by a law firm engaged to investigate allegations that Weatherhead Corporation bribed its employees to accept an inferior grade of Diversified copper.²⁹² In its decision the 8th Circuit of the United States Court of Appeal focused on two questions: Why was the law firm consulted, and with whom was the communication conducted? Then the court (en banc²⁹³), held that the pur-

²⁸⁹ Glen Weissenberger, "Toward Precision in the Application of the Attorney Client Privilege for Corporations" (1980), 65 *Iowa L. Rev.*, 899-930, at 918.

²⁹⁰ *Santa Ursula Navigation S.A. v. St. Lawrence Seaway Authority* (1981), 25 C.P.C. 78 (Fed. T.D.).

²⁹¹ *Diversified Industries, Inc. v. Meredith*, 572 F.2d 596 (8th Cir. 1977), affirmed in part and reversed in part, 572 F.2d. 606 (8th Cir. 1978) (banc).

²⁹² *Id.*, at 607.

²⁹³ This legal term refers to a session where the entire membership of the court will participate in the decision rather than the regular quorum. In other countries, it is common for a court to have more members than are usually necessary to hear an appeal. In the United States, the Circuit Courts of Appeal usually sit in panels of judges, but for important cases may expand the bench to a large number, when they are said to be sitting en banc. See *Black's Law Dictionary* (5th edition 1979), at 472-473.

pose of retaining the law firm was to secure legal advice,²⁹⁴ and that the memorandum prepared by the law firm consisted of:

confidential communications of the corporate client and [was] entitled to the attorney client privilege.²⁹⁵

This approach is called the subject matter test. It covers communications with non management employees during an attorney's investigation of matters relating to potential legal action,²⁹⁶ but ~~not~~ material prepared, for example, by an accountant for a corporation unless the material was prepared at the request of the corporation's legal advisor for use in connection with litigation.²⁹⁷

This condition applies only when the subject matter of the communication is the seeking of legal opinion; otherwise no privilege is attached or applied.

- (b) The privilege attaches only to communications between a corporation as a client and its legal advisor, being an authorized agent or agents. This approach is called the control group test. This test was formulated by the court in the case of *City of Philadelphia v. Westinghouse Electric Corporation*.²⁹⁸

²⁹⁴ *Diversified Industries, Inc. v. Meredith*, supra, footnote 291, at 610.

²⁹⁵ Id., at 611.

²⁹⁶ See *Royal Embassy of Saudi Arabia v. Steamship Mount Dirfys*, 537 F. Supp. 55 (E.D.N. Carolina, 1981). In this case the defendant and third party plaintiff, Wilmington Shipping Company, sought the production of a document by the defendant, Ashtor Shipping Company. This document was a report made by the master of the S.S. *Mount Dirfys*, the vessel that is the subject matter in the litigation. The report of the master was put in a statement taken by an attorney representing the owner and underwriters of the ship. The court held that the statement requested in this case was made by a corporate employee to corporate attorneys in the preparation of information contemplating the litigation of this matter; the corporate employee stands in the shoes of the entity for the purpose of privilege (at 56).

²⁹⁷ See *Susan Hosiery Ltd. v. M.N.R.*, [1969]E.X.C.R. 27.

²⁹⁸ *City of Philadelphia v. Westinghouse Electric Corporation*, 210 F. Supp. 483 (E.D. of Pa. 1963). In this case the claim was made in connection with a motion by the plaintiff for penalties against the defendant for refusal to answer interrogatories, and to produce documenta-

This test extends the privilege only to communications made by a person

in a position to control or even to take a substantial part in a decision about any action, which the corporation may take upon the advice of the attorney.²⁹⁹

However, this approach was criticized by the court in the Diversified Industries case,³⁰⁰ and in several law reviews,³⁰¹ on the grounds that effective legal advice depends in most cases upon the information held by low level employees, so that failure to extend the privilege to communication with those employees would contradict the purpose of the privilege, especially when those employees have a great deal of knowledge about the subject matter of the advice.³⁰² The United States Supreme Court, in *Upjohn Corporation v. U.S.*³⁰³ has also confirmed this criticism clearly, and has unequivocally rejected the control group test as a basis for delineating the scope of the privilege as it applies to corporate communication.³⁰⁴

tion containing a statement made by an employee of the corporation to its lawyer. The attorney client privilege was asserted not only on behalf of the corporation but also on behalf of the employee, who was the source of the information sought by the plaintiff. The court held that the communications, the sources of the facts required to answer the interrogatories, sought to be protected in the present case, are not within the attorney client privilege (at 486).

This control group test "is not yet the law in Canada." See T.B. McKelg, "Problem Areas for Corporate Counsel: Privilege" (1981) *Annual Institute on Continuing Legal Education*, 18.

²⁹⁹ *Id.*, at 485.

³⁰⁰ *Diversified Industries, Inc. v. Meredith* 572 F. 2d 596 (8th Cir. 1977), affirmed in part and reversed in part, 572 F. 2d 606 (8th Cir. 1978). The court said:

The control group test inhibits the free flow of information to a legal advisor and defeats the purpose of the attorney client privilege(at 609).

³⁰¹ John D. Donovan, Jr., "Application of the Attorney Client Privilege to Corporations: New Directions and a Proposed Solution" (1974), 20 *Boston College L. Rev.*, 953-974, at 961.

³⁰² Dennis J. Black and Nancy E. Barton, *supra*, footnote 233, at 13.

³⁰³ *Upjohn Corporation v. U.S.*, 101 S.Ct 677(1981) 449 U.S. 383, 66 L. Ed. 2d 584.

³⁰⁴ John E. Sexton, "A Post Upjohn Consideration of the Corporate Attorney Client Privilege" (1982), 57 *N.Y.U. L. Rev.*, 443-520 at 462.

Upjohn is a multinational pharmaceutical corporation doing business in almost 150 countries. The facts in the case were that an independent accounting and auditing of one of Upjohn's foreign subsidiaries discovered evidence that the subsidiary had made illegal payments to foreign government officials. The accountant submitted the report to a corporate general counsel, who then discussed this illegal payment with the chairman of the company's board of directors and with outside counsel. As a result, the company commenced an internal investigation of the questionable payments, and the corporate counsel sent a questionnaire to all of the company's overseas managers requesting information regarding such bribes. The letter accompanying the questionnaire indicated that company headquarters needed all available information concerning these illegal payments to foreign officials, and that the responses must be sent to the general counsel. It also indicated that this matter must be treated confidentially, but should be discussed with any employee who may possess such information. After receiving the responses to the questionnaire, the inside and outside counsels interviewed several officers, taking hand written notes that reflected the content of the conversations and their impressions. Consequently, the Upjohn Corporation voluntarily submitted a report to the SEC and the IRS (Internal Revenue Service), disclosing the questionable payments. The IRS issued an administrative summons for the production of all documents gathered during the corporation's internal investigation; however, the company refused on the grounds that the documents were protected from disclosure by either the attorney client privilege or the work product doctrine.³⁰⁵ The district court granted enforcement of the summons. The company declined to produce the documents and appealed to the Sixth Circuit of the United

³⁰⁵ The work product doctrine means that any material prepared by an attorney in anticipation of litigation, including private memoranda, written statements of witnesses and mental impressions of litigation for trial, are protected against discovery. *Black's Law Dictionary* (5th edition, H.C. Black, 1979), at 1440.

States Court of Appeals.³⁰⁶ The appellate court held that the privilege did not apply, using the control group test.³⁰⁷ Consequently, the court remanded the case to the district court for the determination of which corporation employees fell within the controlling group.³⁰⁸ However, when the United States Supreme Court finally agreed to hear the case, in its analysis it rejected the control group test on the following grounds:

1. This test is inadequate because it overlooks the need for the privilege to protect not only professional advice given by the attorney to corporate employees who can act on it (the control group), but also the information given to the attorney to enable him to form a judgment and provide sound legal advice.³⁰⁹
2. This test narrows the scope of the privilege, which makes it difficult for the attorney to conduct a full investigation of the facts before rendering and formulating legal advice.³¹⁰
3. This test "is difficult to apply in practice."³¹¹

The Supreme Court also implicitly rejected the subject matter test and adopted a case case analysis of the issue.³¹² This approach would seem to be the one most compatible with the purposes and policies of the privilege as applied to corporations. In the final analysis, the Supreme Court reversed the judgement of the appellate court and held that:

³⁰⁶ *United States v. Upjohn Corporation*, 600 F. 2d 1223 (6th Cir. 1979).

³⁰⁷ *Id.*, at 1225.

³⁰⁸ *Id.*, at 1227

³⁰⁹ *Upjohn Corporation v. U.S.* 101 S.ct. 677(1981), at 683.

³¹⁰ *Id.*, at 684.

³¹¹ *Ibid.*

³¹² John W. Gergaz, "Attorney-Corporate Client Privilege: Cases Applying Upjohn, Waiver, Crime Fraud, Exceptions, and Related Issues" (1983), 38 *Bus. Law.*, 1653-1683, at 1665.

the communication by Upjohn employees to counsel are covered by the attorney client privilege ... so far as the responses to the questionnaire and any notes reflecting responses to interview questions are concerned ...³¹³

Courts still differ in their holdings concerning these two elements of privilege as they apply to communication between a corporation as a client and a legal advisor. However, they seem to agree on the two remaining elements, which are very important ones, namely:

- (c) the preservation of confidentiality, and
- (d) the absence of waiver.

All courts agreed that these two conditions must be met and satisfied before the invocation of the privilege. Nonetheless, the interface between them is inevitable, because confidentiality requires that communications between a legal advisor and his client be made with no one else present, so that the privilege may not be waived by the client by implication when he exposes to others the advice given to him by his solicitor or legal advisor, and gives the conditions of the meeting as a reason for his conduct.³¹⁴ Moreover, the privilege does not apply to documents prepared and material gathered by an attorney appointed by judicial decree to investigate certain instances.³¹⁵

Furthermore, the courts are very diligent in preserving the essential purpose of privilege, for example the court *In Re Shell Canada Ltd. and Director of Investigation and Research* held that the power of the Director of Investigation and

³¹³ *Upjohn Corporation v. U.S.* 401 S.ct 677(1981), at 686.

³¹⁴ See *Hunter v. Rogers*. [1982] 2.W.W.R. 189(B.C.S.C.)

³¹⁵ See *SEC v. Canadian Javelin Ltd.*, 451 F.Supp. 594 (D.D.C. 1978), vacated on other grounds. The Court appointed an attorney to monitor and report on Javelin's compliance with prior injunctions. The court held that the counsel was not retained to offer legal advice and that he had a duty to the court and to the public but not to the corporation. At 596.

³¹⁵ *In Re Shell Canada Ltd. and Director of Investigation and Research* [1975] F.C. 184

Research did not extend to the investigation of documents that are bona fide communication between solicitor and client:

...because [the Combines Investigation Act] revealed no intention of undermining the solicitor-client relationship of confidentiality.³¹⁶

However, the Canadian Competition Act of 1986³¹⁷ requires the Director of Investigation to seek a court warrant to acquire information relevant to the inquiry or subject matter.

The absence of waiver and confidentiality elements, however, are more difficult to ascertain and to apply when the client is a corporation. This is especially so in some cases of internal corporate investigation, when the investigating legal advisor retains an independent auditor or accountant to assist him.³¹⁸ Yet, the waiver is also complex in the corporate context, because it has to be made by

(C.A.). See generally, Robert A. Kasting, "Recent Developments in the Canadian Law of Solicitor Client Privilege" (1978), 24 *McGill L. Rev.*, 113-122.

³¹⁶ *Re Shell, Id.*, at 184. The case was brought and argued pursuant to section 10(1) of the *Canada Combines Investigation Act* R.S.C.1970, c.23, which empowered the Director of Investigation and Research to enter any premises and take any evidence that he believes relevant to the matter being inquired into.

³¹⁷ *Canada Competition Act* (formerly Combines Investigation Act) R.S.C. 1970, c.23, as amended by S.C. 1986, c.26, s.18:

13(1) where, on the ex parte application of the Directors or his authorized representative, a judge of a superior or County Court or of the Federal Court is satisfied by information on oath or affirmation

(b) that there were reasonable grounds to believe that there is on any premises, any record or other thing that will afford evidence ... as the case may be, the judge may issue a warrant under his hand authorizing the Director or any other person named in the warrant to

(c) enter the premises, subject to such condition as may be specified in the warrant, and

(d) search the premises for any such record or other thing and copy it or seize it for examination or copying...

(2) A warrant issued under this section shall identify the matter in respect of which it is issued, the premises to be searched and the record or other thing, or the class of records or other things, to be searched for.

(5) Every person who is in possession or control of any premises or record or other thing in respect of which a warrant is issued ... shall, on presentation of the warrant, permit the Director or other person named in the warrant to enter the premises, search the premises and examine the record or other thing and to copy it or seize it.

³¹⁸ Dennis J. Black and Nancy E. Barton, *supra*, footnote 233, at 17.

the agent(s) authorized to manage the corporation and speak on its behalf under whatever test (as discussed) is employed. The safeguard that the MNC legal advisor should adopt to avoid any appearance of a lack of confidentiality and implied waiver is to take every precaution to preserve the privileged documents and keep them in his custody so as to prevent the dissemination of information contained therein.³¹⁹

³¹⁹ Id. at 19.

(ii) **Disclosure of Privileged Documents to Government Agencies**

A problem arises when the administrative agency requires a disclosure of documents that are otherwise privileged. This was the situation in the aftermath of the SEC voluntary disclosure of illegal payments by multinational corporations, which raised the question of whether or not such disclosure to a government agency waived the privilege.³²⁰ The court cases treating this issue differ in their answers. In *Diversified Industries, Inc. v. Meredith*³²¹ the court held that:

As Diversified disclosed these documents in a separate and non public SEC investigation, we conclude that only limited waiver of privilege occurred.³²²

This characterization of the disclosure to an administrative agency as a limited waiver rests on a public policy ground, because for the court

to hold otherwise may have the effect of thwarting the developing procedure of corporations to employ independent outside counsel to investigate and advise them in order to protect stockholders, potential stockholders, and customers.³²³

Nonetheless, this concept of a limited waiver is not available when a corporation withholds some of the documents that it is supposed to disclose to the government agency, for example, in the *Re Sealed Case*³²⁴ the corporation had been involved in several illegal payments in foreign countries and in the United States. In the voluntary disclosure program,³²⁵ the corporation had selectively released some of

³²⁰ The voluntary disclosure program is based on corporate self investigation and reporting to the commission.

³²¹ *Diversified Industries, Inc. v. Meredith* 572 F. 2d 596 (8th Cir. 1977).

³²² *Id.*, at 611.

³²³ *Ibid.*

³²⁴ *Re Sealed case*, 676 F. 2d 793, (D.C. Circuit 1982).

³²⁵ This was an offer of amnesty by the SEC after the Watergate scandal. It was an ap-

the documents to the SEC to create a misleading picture of its activities. The grand jury investigating the same activities sought the disclosure of the rest of those documents, but the corporation refused on the ground that those documents were privileged under a work product doctrine. The court rejected the corporation's reasoning on the ground that the corporation's manipulative action defeated its right of asserting the benefit of the work product doctrine immunity or implied waiver concept. The rationale was that:

through the doctrine of implied waiver and exception, the law entrusts the courts with a duty to guard that the offices of lawyers, and the respect which we have for the bar, are not used for unfair or corrupt purposes.

In the exercise of that duty, we have determined that there is a substantial likelihood that the multinational corporation before us has attempted to manipulate its privilege by withholding vital documents while making a great pretense of full disclosure of their contents. It does not deserve the protection enjoyed by those who use the adversary system for its legitimate ends.³²⁶

proach by the SEC to force U.S. MNCs to disclose illegal political contributions in the U.S. and bribes to foreign officials abroad through the establishment of internal corporate procedures to investigate illegal payment and prevent future wrongdoing of this kind. In exchange the SEC was not to initiate enforcement action against the corporation that revealed the information. However, the result of this program was that five hundred giant MNCs came forth to admit that they had made illegal payments both in the U.S. and abroad. Although this program relieved the SEC of the burden of investigation, it overlooked the power of outside counsel and independent directors to compel the disclosure of such information and lacked the safeguards against disclosure of information gathered by internal corporate investigators and revealed to the SEC. Interested shareholders were then able to use such information as evidence in derivative actions.

³²⁶ *Re Sealed Case*, 676 F. 2d 793, (D.C. Circuit 1982).

(iii) The Crime Fraud Exception

The purpose of the corporate client privilege is to encourage corporate management and the director to communicate freely with the corporation's legal advisor when seeking legal advice, and not to shield the corporation's illegal activities. Logically, when the corporation's management or directors intend to use the privilege to conceal such activities, the privilege does not apply, because the rationale behind the privilege is the furthering of justice and public policy considerations. So that any abuse of these considerations will cause the privilege to fail,³²⁷ and potential liability of both the legal advisor³²⁸ and the corporations' directors and management for breach of their fiduciary responsibilities.³²⁹ However, in seeking the application of these exceptions, the burden of proof is on the plaintiff to present a *prima facie* case of fraud, which in the corporate context means it must be proven that the communication was not sought to secure legal advice but merely to further the illegal activities.

Some recent cases involving illegal payments by multinational corporations explore these exceptions in depth: In the *Re Sealed* case,³³⁰ the Ninth Circuit of the United States Court of Appeals found that the exception or waiver of the work product privilege will also serve as the exception or waiver of the attorney client privilege.³³¹ The court also held that

the District court was wrong in rejecting the exception theory.³³²

³²⁷ John W. Gergaz, *supra*, footnote 312, at 1676.

³²⁸ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972). The case showed that there are times when counsel has an obligation to make disclosure to the shareholders of the client corporation, such as when his client has committed fraud or is intending to commit a fraud or crime.

³²⁹ Dennis J. Black and Nancy E. Barton, *supra*, footnote 233, at 51.

³³⁰ *Re Sealed* case, 676 F. 2d 793 (D.C. Circuit 1982).

³³¹ *Id.*, at 812.

³³² *Id.*, at 813.

when the SEC sought that the crime fraud exceptions be applied to the case, because the company tried to conceal two of the documents that contained information about management policies and practices regarding bribery and corruption.³³³ The SEC argued that those documents were very important for the evaluation of the company report under the voluntary disclosure program.³³⁴ Eventually, the court agreed with the SEC and held that:

our own review reveals that they [the documents] are necessary for a fair evaluation of the representations in the report. If we allowed Company to withhold them under a claim of privilege, we would encourage further games of cat mouse between corporations and their regulators.³³⁵

The court, in rejecting the company claim of privilege, said:

Certainly, in such circumstances where lawyer and client attempt to manipulate the work product privilege as Company and its counsel have done in this case, the cause of justice compels disclosure, and a waiver is implied.³³⁶

In the *Re International System and Controls Corporation (ISC)* case,³³⁷ the court dealt with the instance of an MNC that conducted business throughout the Middle East. As part of that business, ISC allegedly engaged in paying "commissions" or "bribes" to foreign nationals in order to secure contracts. When the SEC requested information regarding these 'sensitive payments' in compliance with a voluntary disclosure,³³⁸ the ISC appointed a committee to investigate the alleged

³³³ *Id.*, at 822.

³³⁴ *Ibid.*

³³⁵ *Id.*, at 824.

³³⁶ *Id.*, at 825.

³³⁷ *Re International System and Control Corporation, etc.* (I.S.C.) 693 F. 2d 1235 (5th Circuit 1982).

³³⁸ *Id.*, at 1237.

bribes. The committee hired a law firm and an accounting firm to investigate any illegal payments made by ISC or its subsidiaries. As a result, two derivative suits emerged against the board of directors, alleging that the board had knowingly caused illegal payments to be made, and had negligently failed to inquire and uncover the illegal payments.³³⁹ The plaintiffs in the consolidated derivative suits moved to compel the production of the information that resulted from the investigation, especially the accounting binders. The ISC invoked the attorney client privilege and the work product doctrine. The District Court ordered the production of certain documents,³⁴⁰ but the company appealed the order. The Ninth Circuit of the United States Court of Appeals vacated the order on two grounds. First, the work product doctrine applies only when the plaintiff shows undue hardship in getting the information contained in the documents:

The district court did not make the finding of substantial need and undue hardship ... and of course has broad discretion to determine whether an adequate showing has been made.³⁴¹

Secondly, the plaintiff must make a *prima facie* case in order to invoke the exception. However, in this case the lower court found the plaintiff had made a *prima facie* case of fraud. The appellate court found nothing in the record to suggest such findings, except the plaintiff's allegations.³⁴² For a *prima facie* showing there must be two elements:

First, there must be a *prima facie* showing of a violation sufficiently serious to defeat the work product privilege. Second, the court must find some valid relationship between the work product under subpoena

³³⁹ *Id.*, at 1238.

³⁴⁰ *Ibid.*

³⁴¹ *Id.*, at 1240.

³⁴² *Id.*, at 1242.

and the prima facie violation.³⁴³

The court concluded that there must be a showing of a specific intent to further fraud or crime in the defendant's consultation with an attorney or in the preparation of a document. This holding was different from that of the *Re Sealed* case, in which it was found that the corporation withheld documents from an investigation of crime by a grand jury.³⁴⁴ The intent could be shown, for example, if a member of the management knew or had reason to know of specific illegal payments, but did not disclose them when the investigation commenced.

³⁴³ Id.

³⁴⁴ Id., at 1243.

6. Appraisal and Conclusions

It is generally accepted that the legal profession's first and foremost concern is the interest of the client, and that this interest can vary from one client to another. Clients are, also, distinguishable in terms of their legal rights and duties on the basis of their status, standing in the society, and behaviour. The legal advisor is concerned with securing his client's substantive rights, which are determined by the rules of law, which contain implicit limitations and are subject to interpretation. However, the nature of the client has a direct relevance to the legal professional's discretion in making decisions, and that may influence his ethical responsibility. The representation of an artificial client such as a corporation, however, affects the scope of the legal professional's exercise of his discretion. The traditional concept that the entity is the client is conceptually difficult for a legal practitioner to comprehend, for if one's client is a legal fiction, how can that client exercise the power of decision? A legal practitioner representing a legal entity has a relationship with someone who speaks on behalf of and represents the legal entity, so he might perceive the chief executive officer as his client, perhaps at his peril. He must bear in mind that his contact with a corporate officer must serve as a ground for his relationship to the corporation as a whole, and this limits his contact with those officers to their official capacities only. Those officials are entitled to a legal advisor's services only in so far as those services are directed to the entity. Thus, the legal advisor's duties to the corporate officers are determined by their rights and duties as officials.³⁴⁵

Consequently, when a legal professional represents a corporation, he has duties and responsibilities to the corporation independent of those to the corporate

³⁴⁵ L. Ray Patterson, "The Limits of the Lawyer's Discretion and the Law of Legal Ethics" (1979), *Duke. L. J.*, 1251-1274, at 1266.

officials, and this was the rationale behind the holding in *SEC v. National Student Marketing Corporation*³⁴⁶ The law will determine the extent of the legal advisor's duties to the legal entity itself, and when those duties will extend to those composing the legal entity, either shareholders, directors, or officers. Hence, the distinctive role of a legal practitioner serving a corporation as a legal advisor reflects the extent to which the client has delegated the care of his rights to the legal advisor, and that is also a measure of the legal advisor's responsibilities.³⁴⁷

In the cases that we have discussed, which involved illegal payments by MNCs, we have seen how courts have characterized the role of corporate legal advisor, the grounds that the court have relied upon, and the rationale they have used in laying down their decisions. We have discussed the court's description of the legal advisor's role when the issues of the applicability of the attorney client privilege come into play, and the extent to which this privilege can be asserted, especially when the client has committed or was about to commit an act in violation of the law. An example of the latter is the holding of the United States court of appeal for the Ninth Circuit in the *Re Sealed* case, in which the court rejected the defence of the work product privilege to produce important documents, on the ground that the legal advisor and the corporation attempted to manipulate the work product defence.

³⁴⁶ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972).

³⁴⁷ L. Ray Patterson, *supra*, footnote 345, at 1266.

CHAPTER 4.0

MULTINATIONAL CORPORATIONS' INTERNAL REMEDIES FOR ILLEGAL PAYMENTS

1. General Remarks

Ostensibly, MNCs concerned with the thunderclap accompanying the initial public disclosure of illegal payments, have taken several steps to shield the public and the shareholders from the glare of publicity that surrounds these situations. Usually this has meant taking manifest action to eliminate or at least mitigate the practice of making illegal or questionable payments.

The first step in this process was the publication of a code of conduct providing MNC employees with ethical and lawful guidelines for conducting business. The code represents an awareness of the importance of business ethic and recognition by MNCs of the validity of criticisms levelled against them.

The second step was the installation of independent outside directors. These measures are now compulsory in some common law jurisdictions. In Canada, Sec. 9 (2) of the Canada Business Corporations Act of 1975 requires those corporations involved in issuing securities to the public to have at least three directors, two of whom are outside directors. In *Ontario's Business Corporation Act of 1982*, Sec.115(3),³⁴⁸ the requirement is less strict than that of the federal jurisdiction: For corporations offering shares to the public, only one third of the board of directors are required to be from the outside, that is, they must not be officers or employees of the corporation nor of any of its affiliates. Ironically, however, when one cogitates on these requirements, one finds that both acts fall short of

³⁴⁸ See *Ontario Business Corporations Act*, 1982, R.S.O., C.4.s.115(3).

specifying the extent of the outside directors' independence. Thus, the responsibility still rests with the MNCs to assure the public and the shareholders of the independence of outside directors and to effectuate their benefit and role as a device for monitoring against any wrong doing.

The third step was the election of an audit committee from among those outside directors. Although this monitoring device started as a recommendation, we will see that some common law jurisdictions have made it compulsory, although the requirements and procedures vary. The fourth step has been intermittent internal investigations by MNCs to make certain that all business activities are being conducted in accordance with the ethical standards (and with the code of conduct, where one exists) legally adhered to by the company constituencies. This last measure is one shareholders sometimes take advantage of when the internal investigation reveals bribes or questionable payments, by bringing derivative suits against the directors involved or against management for recovery. The MNC's usual counter to such derivative suits is to assert the business judgement rule, provided that such a decision by the board of directors shall be under the scrutiny of the court to prevent and deter any abuse of the business judgment rule.

2. Establishing a Code of Conduct for MNC Employees

The establishing of a code of conduct is one of the most important steps taken by MNCs as a remedial action against any suspected or perceived misconduct on the part of their employees, from top management to the lowest level employees. Although the existence of corporate codes of ethical conduct can be traced back to the turn of the century in the United States,³⁴⁹ several studies indicate that the most comprehensive code of MNC ethical conduct was a necessary result of several scandals that rocked the business community in the mid '70s. In the forefront of these scandals was Watergate, which in turn uncovered a great deal of illegal behaviour by MNCs in the U.S. and abroad. These revelations served as a catalyst for reexamining the ethical side of MNCs' business conduct abroad.³⁵⁰

There was an emerging need to restore public confidence and to improve the public perception of MNCs' role in the community.³⁵¹ Establishing and promulgating a code of ethical conduct would curtail or possibly terminate the prevalent tendencies among MNC executives toward self-interest and an obsession with success to the detriment of the interest of society in general.³⁵² The code would be used to guide corporate personnel in their business dealings and to help lower level employees to resist pressure put on them by top management to compromise the ethical standards set up by the MNC. In this way all employees were granted the opportunity and the responsibility to save the MNC's image and to protect public confidence.³⁵³ As one writer put it:

³⁴⁹ George C. Benson, *Business Ethics in America*, (1982), at 42.

³⁵⁰ Peter A. Arlow and Thomas A. Ulrich, "Auditing Your Organization's Ethics" (August 1980), 37 *Internal Auditor*, 26-31, at 26.

³⁵¹ Jack N. Behrman, *Discourses on Ethics and Business* (1981), at 136.

³⁵² *Id.*, at 134.

³⁵³ Terry P. Brown, "Profit-Minded Chief at Bendix Tries to Set a Business Code," *Wall*

The code of conduct is a milieu in which the best sentiments of MNC employees are translated into action. It provides to society a desirable atmosphere of ethical behavior, which is usually signaled from the top to the lower level employee and creates harmonization of the interests of both society and MNCs.³⁵⁴

From the management point of view, the code of conduct is a statement of an MNC's policy for doing business; It spells out its philosophy about its basic ethical beliefs and its commitment to the society where it operates, and it also provides broad guidelines for its constituencies.³⁵⁵ A study conducted by the University of Michigan Business School revealed that most of the codes provide in some 'context' a general statement about the role of ethical issues in the company management philosophy, and the role of the code in capturing and communicating rules and guidelines on such matters.³⁵⁶ While the code is drafted in most cases by management, the approval of the board of directors or its executive committee is necessary.³⁵⁷ The objective of the code is the mutual support of management and employee in carrying out their responsibilities and assessing their compliance with legal and ethical standards.³⁵⁸

A comprehensive and explicit code of conduct includes penalties for illegal or questionable conduct

• "such as, offering a bribe, concealing knowledge of a bribe, accepting a bribe, concealing knowledge of an accepted bribe, accepting a gift of

Street Journal, November 18, 1977, at 1, col. 1.

³⁵⁴ Jack N. Behrman, *supra*, footnote 351, at 134.

³⁵⁵ Glen R. Sanderson and Eris I. Varner, "What's Wrong with Corporate Codes of Conduct?" (1984), 66 *Management Accounting*, 28-35, at 30.

³⁵⁶ Bernard J. White and B. Ruth Montgomery, "Corporate Codes of Conduct" (1980), 23 *Calif. Management Rev.*, 80-87, at 85.

³⁵⁷ George C. Benson, *supra*, footnote 349, at 43.

³⁵⁸ Jack N. Behrman, *supra*, footnote 351, at 135.

substantial value... falsification of corporate records, and illegal political contributions.³⁵⁹

The enforcement of the code is very important and can be supervised by the board of directors for compliance,³⁶⁰ for as Mr. Hodge, a former United States Secretary of Commerce, stated, "A code that does not provide for the expulsion of any member violating the code is not worth the paper it is written on."³⁶¹

So, for a code to be effective and serve as a deterrent to any tendency on the part of MNC managers, directors or employees to make illegal payments or pay bribes, it must be sufficiently comprehensive, clear and explicit to develop the necessary control of the behaviour of MNC constituencies.³⁶² Furthermore, explicitness and clarity of the code induces the discussion of ethical conduct among employees, which consequently may provide an additional input into management's standards, and, in so doing, further cement [the employees'] support of the organization".³⁶³

In addition to the advantage of sharpening the realization of management's responsibilities, establishing a code also reduces government interference in the freedom of enterprise: Self policing by MNCs generates government confidence that there is less need to restrict corporate activities beyond the normal legal and ethical standards.³⁶⁴

³⁵⁹ George C. Benson, *supra*, footnote 349, at 42.

³⁶⁰ Glen R.S. Anderson and Eris I. Varner, *supra*, footnote 355, at 31.

³⁶¹ Quoted in Jack N. Behrman, *supra*, footnote 351, at 135.

³⁶² Hurd Baruch, "From the Board room: The Audit Committee: A Guide for Directors" (May 1980), 58 *Harv. Bus. Rev.*, 174-186, at 186.

³⁶³ Peter Arlow and Thomas A. Ulrich, *supra*, footnote 350, at 31.

³⁶⁴ A clear example was the passage of the FCPA in the United States. It was a direct response to corporate misconduct. This legislation requires corporate management to devise an effective system of "internal accounting control." This requirement has inticed many MNCs to develop or expand their code of conduct. See Bernard J. White and B. Ruth Montgomery, *supra*, footnote 356, at 81.

3. Changing Attitudes Toward the Composition of MNC Boards of Directors

Ever since the Watergate scandal, there has been a tendency to more closely examine the governing boards of MNCs.³⁶⁵ This tendency includes the reassessment of the role of the board of directors in many of the United States MNCs, and an affirmation of the accountability of those in decision making positions, particularly with respect to instances of illegal conduct.³⁶⁶ This changing demand for board insight was mandated by the reaction to many instances of illegal payments, bribes, kickbacks and other illegal activities.³⁶⁷ This reaction in turn brought about the change in the traditional composition of the board of directors, which gave MNCs wide latitude to define and assess responsibility and consequences for future actions.³⁶⁸ These and other factors are a rationale for imposing outside independent directors who not only serve as watchdogs but also seek to further the public interest, however defined. Outside board members ensure effective judgment concerning management, and exhort MNCs to be more sensitive about illegal activities.³⁶⁹ While this new "monitoring model" has gained wide acceptance among commentators,³⁷⁰ some have called for yet more radical changes.³⁷¹

³⁶⁵ Daniel R. Fischel, "The Corporate Governance Movement" (1982), 35 *Vand. L. Rev.*, 1259-1292, at 1280.

³⁶⁶ Robert H. Mundheim and Noyes E. Leech, "The Outside Directors of the Publicly Held Corporation" (1976), 31 *Bus. Law.*, 1799-1836, at 1801.

³⁶⁷ Court decisions, particularly in the case of *Escott v. Bar Chris Construction Corp.*, 283 F.Supp. 643 (S.D.N.Y. 1968), emphasized the responsibility of directors to take an active role in directing the affairs of the corporation and reasserted the directors' liability for misleading financial statements. Also consider the use by the Securities and Exchange Commission of injunctive remedies requiring the installation of independent directors and audit committees as a means of settling investigations regarding illegal payments. See Stephen C. Jones, "The SEC and Court Appointed Directors: Time to Tailor the Director to Fit the Suit" (1982-83), 60 *Wash. U.L.Q.*, 507-536.

³⁶⁸ Robert H. Mundheim and Noyes E. Leech, *supra*, footnote 366, at 1801.

³⁶⁹ Daniel R. Fischel, *supra*, footnote 365, at 1285.

³⁷⁰ This concept of a monitoring model was originated by Professor M. Eisenberg. "Legal Models of Management Structure in the Modern Corporation: Officers, Directors, and Accountants" (1975) 63 *UCLA L.Rev.*, 375-439, at 398-399.

In order to assess the viability of outside directors, we shall examine how boards are composed, how outside directors are selected, how their independence is guaranteed and how they function on the board. We shall then discuss their liabilities.

³⁷¹ In the United States, some legal writers suggested a Federal Chartering Corporation, with some public direction committed to non shareholders' constituencies or at least the imposition of minimum standards for state chartering corporations. See generally M. Green and R. Nader, *Taming the Giant Corporation* (1976). Also see William L. Cary, "Federation and Corporate Law: Reflection Upon Delaware" (1973-74), 83 *Yale L.J.*, 663-705.

A. The Composition of the Board and the Selection of Outside Directors

It is not unusual practice among MNCs to appoint members of the board of directors from among those who have achieved a certain position within the organization, and have contributed to its success.³⁷² It shall be recognized that an incentive system, which establishes quantitative performance as the only standard for advancement, has encouraged many executives and high ranking employees to compromise their moral values in their eagerness to reach higher positions.³⁷³ In the case of those who attain a position on the board of directors, their board room decisions may conflict with their loyalties to fellow senior management colleagues who elected them.³⁷⁴ Having outside directors avoids such situations, and insures that board decisions are uninfluenced by corporate management decisions. This method of monitoring management activities has gained momentum in recent years, especially in the light of several highly publicized MNC scandals and the recent trend toward MNC accountability.³⁷⁵ This trend toward accountability and the revival of the board of directors as the ultimate authority in managing the corporation is dispelling the veil of prestige that formerly surrounded the traditional role of outside directors. Outside directors are now placed at an arm's length position, from which they are enjoined to protect the public and the shareholders,³⁷⁶ and to reestablish the reputation of MNCs after the expose of illegal practices ranging from inside trading to bribery to illegal political contributions.³⁷⁷

³⁷² William E. Perry, "Effective Audit Committees" (August 1977), 34 *Internal Auditor* 20, at 18.

³⁷³ Victor F. Demarco, "The Board of Directors: The Rubber Stamp is Cracking" (June 1976), 33 *Internal Auditor*, 22-28, at 23.

³⁷⁴ Robert H. Mundheim and Noyes E. Leech, *supra*, footnote 366, at 1804.

³⁷⁵ Victor M. Earle III, "Corporate Governance and the Outside Director A Modest Proposal" (1979), 36 *Wash. & Lee. L. Rev.*, 787-808, 787.

³⁷⁶ Avery S. Cohen, "The Outside Directors Selection, Responsibilities, and Contribution to the Public Corporation" (1977), 34 *Wash. & Lee. L. Rev.*, 837-858, at 842.

³⁷⁷ Larry D. Soderquist, "Toward a More Effective Corporate Board: Re examining Roles of Outside Directors" (1977), 52 *N.Y.U.L. Rev.*, 1341-1363, at 1356.

Although outside directors are usually lawyers, bankers or professionals from non-competing companies, the composition of the board sometimes faces opposition from MNC executives, because of their fear that the outside directors will intrude upon the affairs of management.³⁷⁸ Despite this resentment and the frequent rejection of the expertise that outside directors have to offer, MNCs seem more interested than ever in retaining outside professionals for their boards, especially those who have no previous connection with the corporation and no conflicting interests.³⁷⁹ These qualifications are vital, because the purpose of recruiting outside directors is to maintain a high standard of performance of management by monitoring its decisions, and to prevent and discourage any diversion from legal standards and ethical obligations.³⁸⁰ Maintaining their independence is the only way outside directors can properly carry out these responsibilities.³⁸¹ In this context, independence means the capacity to advise or monitor without subservience to management,³⁸² and also assumes the maintenance of an effective working relationship between the outside directors and MNC management.³⁸³

However, logically, accomplishing these duties requires the directors to have a fair amount of knowledge, so that they can play their role as policy makers and make important contributions to the corporation,³⁸⁴ otherwise they would simply

³⁷⁸ Robert H. Mundheim and Noyes E. Leech, *supra*, footnote 366, at 1830.

³⁷⁹ Ronald P. Klein, "The Corporate Law Department: Lawyer as an Employee" (1978-79), 34 *Bus. Law.*, 842-852, at 851.

³⁸⁰ Robert H. Mundheim and Noyes E. Leech, *supra*, footnote 366, at 1830.

³⁸¹ David S. Ruder, "Current Issues Between Corporations and Shareholders: Private Sectors' Responses to Proposals for Federal Intervention into Corporate Governance" (1981), 36 *Bus. Law.* 771-782, at 775.

³⁸² The outside director loses his independence when he has some sort of connection with an MNC or its management. For example, a non independent outside director would be someone who works as a consultant or is an MNC banker, a personal friend to CEO, or a former school mate.

³⁸³ Robert H. Munhdeim and Noyes E. Leech, *supra*, footnote 366, at 1830.

³⁸⁴ Hurd Baruch, *supra*, footnote 362, at 174.

be acting as the "rubber stamp" of management.³⁸⁵

It might be argued that the effectiveness of an outside director may be weakened by the fact that as an outsider he may not get full cooperation from MNC management, whose concerns about privacy might block the flow of information into the board.³⁸⁶ The answer to this argument is that, however plausible this may be in theory, outside directors usually maintain their own private staffs who gather the information needed to give rational analysis to the MNC's management decision.³⁸⁷ Rather than passively perform their duties by relying on oral reports or selected information given them by MNC management, they must build their own information channels and if necessary conduct their own investigations when they see any signs of impropriety.³⁸⁸ This duty to acquire dependable information through a reliable channel is compatible with the outside director's distinct role of investigating MNC misconduct and taking or suggesting corrective measures against the wrongdoers.³⁸⁹ So, the suggestions of outside directors shall be determined on the basis of personal integrity, knowledge and experience.³⁹⁰ Their obligations are the same as those of inside directors; however, they may be chargeable with a number of added obligations, some of which are fiduciary and others not.³⁹¹ Although this may seem to be beyond what has been historically required,

³⁸⁵ Victor F. DeMarco, supra, footnote 373, at 23.

³⁸⁶ Robert M. Ester, "Outside Directors, More Vulnerable than Ever" (January 1973), 51 *Harv. Bus.Rev.*, 107-114, at 108.

³⁸⁷ Robert H. Mundheim and Noyes E. Leach, supra, footnote 366, at 1805.

³⁸⁸ Victor M. Earle III, supra, footnote 375, at 791.

³⁸⁹ Leonard S. Janofskey, "Liability of Management and Directors for Illegal Conduct: Protective Action" (1975-76), 31 *Bus. Law.*, 1313-1322, at 1316.

³⁹⁰ Statement of the business roundtable about "*The Role and Composition of the Board of Directors of the Large Publicly Owned Corporation*," reprinted in (1978), 33 *Bus. Law.*, 2083-2113, at 2107.

³⁹¹ The non fiduciary duties and obligations may include "the duty to disclose conflict of interest, provide adequate supervision, be reasonably informed and avoid intentional misconduct, and the duty to act for the benefit of the company." See Victor M. Earle III, supra, footnote 375, at 792.

it is all for the protection of MNCs and their shareholders.

B. The Liability of Outside Directors

As mentioned, outside directors must acquire the necessary information to make their personal judgments about the general operation and conduct of the MNCs concerned. This knowledge must be acquired before they accept the position of directorship. They shall also take diligent steps to align themselves with MNC financial stands.³⁹² Lack of information will not excuse them from future liability. It shall be noticed that as the law has developed in this area, it has placed the outside director on an equal footing with the inside director in assuming responsibility for individual as well as collective decisions in playing his role as a board member, and in controlling the company's activities.³⁹³ This development of the law has been an outgrowth of MNC misconduct especially the concern with illegal payments and the consequences of litigation³⁹⁴ against those directors who apparently showed a lack of interest in finding out about irregular MNC activities.³⁹⁵ This increased liability is legally justified by the fact that the board of directors is elected to guide the MNC, either directly or through a committee, to the adherence to legal and moral standards,³⁹⁶ so directors, either inside or outside, must be alert and use reasonable care in directing the entity, and must

³⁹² See *Gould v. American Hawaiian Steamship Co.*, 351 F. Supp. 853 (D. Del. 1972). The case signaled a deepening responsibility. The outside directors were held liable for their negligence in failing carefully to review a merger proxy statement. In the words of the court: "When possible, the [statute] should be interpreted to afford incentives to directors to undertake active and vigorous scrutiny of Corporate activities." at 859. Also see Avery S. Cohen, *supra*, footnote 376, at 852.

³⁹³ See *Lanza v. Drexel & Co.*, 479 F.2d 1277 (2d Cir. 1973). In this case the outside director, an investment banker, narrowly escaped liability for failure to discover and to cause the correction of false and misleading representations made by his corporation in the course of negotiating the acquisition of another company. Also see Robert M. Ester, *supra*, footnote 386, at 108.

³⁹⁴ Gordon R. Corey, "Some New Comments on the Directors' Audit Committee and the Audit Function" (October, 1977), 34 *Internal Auditor*, 25-30, at 27.

³⁹⁵ Eurd Baruch, *supra*, footnote 362, at 175.

³⁹⁶ *Ibid.* Also see *supra*, footnote 364 and accompanying text.

take disciplinary action if there are any just grounds for suspicion of impropriety on the part of management or employees.³⁹⁷ Failure to carry out these responsibilities, as one writer suggests, is subject to court sanction, especially when such failure violates the law or causes injuries to the MNC's shareholders.³⁹⁸ Indeed, this new exposure to liability for the misdeeds of the MNC, without distinction between outside director and inside director, forces the board of directors to become more involved in MNC activities.³⁹⁹ For now it is not enough to dispose of their duties as the protectorate of the shareholders, but just as importantly they must shield themselves from liability.⁴⁰⁰ 4.

³⁹⁷ Gordon R. Corey, *supra*, footnote 394, at 27.

³⁹⁸ See *Escott v. Bar Chris Construction Corp.*, 283 F. Supp. 643 (S.D.N.Y. 1968). In this case, the court found that outside directors had failed to fulfill their "due diligence" responsibilities in connection with the preparation of a prospectus for a public offering of securities. Also see *SEC v. Penn Centra Co.*, [1973-74 Transfer Binder] CCH Fed. Sec. L. Rep. #94, 527 (E.D.Pa. May 2, 1974). See also Larry D. Soderquist, *supra*, footnote 377, at 1362.

³⁹⁹ Richard J. Farrell, "The Audit Committee: A Lawyer's View" (1973), 28 *Bus. Law.*, 1089-1095, at 1092.

⁴⁰⁰ William E. Perry, *supra*, footnote 372, at 11.

4. Creation of an Audit Committee to Oversee MNC Activities

The idea of establishing an audit committee was introduced by the New York Stock Exchange in the late 1930s, when it recommended that outside auditors be selected by directors of companies listed in the stock market.⁴⁰¹ The recent interest in establishing audit committees for MNCs has gained momentum since the revelation of certain questionable payments. The function was first seen as a self-serving one, since the audit committee would investigate alleged payments and other violations of the law and at the same time would keep the information confidential.⁴⁰² Although it began as a recommendation, many of the U.S. MNCs continue to endorse and create such committees, especially since the U.S. Congress passed the Foreign Corrupt Practice Act of 1971⁴⁰³ with its accounting control requirement.⁴⁰⁴ Despite the reasons that made some MNCs create audit committees, it is only a matter of time until all corporations follow suit,⁴⁰⁵ because the primary purpose of such committees is to prevent misuse of corporate funds by management.⁴⁰⁶

It is of interest here to mention that audit committees are required as a matter of law in the Province of Ontario. The 1982 Business Corporation Act of

⁴⁰¹ Johnny M. William, "The Audit Committee: Overseer of Internal Control Functions" (December 1980), 37 *Internal Auditor*, 43-51, at 43.

⁴⁰² David P. Weiner, "Do Private Universities Need Audit Committees?" (January 1981), 62 *Management Accounting J.*, 51-53, at 51.

⁴⁰³ Pub. L. No. 95-213, tit. 1, 91 Stat. 1494(1977) 7 (Codified at 15 U.S.C. Secs. 78dd 1, 78dd 2, 78ff. [Supp. I, 1977])

⁴⁰⁴ See Johnny M. William, *supra*, footnote 401, at 45. However, there is some sympathy for restricting the scope of the FCPA: "President Reagan's Administration is seeking the amendment of the FCPA, from the early days in office, to remove some of the stricter requirements and its criminal penalties." See Staff Reporter, "General Accounting Office Urges Easing of Corrupt Practices Act," *New York Times*, March 5, 1981, Sec. D, at 8, col. 5.

⁴⁰⁵ William E. Perry, *supra*, footnote 372, at 18.

⁴⁰⁶ George W. Dent, Jr. "The Revolution in Corporate Governance, The Monitoring Board, and the Director's Duty of Care" (1981), 61 *Boston U. L. Rev.*, 623-681, at 673.

Ontario,⁴⁰⁷ requires the selection of such a committee from the board, a majority of whom are to be neither officers nor employees of the company. Under the Canadian Business Corporation Act,⁴⁰⁸ only those companies listed in the Stock Market are now required to have audit committees. However, the conditions differ between the two acts.

⁴⁰⁷ Ontario Business Corporations Act, R.S.O.1982, c. 4, s. 157 (1) of the Act says: "A corporation that is an offering corporation shall... have an audit committee composed of not fewer than three directors of the corporation, a majority of whom are not officers or employees of the corporation or any of its affiliates..."

⁴⁰⁸ Canada Business Corporations Act, S.C 1975, c. 33, s. 165 (1) requires those corporations described in Sec. 97 (2) of the Act as those "issued securities of which are or were part of a distribution to the public..., to have an audit committee composed of not less than three directors of the corporation, a majority of whom shall be outside directors. But the difference is this: The Act in Sec. 165 (2) gives the directors the right to apply for "an order authorizing the corporation to dispense with an audit committee." See also Viscount Caldeconte, "The Chairman Perspective" (November 1978), 179 *The Accountant*, at 706.

A. The Composition of the MNC Audit Committee

Questions that now arise are: How is an audit committee established? And who will be allowed to serve on it? First, the audit committee should be established by a formal resolution of the board of directors of the MNC, who set down in general terms the functions and responsibilities of the proposed committee, building in the flexibility necessary for effectiveness.⁴⁰⁹ The members of the audit committee shall be independent outside directors who have no connection whatsoever with the company, and at least some should have financial backgrounds,⁴¹⁰ for the audit committee's specific task is to ensure effective and appropriate internal accounting control.⁴¹¹ It should be kept in mind that the audit committee has no relationship with the MNC's stockholders,⁴¹² and that its work must be reviewed by the full board of directors in an atmosphere balanced by prudence and good faith.⁴¹³

⁴⁰⁹ C.B. Gough, "How to Establish an Audit Committee" (November 1978), 179 *The Accountant*, at 707.

⁴¹⁰ Avery S. Cohen, *supra*, footnote 376, at 856.

⁴¹¹ Hurd Baruch, *supra*, footnote 362, at 182.

⁴¹² C.B. Gough, *supra*, footnote 409, at 706-707.

⁴¹³ Hurd Baruch, *supra*, footnote 362, at 186.

B. The Role and Functions of the MNC Audit Committee

Although the audit committee provides a mechanism by which outside directors can investigate corporate accounting and monitor MNC financial practices without management pressure,⁴¹⁴ its role in today's business world is seen as "management's conscience as to what is right or wrong in the company, providing assurance that [board] policies and objectives are being complied with."⁴¹⁵ Thus, the challenge for the MNC audit committee lies in the moral arena, where it must be vigilant in combatting illegal payment practices as wrongdoings and as violations of the public trust.

The independence of the audit committee is extremely important⁴¹⁶ in order for it to achieve the goal for which it has been established and to be effective in performing its duties. Also, it shall have the full freedom to inquire into and to investigate any operation of the MNC that seems suspicious.⁴¹⁷ Despite the important role that the audit committee plays in MNC self-government,⁴¹⁸ its primary function as "management's conscience" are:

- (a) to select an outside auditor, verify his credibility, and supervise his performance⁴¹⁹
- (b) to evaluate the objectivity and accuracy of the MNC's financial disclosures⁴²⁰

⁴¹⁴ Richard J. Farrell, *supra*, footnote 399, at 1094.

⁴¹⁵ H.L. Aikin, "Focus: The Board of Directors and the Internal Auditor" (June 1974), 44 *CPA Journal*, at 7.

⁴¹⁶ The independence of the audit committee requires that the membership be composed of those persons with no connection with the MNC. So no officers or directors of the company would sit on this committee, nor any partially independent members. See James A. Durane, "Independence and the Audit Committee" (December 1980), 37 *Internal Auditor*, 49-51, at 49.

⁴¹⁷ Johnny M. William, *supra*, footnote 401, at 45.

⁴¹⁸ Hurd Baruch, *supra*, footnote 362, at 176.

⁴¹⁹ Daniel R. Fischel, *supra*, footnote 365, at 1281.

⁴²⁰ Read L. Colegrove, "The Function and Responsibilities of the Corporate Audit Committee" (June 1976), 33 *Internal Auditor*, 16-21, at 17. See also Robert H. Mundheim and

- (c) to evaluate the cost benefit analysis of corporate political contributions, where legal, and when company policy permits such contributions⁴²¹
- (d) to propose and seek any structural change deemed necessary for the better functioning of the internal auditing department and its staff.⁴²²

However, these functions are not exhaustive, and the board of directors may ask the audit committee to perform other tasks such as investigating any alleged misconduct by the MNC in a derivative suit.

Furthermore, the audit committee serves as a liaison between the external auditor and the board of directors.⁴²³ Its relationship with the internal auditors shall be of a cooperative nature, because auditors, either internal or external, on detecting an irregularity or an inconsistency in an MNC financial statement, is expected to adhere to what is known as "generally accepted accounting principle" (GAAP). Under this code, an auditor shall not approve an MNC's financial statement when an evident bribe or illegal payment is classified as a miscellaneous expense item.⁴²⁴ The auditor's knowledge of his client's operations will inevitably lead him to discover illegal acts or at least raise suspicion of covert illegality, such as the payment by his client to a foreign agent of a commission that is beyond the usual practice.⁴²⁵

Thus, open lines of communication among auditors can be a measure of the success or failure of the audit committee. The audit committee is also the best forum for auditors to pinpoint illegal conduct and seek ways to deal with it

Noyes E. Leech, *supra*, footnote 366, at 1815.

⁴²¹ Hurd Baruch, *supra*, footnote 362, at 186.

⁴²² Louis Braiotta, Jr. "How Audit Committees Monitor Internal Auditing" (April 1982), 39 *Internal Auditor*, 27-29, at 27.

⁴²³ David P. Weiner, *supra*, footnote 402, at 51.

⁴²⁴ Kenneth I. Soloman and Hyman Muller, "Illegal Payments: Where the Auditor Stands" (1977), *The Journal of Accountancy*, 51-57, at 52.

⁴²⁵ *Id.* at 54.

without fear of pressure from the MNC management.⁴²⁶

⁴²⁶ Johnny M. William, supra, footnote 401, at 47.

5. MNC Internal Investigation and the Effects of Shareholders' Derivative Suits.

The principle goal of a derivative suit is to halt the violation of laws or ethical standards that MNCs have themselves promulgated and have asked their employees to adhere to. Such violations are unlikely to occur when MNCs diligently take efforts to establish a mechanism and framework by which to prevent or deter violations before they occur.⁴²⁷ The advantage of MNC self-investigation is to give management and the board of directors the knowledge necessary to evaluate the company policy and to determine what activities shall be terminated and what modifications in business practices should be adopted.⁴²⁸ This investigation is vital, because a great deal of misconduct and violations are carried out by low level employees who are eager to show how successful they are in promoting company business, regardless of the means used.⁴²⁹

⁴²⁷ Harvey L. Pitt, "The Foreign Corrupt Practices Act of 1977 and the Regulation of Questionable Payments" (1979), 34 *Bus. Law.*, 623-664, at 642.

⁴²⁸ Arthur F. Mathew, "Internal Corporate Investigation" (1984), 45 *Ohio St. L.J.*, 655-702, at 671.

⁴²⁹ In the United States, "the SEC payments report suggests that corporate misconduct typically occurs at a much lower level within the corporate hierarchy." See John C. Coffee, Jr., "Beyond the Shut Eyed Sentry. Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response" (1977), 63 *Va. L. Rev.*, 1099-1278, at 1105.

A. Dimensions and Consequences of MNCs' Internal Investigation

The significance and magnitude of self-investigation may be difficult for an MNC to predict at the outset. It poses complex problems for management, who must weigh undesirable side effects against the benefit that may be obtained from the investigation.⁴³⁰ The viability of the self-investigation remedy is measured by how successful the MNC is in maintaining the confidentiality of the information gathered. The main threat to confidentiality is the danger that the investigation will in fact uncover an important fact that if disclosed may be used to build a case against the corporation.⁴³¹ This fear has promoted the emerging doctrine of self-evaluative privilege, or the privilege of self-critical analysis the subject of several legal comments⁴³² which alleviates forced disclosure through limited waiver.⁴³³ In fact, in the area of illegal payments and bribery, several derivative suits have emerged as a result of MNC self-investigation, as we will see in the following pages.

B. Shareholders' Derivative Suits: Rationale and Results

In some writers' opinions the main concern of shareholders of MNCs is to succeed in their investments, and not eliminate questionable albeit effect business practices.⁴³⁴ This tendency, however, cannot be taken as the philosophy of all or even the majority of shareholders, for obviously their economic interests are

⁴³⁰ Arthur F. Mathew and Nancy C. Crisman, "Limited Waiver of Attorney Client Privilege and Work Product Doctrine: Internal Corporate 'Self Evaluation Privilege'" (1983-84), 21 *Am. Crim. L. Rev.*, 123-177, at 125.

⁴³¹ Arthur F. Mathew, *supra*, footnote 428, at 672.

⁴³² Notes: "The Privilege of Self Critical Analysis" (1983), 96 *Harv. L. Rev.*, 1083-1101. See also Clyde C. Kahrl, "The Attorney Client Privilege: The Self-Evaluative Report Privilege and Diversified Industries, Inc. v. Meredith" (1979), 40 *Ohio St. L.J.*, 699-728, at 722-725.

⁴³³ See Arthur F. Mathew and Nancy C. Crisman, *supra*, footnote 430, at 126.

⁴³⁴ J.A.C. Hetherington, "When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights" (1979-80), 8 *Hofstra L. Rev.*, 183-255, at 185.

affected by dubious MNC practices.⁴³⁵ In the United States, when several MNCs conducted internal investigations and reported the discovery of several illegal payments and secret political contributions, many shareholders' suits were filed⁴³⁶ with a view to remedying the illegal activities and management misconduct. These remedies range from requests for injunctive relief and damages to restitutions of bribes paid or money spent on illegal activities.⁴³⁷

Although MNCs may seek to advance the legal advice of counsel or duress by the host governments officials as a defense,⁴³⁸ as a general rule this is not considered

⁴³⁵ Shareholders may bring suit on the grounds that bribes and illegal payments affect and injure their respective interests, because the contracts that were obtained by the MNC "contributed a false appearance of soundness to their investment" or "the illegally obtained foreign business falsely inflated the price of the stock." See Mary Siegal, "The Implication Doctrine and the Federal Corrupt Practices Act" (1979), 79 *Colum. L. Rev.*, 1085-1117, at 1087. In the Canadian Business Corporation Act, 1975, C. 33, Sec. 231 gives the shareholder the right to bring suit so long as he is in good faith and the suit is in the best interest of the corporation [it is enough that the suit appears to be in the best interest of the corporation; it is sufficient to show an arguable case exists] (see *Bellman v. Western Approaches Ltd.* [1981], 33 B.C.L.R. 45 [C.A.]), and reasonable notice has been given to the board of directors.

⁴³⁶ See *Rosengarten v. International Tel. & Tel. Corp.*, 466 F. Supp. 817; (S.D.N.Y. 1979). See also *Re Tenneco Securities Litigation*, 449 F. Supp. 528 (S.D. Tex. 1978); *Gall v. Exxon Corp.*, 418 F. Supp. 508 (S.D.N.Y. 1976); *Auerbach v. Bennett*, 47 N.Y. 2d 619, 393, N.E. 2d 994, 419 N.Y.S. 2d 920 (1979).

⁴³⁷ See *Goldex Mines Ltd. v. Revill*, [1975], 70 O.R. (2d) 216, 221 (C.A.), in which the Ontario Court of Appeal dealt with the distinction between personal action and derivative action. It is stated that

...Where a legal wrong is done to shareholders by directors or other shareholders, the injured shareholders suffer a personal wrong, and may seek redress for it in a personal action. That personal action may be by one shareholder alone, or (as will usually be the case) by a class action in which he sues on behalf of himself and all other shareholders in the same interest (usually, all other shareholders save the wrongdoers). Such a class action is nevertheless a personal action.

A derivative action, on the other hand, is one in which the wrong is done to the company. It is always a class action, brought in representative form, thereby binding all the shareholders..[at 221]

The shareholder's suit is a derivative one. It is "an action brought by a shareholder on behalf of his corporation against third parties or against officers or directors of the corporation." See David S. Ruder, "Protection for Corporate Shareholders: Are Major Revisions Needed?" (1983), 37 *U. Miami L. Rev.*, 243-272, at 261. The "action is a derivative action when the suit is based upon a primary right of the corporation, but is asserted on its behalf by the stockholders because of the corporation's failure, deliberate or otherwise, to act upon the primary right." See H.C. Black, *Black's Law Dictionary* (5th ed. 1979), at 399.

⁴³⁸ Theories that may be advanced by MNCs to defend their actions against shareholders'

valid where illegal payments are concerned, because MNCs are forbidden by law to ignore the overriding consideration of the society in which they operate by conducting unethical activities.⁴³⁹

Traditionally, common law courts have applied the business judgment rule to relieve MNCs of liability of certain questionable conduct in the absence of fraud, conflict of interest or gross negligence.⁴⁴⁰ To challenge the rule, legal commentators have suggested that several arguments could be invoked by shareholders to effectuate their suits and to encourage the courts not to endorse an MNC's board of directors' decision to dismiss a suit. Assuming the shareholders see no chance of challenging the board's independence, the other arguments are:

- (a) The failure of directors to discover illegal payments and MNC misconduct is considered to be a breach of their fiduciary duties, even if they had no knowledge of the irregularities.⁴⁴¹
- (b) For uninvolved directors to decide not to sue the involved directors "constitutes a continuing wrong against the corporation."⁴⁴²

However, these theories have been challenged and the courts have held otherwise.⁴⁴³ as we will see.

suits, and vice versa, are discussed thoroughly by John C. Coffee, Jr., supra footnote 429, at 1161-1241.

⁴³⁹ In the writer's view, MNCs cannot invoke the civil law doctrine of "desuetude," which means the unenforced statute may be considered abrogated. This is because violation of the law is so widespread, either due to lack of knowledge of the law or because of administrative decisions, that few instances of its breach exist and few are prosecuted for economical reasons. See Arthur E. Bonfield, "The Abrogation of Penal Statute by Non-Enforcement" (1964), 49 *Iowa L.Rev.*, 389-440. This is why, in the writer's view, laws are often broken and bribes are accepted despite bans imposed by the country. See *Staff Reporter*, "Breaking the Rules? SEC Says U.S. Firms Paid Commissions in Algeria Despite Payment Ban There," *Wall Street Journal*, January 16, 1980, at 38, col. 1.

⁴⁴⁰ Douglas W. Hawes and Thomas J. Sherrard, "Reliance on Advice of Counsel as a Defence in Corporate and Securities Law" (1976), 62 *Va. L. Rev.*, 148, at 41.

⁴⁴¹ John C. Coffee, Jr., supra footnote 429, at 1188.

⁴⁴² Id., at 1227.

⁴⁴³ The wrong doing theory cannot be asserted against those who never participated or sat on the board at the time the illegal payment was made, unless the lack of independence of

(i) **Derivative Suit Requirements**

In almost every common law jurisdiction, share holders intending to bring suit on behalf of the corporation against the board of directors or management to correct wrong doing must first make a formal demand requesting that the board of directors institute a derivative action on behalf of the shareholders for the benefit of the corporation.⁴⁴⁴ In *Cramer v. General Telephone & Electronics Corp.*⁴⁴⁵ a shareholder brought a derivative suit against General Telephone & Electronics Corporation (GTE). This suit was the result of an internal corporate investigation that GTE conducted in the aftermath of the Watergate scandal. The investigation revealed that GTE had made bribes totalling millions of dollars, and illegal payments in a number of countries. The shareholder contended that certain directors of GTE had participated in making illegal payments and had failed to disclose them in the annual report, and that by doing so they had breached their fiduciary duties and wasted corporate assets.⁴⁴⁶ The district court dismissed the claim in part and granted the defendant summary judgement.⁴⁴⁷ When the plaintiff

those directors is established by the plaintiffs or shareholders. See Janet Johnson, "The Business Judgement Rule: A Review of Its Application to the Problem of Illegal Payments" (1981) *J. Corp. Law*, 481-510, at 490.

⁴⁴⁴ H. Henn, *Handbook of the Law of Corporations and Other Business Enterprises*, Sec. 364, at 771-772. (2d. ed. 1970) See also Sec. 232 of the Canada Business Corporation Act as amended in 1975. It gives shareholders the right to bring a suit (Sec. 232 [1]), provided that "the complainant has given reasonable notice to the directors of the corporation or its subsidiary of his intention" (Sec. 232 [2][a]). The Ontario Business Corporation Act is more specific when it requires in Sec. 245 (2)(a) that a certain amount of time must have lapsed, and the court will not hear the shareholder's suit until it is satisfied that (a) "the directors of the corporation or its subsidiary will not bring, diligently prosecute or defend or discontinue the action." Besides, the shareholder must be in good faith and his action must be in the interest of the corporation. Also see *Abraham v. Prosaccer Ltd.*, [1979], 105 D.L.R. (3d) 341, at 343, 26 O.R. (2d) 769, at 771. See also M.A. Maloney, "Wither the Statutory Derivative Actions?" (1986), 64 *Can. Bar. Rev.*, 309-341, at 319. Also see generally B.G. Hanson, "Corporation Law" (1978), 10 *Ottawa L. Rev.*, 617-740, at 674-686.

⁴⁴⁵ *Cramer v. General Telephone & Electronics Corp.*, 443 F. Supp. 516 (E.D.P.A. 1977).

⁴⁴⁶ *Id.* at 518.

⁴⁴⁷ *Id.* at 526.

appealed the case, the United States Court of Appeals for the Third Circuit⁴⁴⁸ affirmed the lower court decision on the ground that the plaintiff failed to make a demand upon GTE directors to institute the litigation.⁴⁴⁹ The Court of Appeals stated that:

...in the instant case, however, Cramer's complaint does not adequately explain why he failed to make a demand upon the directors...⁴⁵⁰

Although the plaintiff argued that making a demand was futile because the special litigation committee opposing this suit was dominated by the defendants,⁴⁵¹ namely the board of directors involved in illegal payment, the court rejected this argument, stating that:

We cannot agree with Cramer that the four directors named as defendants in the instant case dominated the Board to such an extent that the plaintiff should be excused from the mandatory requirement of Rule 23.1 that he first make a demand on the directors...⁴⁵²

The objective behind this procedural restriction is to give the board of directors an opportunity to exercise their power⁴⁵³ and to curtail the abuse of the derivative suit.⁴⁵⁴ Nonetheless, these procedural requirements may hinder the shareholder's

⁴⁴⁸ *Cramer v. General Telephone & Electronics Corp.*, 582 F. 2d 259 (3d. Cir. 1978).

⁴⁴⁹ *Id.*, at 265.

⁴⁵⁰ *Id.*, at 276.

⁴⁵¹ *Ibid.*

⁴⁵² *Id.*, at 277.

⁴⁵³ See also Canada Business Corporations Act, S.C. 1974-76, c.33 as am., S.232(2). See also Daniel R. Fischel, "The Demand and Standing Requirements in Shareholders' Derivative Action" (1976), 44 *U. Chi. L. Rev.*, 168-204, at 171. See also Michael St. Patrick Baxter "The Derivative Action Under the Ontario Business Corporation Act: A Review of Section 97," (1982), 27 *McGill L. Rev.*, 453-478, at 466.

⁴⁵⁴ For a Canadian view of the shareholders' derivative suit, see Michael St. Patrick Baxter, *Id.*, at 457. Also see Bruce Welling, *Corporate Law in Canada*, (1984), at 517. The abuse of a derivative suit can come in the form of a striking suit by shareholders brought purely as an attempt to obtain settlements for personal gain. See Dykstro, "The Revival of the Derivative Suit" (1967), 116 *U. Pa. L. Rev.*, 74-82, at 77.

suit when directors take the position not to sue. Derivative suit is definitely one way of deterring management from making bribes or illegal payments,⁴⁵⁵ and of remedying the abuse of power bestowed on corporate directors, because

...the protection of a corporation from fiduciaries' abuse and the efficiency of the markets depends on information as to how the corporation is managed. A derivative suit is one of the means for conducting a thorough investigation of corporate management. Furthermore, even though shareholders may sell their shares when dissatisfied with managements' performance, the sale does not make corporate fiduciaries accountable, except through takeovers.⁴⁵⁶

The demand requirement may be excused if share holders can prove that making a demand on the MNC board of directors to sue on behalf of the corporation would be futile⁴⁵⁷ because of conflict of interest⁴⁵⁸ or the board's lack of independence.⁴⁵⁹ One writer suggests that shareholders name all current directors

⁴⁵⁵ Daniel R. Fischel, *supra*, footnote 365, at 1290.

⁴⁵⁶ See T. Frankel and W.M. Barsky, "The Power Struggle Between Shareholders and Directors: The Demand Requirement in Derivative Suits" (1983), 12 *Hofstra L.Rev.*, 39-75, at 55. *

⁴⁵⁷ Several grounds may be advanced and asserted to show the futility of making a demand on directors to bring a suit on behalf of a corporation. Those grounds are control, conflict of interest or directors' participation in the transaction attacked, and director opposition to the suit. See Daniel R. Fischel, *supra*, footnote 453, at 173-180.

⁴⁵⁸ Common law courts are reluctant to relieve the shareholder of the demand requirement; however, it is within the sound discretion of the judge to determine the need for a demand. See *Re Daon Dev. Corp.* (1984). 54 B.C.L.R. 235 (S.C.) The futility of a request to directors to bring action does not relieve the obligation to make such a request. Also see *Nancy Abbe v. Stanley B. Goss* 411 F. Supp. 923 (S.D.N.Y.1975), where the plaintiff shareholder admitted that she had not made a demand because it would have been futile, as the defendant controlled the corporation's decision making. The court agreed with the plaintiff after investigating the evidence, saying: Applying "sound discretion" to the facts of this case, it would appear that the individual defendant's control of Tenna [the company's name] was sufficient to excuse a Rule 23.1 demand...[At 925] However, this variance among courts in formulating a test to determine whether a demand is excused or not is due to the fact that demand is a procedural issue, not a substantial one.

⁴⁵⁹ Kon Sik Kim, "The Demand on Directors' Requirements and the Business Judgement Rule in the Shareholder Derivative Suit: An Alternative Framework"(1981), 6 *J. Corp. Law*, 511-529, at 513.

or defendants in order to prevent MNCs from forming a special litigation committee from among those directors not being sued or not involved in illegal payments;⁴⁶⁰ however, courts shall not accept such a manoeuvre without questioning either the good faith of the committee's members in terminating the suit in the best interests of the corporation or the independence of the committee's members.⁴⁶¹

Certainly, MNCs would retain control over the progress of the shareholder suit by invoking the business judgement rule,⁴⁶² and in almost all illegal payment cases that were brought by shareholders and investigated by special litigation committees, the decisions were not to sue or terminate the suit as it was not in the best interests of the corporation from the committee's point of view.⁴⁶³ Yet, courts have supported the decision by granting summary judgment without even trying the issue, as long as the committee's decision to terminate the suit was taken in good faith,⁴⁶⁴ and the committee had been delegated the authority to terminate the suit by the board of directors.⁴⁶⁵

⁴⁶⁰ Janet Johnson, supra, footnote 443, at 488-489.

⁴⁶¹ Leonard S. Janofsky, supra, footnote 389, at 1319.

⁴⁶² See Kon Sik Kim, supra, footnote 459, at 511.

⁴⁶³ *Abbey v. Control Data Corporation*, 603 F. 2d 724 (8th cir. 1979), Cert. denied, 444 U.S. 1017(1980); *Gall v. Exxon Corp.*, 418 F. Supp. 508 (S.D.N.Y.1976); *Auerbach v. Bennett*, 47 N.Y. 2d 619, 393 N.E. 2d 994, 419 N.Y.S. 2d 920 (1979); *Miller v. American Tel. & Tel. Co.*, 507 F. 2d 759, 762 (3d Cir. 1974).

⁴⁶⁴ Richard W. Hunt, "Abbey's Modification of Zapata: A Further Restriction on the Power of Special Litigation Committees: *Abbey v. Computer & Communication Technology Corp.* " (1984), 9 *Del. J. Corp. Law*, 105-124, at 106-107.

⁴⁶⁵ Kon Sik Kim, supra, footnote 459, at 511.

(ii) **The Business Judgment Rule and the Success of Derivative Suits in the Area of Illegal Payments**

Traditionally, the business judgment rule has been invoked by corporate directors to block shareholders' derivative suits at the outset and use it "as a defence of the merits"⁴⁶⁶ of the case provided that corporate directors have exercised due diligence and were in good faith when taking the decision that triggered the suit.⁴⁶⁷ The rule protects MNC directors from any liability that may ensue from decisions they make in directing the corporation and exercising their business judgment.⁴⁶⁸ It places the "primary control over litigation on behalf of a corporation in the hands of the board [of directors], rather than in the hands of the shareholders,"⁴⁶⁹ provided the members of the board are independent, capable of making impartial decisions, and acting in the best interests of the corporation. The independence requirement emphasizes the need for MNCs to have outside directors who may well be perceived to be more independent of management, and thus more able to discharge their duties and to manifest disinterest when ruling on the basis of a business judgment rule of any derivative suit.

In illegal payment cases, the use of the business judgment rule as a defence has created an obstacle to the success of shareholders' suits sought to recover the amount of bribes paid or restitution for civil and criminal penalties levied upon the MNCs as a result of the disclosure of these payments by the administrative author-

⁴⁶⁶ M.M. Brown and W.J. Phillips, "The Business Judgement Rule: *Burks v. Lasker*, and Other Recent Developments" (1981), 6 *J. Corp. Law*, 453-480, at 462. Also see *Prudential Assurance Co. Ltd. v. Newman Industries Ltd.*, (No. 2), [1982] 2 W.L.R.31 (C.A.), and, see also *Burows v. Becker*, [1969] S.C.R. 162, 173-174, 70 D.L.R.(2d) 433, 440-442.

⁴⁶⁷ Samuel Arshat, "The Business Judgement Rule Revisited" (1979-80), 8 *Hofstra L. Rev.*, 93-134, at 127.

⁴⁶⁸ J.C. Coffee and D.E. Schwartz, "The Survival of the Derivative Suit: An Evaluation and a Proposal for Legislative Reform" (1981), 81 *Colum. L. Rev.*, 261-336, at 281.

⁴⁶⁹ Meredith M. Brown and W.J. Phillips, *supra*, footnote 466, at 469.

ity.⁴⁷⁰ For example, in the case of *Auerbach v. Bennett*⁴⁷¹ the plaintiff shareholders of General Telephone & Electronics Corporation (GTE) brought suit against GTE following an internal investigation by the corporation that revealed that GTE had made illegal payments and bribes to officials in the United States and abroad.⁴⁷² The suit sought the recovery of these payments on behalf of GTE. The company board appointed a special litigation committee to deal with the suit, consisting of those directors who had not been members of the board at the time the payments were made.⁴⁷³ The committee was authorized by the board to determine what position GTE should take with respect to the suit. It retained special counsel and reviewed the company's audit committee. It determined which directors were involved and interviewed them.⁴⁷⁴ The special litigation committee came to the conclusion that it would not be in the best interests of GTE to prosecute the action or to pursue the litigation.⁴⁷⁵ The trial court dismissed the action on the grounds that the business judgement rule foreclosed any action against the defendant for making the illegal payments, because the rule forbade the court to question the soundness of the committee's decision so long as it was in good faith and acting independently.⁴⁷⁶ The New York Appellate Court⁴⁷⁷ affirmed the district court decision, holding that:

... a derivative action may be dismissed if an independent committee of the board concludes, after sufficient investigation, that the suit should not proceed.⁴⁷⁸

⁴⁷⁰ Janet Johnson, supra, footnote 443, at 482.

⁴⁷¹ *Auerbach v. Bennett*, 408 N.Y. 2d 83, (1978).

⁴⁷² Id., at 84.

⁴⁷³ Id., at 85.

⁴⁷⁴ Id., at 84.

⁴⁷⁵ Ibid.

⁴⁷⁶ Id., at 87.

⁴⁷⁷ *Auerbach v. Bennett*, 47 N.Y. 2d 619 (1979).

⁴⁷⁸ Id., at 637.

The court further stated that:

... the substantive aspects of a decision to terminate a shareholder's derivative action against defendant corporate directors ... are beyond judicial inquiry under the business judgement doctrine...⁴⁷⁹

Also the court felt that no serious question had been raised about the independence of the special litigation committee or the adequacy of the procedures used in arriving at its determination.⁴⁸⁰

This position of a state court is also the same as that of the United States federal courts. The case of *Abbey v. Control Data Corporation*⁴⁸¹ is a prime example. In this case, when the Security and Exchange Commission levied an amount of criminal and civil penalties on the company for making bribes and illegal payments to foreign officials, a shareholder of the corporation brought action against the directors to repay the amount of \$1,381,000 to the corporation. The allegation rested on the violation of certain sections of the United States Federal Securities Law and also on breaches of common law fiduciary duties,⁴⁸² which allow shareholders to seek remedies on the grounds of mismanagement and wasting of corporate assets. The corporation formed a special litigation committee to investigate the issue and to determine the fate of the shareholder's suit. The committee recommended the dismissal of the suit on the grounds that pursuing the suit was not in the best interests of the corporation. The district court then granted summary judgment on the basis of the business judgment rule.⁴⁸³ Consequently

⁴⁷⁹ *Id.*, at 623.

⁴⁸⁰ *Id.*, at 633-635.

⁴⁸¹ *Abbey v. Control Data Corp.*, 603 F. 2d 724(8th Cir. 1979), Cert. denied, 444. U.S. 1017 (1980).

⁴⁸² *Id.*, at 726.

⁴⁸³ *Abbey v. Control Data Corp.*, 460 F. Supp.1242, (D. Minn. 1978). The court emphasised that:

The business judgement rule applies to any reasonable, good faith determination by an independent board that the derivative action is not in the best interest of the corpora-

the plaintiff appealed the lower court ruling and the United States Court of Appeal for the Eighth Circuit subsequently affirmed that:

illegal payment cases clearly involve state law questions of breach of fiduciary duties...⁴⁸⁴

So the plaintiff shareholder who rests his claim on the breach of federal law places himself in a very weak position:

Several courts have refused to find remedy under Sec. 14(a) for secret illegal payments...⁴⁸⁵

This failure to find remedy is usually due to the lack of "transactional causation,"⁴⁸⁶ which means that... the harm to the plaintiff shareholder must have resulted from a corporate transaction which was authorized as a result of a false or misleading proxy-solicitation.⁴⁸⁷ Consequently, for a claim to have good standing, the

...injury to CDC shareholders from the corporation's illegal payment [must] stem directly from the corporate waste and mismanagement involved in authorizing those payments...⁴⁸⁸

This is a matter of a state law, since the governing of internal corporate affairs is left to the discretion of the directors, in the absence of instruction or vote of the shareholders. The appointment and delegation of decision making authority to the

tion. [At 1245]

The court went on to say that

...the independence and good faith of the Special Litigation Committee are not a tissue; plaintiff concedes that the Committee reached its decision in good faith and independent of any pressures and influence from the defendant directors..." [At 1246]

⁴⁸⁴ *Abbey v. Control Data Corp.*, 603 F. 2d 724(8th Cir. 1979), cert. denied, 444 U.S. 1017 (1980)at 731.

⁴⁸⁵ Id., at 732.

⁴⁸⁶ Ibid

⁴⁸⁷ Ibid

⁴⁸⁸ Ibid

special litigation committee was clearly consistent with the long standing common law rule,⁴⁸⁹ except when the plaintiff had charged bad faith or fraud on the part of the outside directors involved with the committee and had made a decision to dismiss the suit because

such a determination [not to pursue suit], like any other business judgement, must be made by the corporate directors in the exercise of their sound business judgement... The conclusive effect of such judgement cannot be affected by the allegedly illegal nature of the initial action which purportedly gives rise to the cause of action...⁴⁹⁰

Legal writers have criticized the Abbey decision on the grounds that neither courts made any attempt to inquire into the precise nature of the illegal payments made by CDC that resulted in the corporation's plea of guilty to the criminal charge. The courts simply accepted the special litigation committee's report, which merely stated that the payments were a customary business practice and were intended to serve the corporation's business interests, without any support for their conclusion.⁴⁹¹ Moreover, this decision by the courts undermined the purpose of the shareholder's derivative suit to monitor director and management activities. Also, the rationale that the payments made were customary practice for furthering MNC business is illusive justification of all types of illegal payments. One writer suggests that in order for the court to prevent the abuse of the business judgment rule, it should subject the special litigation committee's findings to thorough "scrutiny," and "the reason given for a decision not to sue"⁴⁹² should be more convincing and reasonably justified before the courts permit a committee to terminate a

⁴⁸⁹ Id., at 28.

⁴⁹⁰ Id., at 730.

⁴⁹¹ See Janet Johnson, supra, footnote 443. See also Richard W. Hunt, supra, footnote 464.

⁴⁹² John C. Coffee, supra, footnote 429, at 1237.

suit on behalf of an MNC.

(iii) Judicial Review of Board Decisions to Terminate Derivative Suits

The cases we have discussed demonstrate that in the context of illegal payments, common law court, especially in the United States, will not intrude and review the board's or the special litigation committee's decision to dismiss the suit even if "the underlying cause of action appears meritorious"⁴⁹³ so long as the decision to dismiss the suit "is founded upon reasonable care and ... not tainted by self-interest."⁴⁹⁴ However, many legal writers in recent years have questioned the endorsement of a business judgement of the board or special litigation committee by the court on these grounds as not sufficient to terminate the shareholder's derivative suit.⁴⁹⁵ They consider such an endorsement "a technique for judicial abdication."⁴⁹⁶ Indeed, to give the board the power to terminate a derivative action without any monitoring device for the abuse of the rule such as a judicial review, as the court in the United States did creates a dilemma and brings into question the benefit of the suit and the business judgment rule. What we mean by judicial review here is giving the court the final word in terminating the decision, and that does not mean that the court would replace the board in making decisions, but would "activate"⁴⁹⁷ the decision. That is what the revised Canadian Business Corporation Act of 1975 has in fact done.⁴⁹⁸ It resolved the problem that

⁴⁹³ *Id.*, at 1221.

⁴⁹⁴ Meredith M. Brown and W.J. Phillips, *supra*, footnote 466, at 455.

⁴⁹⁵ David S. Ruder, "Protection for Corporate Shareholders: Are Major Revisions Needed?" (1982-83), 37 *U. Miami L. Rev.*, 243-272, at 261.

⁴⁹⁶ Janet Johnson, *supra*, footnote 443, at 497.

⁴⁹⁷ J.C. Coffee and D.E. Schwartz, *supra*, footnote 468, at 325.

⁴⁹⁸ The Canada Business Corporations Act, S.C.1975, c.33, s.232(2) creates as a precondition to the prosecution of a derivative action the requirement that:

... the court is satisfied that ... (c) it appears to be in the best interest of the corporation or its subsidiary that the action be brought, prosecuted, defended or discontinued.

The shareholders under the Act must apply to the court first in accordance with Sec. 232(2). Also, the discontinuation of the suit is reviewed by the court, not by board of directors or a special litigation committee as we have seen in the cases brought in American courts.

the board may maintain special litigation committees that meet the minimum judicial criteria but are still dominated by the board. Such judicial insight also fosters board and committee independence in taking their decision, as they will realize that there will be a court review of the decision.

6. Appraisal and Conclusion

These steps being taken by MNCs as intra-corporate remedies for illegal payments appear to have some effect in cases where they are being taken seriously and being applied competently. The first benefit would be the prevention of government interference in corporate activities, as long as the MNCs are making an honest and genuine effort to maintain and uphold legal and ethical standards. Failure to do so would invite severe government action, either in the country where the MNC is incorporated or in the country where it is doing business. This was the case when the United States enacted the Foreign Corrupt Practices Act⁴⁹⁹ as a means of curtailing illegal payments. Finally, in the case of shareholders' suits, the effectiveness of such steps to halt illegal payments can be more positive if the legislation goes a step further, as the Canadian Business Corporation Act⁵⁰⁰ has done, by giving the court some control over special litigation committees' abuse of the business judgment rule by terminating the suit before even adjudicating its merit. Justice would be better served if board and committee decisions were further subjugated to the final decision of the court.

⁴⁹⁹ See U.S. Foreign Corrupt Practices Act, pub. Law. no. 95-213, tit. 1, 91 Stat. 1494 (1977) (codified at 15 U.S.C. Secs. 78 dd-1, 78 dd-2, 78 ff [Supp. I, 1977]).

⁵⁰⁰ See Canada Business Corporations Act, S.C. 1975, C. 33, sec. 232(2).

PART THREE: LEGISLATIVE CONTROL AND THE PROBLEM OF
ENFORCEMENT AND EXTRATERRITORIALITY

CHAPTER 5.0

LEGAL SANCTIONS OF MNCs' ILLEGAL PAYMENTS

1. General Remarks

Needless to say, bribery and illegal payments in international business are linked, to a considerable degree, to local practices. However, as a general rule, corruption flourishes when dishonest officials are enticed by wealthy, greedy MNCs eager to accomplish their goal of higher profits to the detriment of the general public welfare. Nonetheless, when the issue of illegal payments and bribery surfaced in the mid'70s, and precisely after the Watergate scandal, many MNCs, particularly the U.S. -based corporations, felt the resentment of their practices, domestically and internationally. Consequently, several of them took steps to remedy and counteract their negative image. Those steps, as we have discussed,⁵⁰¹ took the form of various internal measures to curb and eliminate any further corrupt practices,⁵⁰² and to let competitiveness be the determining factor of success, and thus to regain the trust of the general public.

Yet, when the MNCs' steps fall short of achieving these goals, there is no doubt that the responsibility lies with the home country, whether for policy reasons or for the purpose of preserving the free market economy, to take measures to enact appropriate rules of criminal law by which to discourage its MNCs and

⁵⁰¹ See supra, Chapter 4.0.

⁵⁰² Many MNC boards of directors allege that they have no knowledge of bribery or questionable payments and that such activities are the result of decisions made by the corporation's management. See supra, footnote 429 and accompanying text.

business persons from abusing the system and using bribery or illegal payments in their dealings overseas. At the same time such sanctions serve as a message to foreign officials that their practice of corruption is no longer immune from disclosure, and that it will have a negative effect on their continuity in public office.⁵⁰³ Admittedly, the success and efficiency of legal sanctions on bribery and questionable payments depends on the cooperative efforts of the host⁵⁰⁴ countries where MNCs are conducting business. Furthermore, effectiveness is heightened if the effort to squelch corrupt practices in international business takes the form of multilateral action. This promotes the issue of fighting bribery and questionable payments to the international level,⁵⁰⁵ and gives it momentum to overcome the complexity associated with the application of national law that is designed to curtail activities outside the national border.⁵⁰⁶

Inter-governmental cooperation is also important for mutual judicial assistance,⁵⁰⁷ extradition, and settlement of any dispute that may arise as a result of

⁵⁰³ In most cases of scandalous activities revealed by the SEC or as a result of voluntary disclosure by MNCs themselves, illegal payments or bribery were made in countries with close ties with the United States. Examples are the Lockheed payment to the Japanese prime minister, and payments in the Netherlands, Italy and several Middle-East countries. See supra, footnotes 197, 198, 199 and accompanying text.

⁵⁰⁴ The term "host country" means a country in which an entity other than the parent entity is located.

⁵⁰⁵ We will discuss international efforts to prevent such illegal activities by MNCs infra, Chapter 7.0.

⁵⁰⁶ The issue of extraterritorial application of national law arises, and jurisdiction may be asserted on the principle that a country has personal jurisdiction over its citizens (an MNC is considered a citizen of the country where it is incorporated) and can charge them with a violation of national law. Therefore, when the jurisdictional question arises from the application of the national law that is designed to regulate overseas activities, several tests have been advanced, such as the subject matter test, when the act of a national corporation (or of a citizen) in a foreign nation normally is subject to the law of the country where the act takes place. However, another theory advances the notion that when a transaction is concluded outside the country but has a substantial and foreseeable effect on the country's commerce regardless of where the transaction takes place the country can apply its law to mitigate the negative effect on its commerce. See infra, Chapter 6.0 for more discussion of these theories and the defences challenging such notions.

⁵⁰⁷ Gerhard W. Mueller, "International Judicial Assistance In Criminal Matters" (1962), 7 *Vill. L.Rev.*, 193-231.

prosecution and indictment.⁵⁰⁸

Concurrently, cooperation is needed, either bilateral or multilateral, on several issues that arise as a result of the application of local law, such as jurisdictional issues and disclosure of information about bribery or questionable payments, sensitive political contributions, gifts, loans to public officials, fees and excessive commissions. Almost every country in the world has laws prohibiting its public officials from being a party to bribery or any equivalent act,⁵⁰⁹ but because of the distinctive character of bribery in international business, one country, namely the United States, which is the home country⁵¹⁰ of most MNCs, has gone farther to enact laws that prohibit its MNCs from giving bribes to gain access to foreign countries for the purpose of conducting business.⁵¹¹ Attendant upon these laws are many difficulties associated with their application, such as the extraterritorial reach of the act and the embarrassment that would surface when the disclosed information reveals that the beneficiary is a high ranking foreign official or leader of a country having close ties with the United States.⁵¹²

Simultaneously, the United States is supporting international efforts⁵¹³ to solve the problem of MNC illegal payments in the hope of overcoming the

⁵⁰⁸ Michael Bogdan, "International Trade and the New Swedish Provisions on Corruption" (1979), 27 *Am. J. Comp. L.*, 665-677, at 668.

⁵⁰⁹ See for example the Penal Code of Japan, ch. XXV, Crimes of Officials Corruption, art. 193-198, reprinted in Kugel and Cohen, *Government Regulations of Business Ethics*, Book II, sec. 3.8 (1978), also the Indian Penal Code, 1860, no. 45, secs. 161-165A, also see Saudi Regulations for the Prevention of Bribery which was enacted by the Royal Decree no. 15/M on 7, 3, 1383.A.H (Aug. 9, 1962) for full text, see app. I

⁵¹⁰ The term "home country" means the country in which the parent entity is located.

⁵¹¹ See the Foreign Corrupt Practices Act, Pub. Law. no. 95-213, tit. 1, 91 Stat. 1494(1977) (Codified at 15 U.S.C. Secs. 78 dd-1, 78 dd-2, 78 ff [supp. I, 1977]). For the complete text see Appendix II *infra*.

⁵¹² See Jerry Landauer, *supra*, footnote 30 and accompanying text.

⁵¹³ See staff reporter, "Senate Vote Urges Code Barring Bribes by Multinationals," *Wall Street Journal*, November 13, 1975, at 12, col. 3. The U.S. Senate, by a vote of 930, called on U.S. diplomats to negotiate an "international code of conduct" aimed at stopping bribes and kickbacks in business transactions by global corporations.

difficulty associated with the application of the Foreign Corrupt Practices Act(FCPA). The United States is also trying to deter Japan, certain countries in Western Europe, and other nations that have a competitive edge with the United States MNCs and do not have laws against illegal payments and bribery in international business when paid abroad.

In the following pages, we will examine legal sanctions on bribery and illegal payments under Saudi Arabian law with its dual legal system, and under United States law.

2. Legal Sanction Under the Saudi Arabian Legal System

A. Shari'a as Basis for the Legal System

The Shari'a or Islamic law has been applied in the Arabian Peninsula since the time of the Prophet. Its sources are: First; the Quran, which lays down the basic principles, Second; the Prophet's tradition, sunnah, which refers to the pathway, practice, mores, manner of acting and conduct of the Prophet, peace be upon him, in his life. It is supplementary to the Quranic principle in that the Prophet's conduct illustrates the general principles laid down in the Quran. For instance, the Quran commands five prayers (salah) every day as one pillar of Islam, but does not lay down their details.⁵¹⁴ It is the Prophet's practice of salah, and his explanation of its details and forms to his companions that give the follower of Islam full knowledge of it. Furthermore, sunnah also includes as a source of law the Prophet's model of behaviour and the normative practices of his life, which is known as Hadith or tradition. Even though theologians may differentiate between Hadith as the narration of the Prophet's practices and behaviour, and sunnah as the law deduced from this narration, the terms are generally interchangeable. Third; the scholarly works of several jurists through different schools of jurisprudence. The first school was known at its initiation as the Kufah school, in Iraq. It was founded by Imam Abu Hanifah and lasted from 80 A.H. to 150 A.H.,⁵¹⁵ some time after the Imam's death. This school of thought is the most liberal one, because it advocates the doctrine of analogy or qiyas as a source of law in cases where neither the Quran nor the sunnah provides an answer. This school of thought is, in the writer's opinion the most adaptable school for today's

⁵¹⁴ See The Glorious Quran, Surah LXX verses 23 and 34; Surah LXXIV verse 43; Surah CVII verse 5; and Surah CVIII verse 2.

⁵¹⁵ See Asaf A.A. Fyzee, *Outlines of Muhammadan Law*, (3d. ed. 1964), at 32.

civilization.

The second school is the Madinah school, which was established by Immam Malik Ibin Annas in the City of Madinah in the northwestern Arabian Peninsula in 97A.H., and continued to 179 A.H.⁵¹⁶ This school of thought relies heavily on the use of the hadith and the ijma (consensus) and practices of the Prophet's companions in Madinah rather than on qiyas, or analogy, as the Hanafi school has done. Immam Malik is the founder of the doctrine of ijma as a principle of Islamic law. This doctrine, later broadened to include the consensus, not only of Madinah jurists, but also of other leading jurists and scholarly opinions, and came to be known as ijihad, or exerting oneself to form an opinion on a decision that must be made. This broad interpretation of this principle avoided ignoring jurists in other parts of the Islamic world who were just as capable of arriving at an ijma as the Madinah jurists.

The third school is the Shafii school, founded by Immam Al-Shafii,⁵¹⁷ a student of Immam Malik. Immam Al-Shafii was the most systematic legal theorist. He perfected the doctrine of consensus and modified it to comprise the best work of Islamic scholars. He narrowed the use of sunnah to the authentic Prophet's tradition of Hadith, in order to avoid anything based on local practices. He also narrowed the use of the doctrine of analogy (qiyas) to those questions that had no answer in the primary sources of Islam, the Quran and the sunnah. The consensus provided that the use of the doctrine of analogy must conform to the general spirit of Islam and not supercede the primary sources.

The last school is the Hanbali school, founded by Immam Ahmed Ibin Hanbal, and flourishing between 164A.H. and 241 A.H.⁵¹⁸ The founder was a student

⁵¹⁶ Id. at 33.

⁵¹⁷ Ibid.

⁵¹⁸ Id. at 34.

of Immam Al-Shafi. He was a traditionalist who closely adhered to the literal interpretation of Hadith. He opposed reasoning and rejected all forms of qiyas (analogy) and of ijtiḥad (independent judgment), which is considered by other schools as a source of Islamic law. This doctrine of independent judgment emerged in the early development of the four schools to solve differences on matters that had no clear cut answer in the primary sources. The acceptance of this doctrine by the school of thought varied depending on the latitude of their interpretation. Traditionalists rejected this doctrine as a source of law from the beginning and insisted on literal interpretation of the primary sources. This notion of rejecting ijtiḥad or independent judgement as a source of law later became an issue when there was fear that some interested groups might seek to interpret the general principles of Islam according to their own advantage. Thus the traditional approach of the Hanbali school led to imitation (taqlid) of earlier jurists. 519

Scholarly works have been produced by several jurists who represent the different schools of thought. However, as new situations have arisen that have not been dealt with adequately in these sources, the study of Islamic jurisprudence has generated several justifications for Muslim leaders to issue secular legal or administrative standards to regulate in detail subject matter that is important to the preservation of the community, provided that these regulations or laws do not contradict the general principles of Islam.

One of the issues that has arisen in today's complex society is the problem of illegal payments by MNCs to public officials and employees. Although Islamic jurisprudence has discussed the issue of bribery and has declared it a sin, it has not reached the stage of declaring it a crime punishable by a specific penalty. This may be attributed to the inherent character of Islamic society in the days

⁵¹⁹ Ibid.

when there was not much importance attributed to public employees, except certain people such as judges and governors. After the unification of the Kingdom of Saudi Arabia, the authorities realized that there was a need for a comprehensive legal system to regulate the process of modernization and to supplement Islamic law. These regulations of course had to be in accordance with Islamic principles. Since then many laws, in the form of regulations and administrative decrees, have been promulgated to strengthen the legal system and to protect the general public welfare. This movement toward regulating certain problems and issues takes guidance from the Shari'a, which provides for secular authority to be exercised by temporal leaders. In the following pages we will discuss the Islamic principles that treat the issues of bribery and illegal payments, and then we will examine the Saudi experience of regulating these issues.

B. Islamic Law

(i) Crime and Sin

It is important to know that there are three categories of human acts that are considered crimes and are therefore punishable under Islamic law or shari'a. First, there are acts committed against the existence of God, religion or the right of God in general; for example, a Muslim is forbidden to convert from Islam to another religion. The penalties for these crimes have been prescribed in detail in various chapters of the Glorious Quran. The punishments indicated for these crimes are severe, for they touch on the very existence of God.⁵²⁰ Second, there are crimes against humans or their rights, such as murder or theft. The punishments for these are also prescribed in detail in the Glorious Quran. Thirdly, there are crimes against the community and public safety. The most commonly occurring crimes fall into this category. It is left to the Muslim judge to assess the loss and to decide on the penalty called the Tazir or chastisement.⁵²¹ Depending on the significance of the offence committed, the judge may dictate a punishment ranging from jail to lashes⁵²² to a fine.⁵²³

⁵²⁰ Muhammed Abu-Zahrah, *Crime and Penalty in Islamic Jurisprudence*, vol. 1 (1957), Sec. 59, at 62 (in Arabic).

⁵²¹ The purpose of this type of punishment is to prevent the culprit from relapsing. The Quran does not mention this kind of punishment; on the contrary, it classifies several transgressions afterwards punished with Tazir as merely sins.

⁵²² The Tazir with lashes as one type of chastisement may be attributed to the Prophet's tradition as recounted by one of his companions, Abdullah Ibn Umar: "Those who bought provisions wholesale without measure or weights in order to sell them again were punished in the time of the Prophet by whipping." (Bukhari, Bab, Al-Hudud, Hadith No. 43). In another tradition of Ibn Abbas, the Prophet is said to have threatened with twenty lashes any man who insulted another by calling him soft or effeminate (Ibn Majah, Bab, Al-Hudud, Hadith No. 15) (in Arabic).

⁵²³ The penalty of fine is attributed to the Kufah school of thought (one of the four major Sunni schools in Islam, other schools being the Shafi, the Madinah, and the Hanbali) and especially to one of its learned jurists, Abu-Yusuf, who advocated legal reasoning in teaching Islam. He saw it as important for the ruler of a country to inflict Tazir or chastisement by means of seizing property, usually through a fine. The sum exacted should be proportionate to the offence. See Thomas P. Hughes, *Dictionary of Islam*, 1895, at 632-633.

Nevertheless, not all specific offences are listed in the Glorious Quran or mentioned in the prophet's tradition, only examples of various types. The state decides what is significantly harmful to the community at large, and ensures that the authorities regulate these matters in accordance with the principles of Islam.⁵²⁴ For example, narcotics trafficking is now considered a criminal act against the community. Our concern here is with bribery or illegal payments by MNCs to public officials or employees. In the writer's opinion, these are acts harmful to individual citizens of the country as well as to the community at large. It is important to know that the exegesis of some verses of the Glorious Quran by Islamic jurists reveals that it does in fact prohibit bribery indirectly, as the action of bribery is considered an action against the Islamic idea of justice.⁵²⁵ The Almighty God says in the Glorious Quran:

...and eat not up property among yourselves in vanity, nor seek by it to gain the hearing of a judge that ye may knowingly devour a portion of the property of another wrong fully.⁵²⁶

Another section says:

Listener for the sake of falsehood! Greedy for illicit gain...⁵²⁷

It has been a consensus among Islamic jurists in their exegeses of these verses that bribery is included in the unlawful gaining and "devouring" of property or money.⁵²⁸ Furthermore, the prohibition of bribery and illicit payment has also

⁵²⁴ Abdu-Alqadir-Oudah, *Islamic Penal Law Compared with Man Made Law* (Statutory Law), 1949, at 250 (in Arabic).

⁵²⁵ The Glorious Quran was revealed to the Prophet Mohammed in the Arabic language. The meaning can be approximated but we shall warn that translation does not convey the quality and richness associated with reading in the Arabic language. The translation of the verses of the Quran in this thesis is the effort of Marmaduke Pickthall, *The Glorious Quran*, Sixth impression, 1976, London Fine Books Ltd.

⁵²⁶ *The Glorious Quran*, Surah II, "The Cow," verse 188.

⁵²⁷ *The Glorious Quran*, Surah V, "The Table Spread," verse 42.

⁵²⁸ Mohammed Rashid Ridah, *Exegesis of the Glorious Quran*, first edition, at 393 (in Arabic). Also see Mohammad Ibin Jarir Al-Tabari, *Tabari Exegesis of the Glorious Quran*, vol. 10,

been mentioned in the Prophet's tradition, for one of the Prophet's companions has recounted that the Prophet, "peace be upon him," said:

God damned the briber, the bribee and the intermediary between them.⁵²⁹

Another version of this tradition, recounted by Ahmad Ibin Hanbal, and also recited in the major four authenticated books of the Prophet's tradition,⁵³⁰ states that "the prophet damned the briber, the bribee and the intermediary." Ahmad Ibin Hanbal added: "the intermediary is the ambassador between the giver and the taker, even if he did not take remuneration for his ambassadorship, and if he did, his sin is more serious."⁵³¹

at 318 (in Arabic).

⁵²⁹ Recounted by Thouban, see AL-Emam Al-Syouti, *Jamie AL-Sagheir.*, vol. 2, 1364. A.H. at 239, and 245 (in Arabic).

⁵³⁰ The books are (1) Al Bukhari, *Jami Al-Sahih* (2) *Imnam Muslim, Sahih Muslim* (3) Malik, *Al-Muwatta* (4) Ibin Hanbal, *Al-Musnnad* (in Arabic).

⁵³¹ Mohammed Ibin Ismail Al-Sanaani, *Subul Al-Salam, wa Sharh Blugh Al Maraam min Jama Ahadieth Al-Ahkam*, 1349 A.H. ed., (1929), vol. 4, at 91-99 (in Arabic).

(ii) The Distinction Among Bribery, Gift and Commission

Under Islamic law, any form of bribery, such as an illegal payment or a kick-back, is merely a sinful act and does not rate as seriously as a crime against God or against an individual, such as murder and adultery, for which punishments are prescribed in the Glorious Quran

In early Islam, little notice was taken of the bribing of public employees, except where those employees had a great deal of influence on their society. So we find Islamic jurists and jurisprudence concerned only with bribery of judges (quadah), governors (wulah) and tax collectors (omall).⁵³² As a precaution, Islamic jurists differentiate among the types of benefits that public employees might obtain. They make a distinction, for example, between a bribe and a gift. Bribing of judges for the purpose of rendering a judgment upon the briber that is contrary to justice is sinful for both the giver and the taker of the bribe. But if a bribe is given to a judge so that he will uphold the law, the bribe is sinful and forbidden for the bribee and not sinful for the briber, because he gave it to retain his right and to encourage the judge to enforce the law.⁵³³ However, the majority of Islamic jurists prefer the prohibition for both the giver and the taker, because the Prophet's tradition (Hadith) implies a general condemnation of this type of activity.⁵³⁴ In addition, Islamic jurists have mentioned that bribing the ruler or those who have influence on him for the purpose of gaining a position of judgeship or government is sinful and unlawful for both the giver and the taker.⁵³⁵

⁵³² Ibin Qudamah, *Mughoni wa Al-sharh Al-kabeir*, reprinted in 1367 A.H. (1947) vol. 11, at 438 (in Arabic).

⁵³³ Al-Jassas, *Ahkam Al-Quran*, vol. 2, at 527, reprinted in 1378. A.H. (in Arabic).

⁵³⁴ Mohammed Ali Ibin Hazm, *Al-Muhala*, 1351 A.H. (1931), vol. 9, at 157 (in Arabic).

⁵³⁵ Mohammad Bin Ali Al-shawkani, *Nail Al-Awtar min Asrar Muntaga Al-Akhar*, vol. 8, at 513-520 reprinted in 1382. A.H. (in Arabic).

Meanwhile, Islamic jurists have been more vigilant in situations where apparent gifts have been transformed into illegal practices, as when what appears on the surface to be a small token is being accumulated along with many others, thus becoming a substantial sum that is being used to procure influence. In rendering a legal decision of prohibition they examine past relations and the motive behind the gift. For example, if there has been a pattern of a reciprocal exchange of gifts between the public employee and the gift giver, this practice is lawful provided that the reciprocity started before the public employee assumed office. At the very least they must have known each other before the act of gift giving in question occurred. If the gift exchange has come after the public employee assumes his office, it must be decided whether there was reciprocity. One learned Islamic jurist has said that prohibition is the only solution when a public employee is involved and the giver is in need of his services, because any gift under these conditions can be construed as inveiglement or enticement of the recipient to take care of the giver's need before rendering a decision (if he is a judge or a governor). It is in such a way that the fine line between a gift and a bribe is crossed.⁵³⁶

Turning to commissions, Islamic jurists have also mentioned them indirectly. They distinguish between two kinds of fees or *ijara* one made over a period of time and another for carrying out a specific task.⁵³⁷ The services of an intermediary can be hired as long as it is customary in the profession, but the legal reasoning⁵³⁸ is that today's commission paid by an MNC to an intermediary when

⁵³⁶ Ibin Qudamah, *supra*, footnote 532, vol. 9, at 77.

⁵³⁷ Joseph Schacht, *Introduction to Islamic Law* (1964) at 154-155.

⁵³⁸ The legal reasoning concept had been developed since early Islamic jurisprudence, especially by the Shafi school of thought, and was advanced by one of its great and learned jurists, Abu Yusuf, who had systematically in his life applied the rule of reasoning and logic to consistently arrive at solutions to any problems that have no specific answers in the Glorious Quran or the Prophet's tradition. For more about this school of thought, see Joseph Schacht, *Origins of Mohammedan Jurisprudence* (1950), at 269-282.

conducting business when excessive can be analogized to "consuming one another's property in vanity,"⁵³⁹ Thus excessive commission, which amounts to a bribe, is prohibited according to this verse of the Quran

⁵³⁹ The Glorious Quran, Surah II, verse 188.

(iii) Penalties for Bribery

As we have said, bribery has been mentioned in the Glorious Quran only indirectly, and in the Prophet's tradition there is no prescribed penalty for the commission of this act. In the writer's view, this is because Muslims must adhere to Islamic principles in every aspect of their lives, and manifest those principles in their dealings among themselves and with those of other creeds, so as to demonstrate the ascendancy of Islam as a way of life. So any diversion from Islamic principles that is not considered contrary to basic belief has no prescribed punishment in the Quran and is deemed a "sin" under Islamic law. The concept of Tazir⁵⁴⁰ or chastisement is being established by Islamic jurists, on the authority of the Quran,⁵⁴¹ to be inflicted for transgressions that are deemed sin and have no specified punishments in the Glorious Quran.⁵⁴² The application of this concept is highly restricted, and the kind and amount of chastisement is left entirely to the discretion of the judge.

⁵⁴⁰ Tazir, from Azar, means "to censure or repel." It was a discretionary correction administered for offences, for which no fixed punishment is mentioned in the Glorious Quran.

⁵⁴¹ The authority in the Quran can also be adduced by the fact that men are enjoined to chastise their wives for the purpose of correction and amendment.

⁵⁴² See supra, footnote 521, and accompanying text.

C. Statutory Sanction of Illegal Payments

(i) Historical Background

The statutory prohibition of bribery in Saudi Arabia goes back to 1930, two years before King Abdulaziz united the country under the name of the Kingdom of Saudi Arabia. The first prohibition came in Articles 100 and 102 of the General Civil Service Regulations.⁵⁴³ Then, with the gradual growth of the country, the expansion of government jurisdiction and the increase in the number of civil servants, Saudi legislators enacted the Civil Servant Law,⁵⁴⁴ which in several places prohibited civil servants from taking bribes or using influence that might tempt them to ignore the fiduciary duties entrusted to them.

Such was the case until the government enacted a separate law exclusively aimed at the prohibition of bribery,⁵⁴⁵ and this law is known today as the Regulation of the Prevention of Bribery, or the bribery statute in Western legal parlance, however, it is always the tendency of the authorities in the Kingdom of Saudi Arabia not to label any statute or regulatory action with the term "law" in the Western sense, but rather to call it a "regulation," because there is always a struggle to maintain the good will of the religious leaders. The latter oppose the term "law" because to them it means Islamic law. The religious leaders do not want the government to pursue any change of the "status quo" of the Kingdom as the only

⁵⁴³ General Civil Service Regulations, published in the national Arabic newspaper *Um Al-Qura*, No. 347, on 22, 3, 1350 A.H. (1930).

⁵⁴⁴ A second Civil Service law or Regulation was enacted after the uniting of the country under the name of the Kingdom of Saudi Arabia. It was published in the national newspaper *Um Al-Qura*, No. 1061 on 19, 7, 1364 A.H. (1977).

⁵⁴⁵ The Regulation for the Prevention of Bribery was enacted by the government and promulgated by Royal Decree No. 15/m on 7, 3, 1382 A.H. (Aug. 9, 1962) From here on we will refer to it as the "bribery statute." See translation of the statute provided by the writer in Appendix No. 1.

country in the world today that adheres to Islamic law. While the government adheres to Islamic law in the case of a crime against the right of God and the right of person, such as murder or theft, at the same time it allows the banking system to operate contrary to Islamic law, which prohibits interest.⁵⁴⁶ This regulation was enacted so that a cohesive law might be codified, in order to bring home to public officials the importance of carrying out their fiduciary duty to the public, and of preserving the integrity of that position and not using it as a commodity to be traded in the marketplace.

Notwithstanding the simplicity of the statute's language, which took its cue from the unsophisticated society for which it was enacted, it could be easily applied to bribery in today's business, if the authority had the integrity to enforce it upon all those who take bribes those paid off by big corporations to facilitate their entrance into the business opportunities in the country, those who grease the wheels for an MNC's bid to go through the bureaucracy and gain favourable treatment, and those who take bribes from citizens in the country to accomplish their paperwork. Furthermore, this lack of enforcement may also be attributed to the fact that the structure of the Saudi Arabian legal system and government is quite different from that of Canada and the U.S. The availability of information on the enforcement of bribery statutes in the West depends largely on the existence of the

⁵⁴⁶ In spite of the fear of the religious leaders, in the writer's view, using the term "law" in connection with bribery is not contrary to Islam, because now in the country if we look at all the regulations concerning labour, corporation, banking, bribery, import and export, trade in general and many other areas, these are laws in the Western legal interpretation. Also, all these laws do not contradict Islamic law, except for the banking laws, which allow banks to operate on an interest basis. Moreover, it is possible that Islamic principles can be enacted in law in a specific and clear manner in accordance with the interpretation of the most moderate Islamic school of thought. This has the advantage of limiting the judges' discretion from narrow interpretation of Islamic legal principles, bringing about the cohesiveness in the judges' holdings, and preventing them from abusing their power. Finally, we shall recognize that all these regulations or laws are being taught now in the Kingdom in the Institute of Public Administration under the name "Regulation Studies" and in various universities in the Kingdom under a similar name.

concept of accountability of elected officials. This concept is perhaps understood differently in other systems, where accountability is not to the citizens as electors, but to the rulers as guardians of the society's ethics.

In the following pages, we will study the scope and content of the statutory prohibition of illegal payment and bribery, starting with the status of the recipient of the payment.

(ii) Status of the Recipient

At the outset it is important to mention that bribery is considered a crime of a descriptive nature, because it was defined by Islamic jurists in their interpretation of Islamic law, and also because it occupies a distinct position in the eyes of the law and is subject to specific regulations as far as the public official and the employee are concerned. Thus, we shall see that bribery can be committed only by those described by the law. Meanwhile, it is essential to understand the distinction made by some civil law jurists between the definition of a public employee in administrative law and that within criminal law.⁵⁴⁷ Administrative law defines a public employee as anyone occupying a public position and working for the public on behalf of the state or another legal entity administered by the state.⁵⁴⁸ The criminal or bribery statute defines a public employee as any person working in view of the public and for the service of the public in the name of the state, or any legal person under state control in a natural and ordinary way, by which the individual citizen trusts that when executing the work authorized to him he is doing so within the limits prescribed by the law.⁵⁴⁹

The importance of this definition can be realized in the case where a public official claims to be in a certain public position in order to take advantage of it, when he is not truly incumbent by the law. The Saudi bribery statute thus defines "public employee" broadly for the purpose of encompassing several categories including the "apparent" employee.⁵⁵⁰ Intaking this broad definition it may be the

⁵⁴⁷ Dr. Ahmad Al-Alfi, *Treatise in Saudi Criminal Regulations*, 1396 A.H. (1976), at 94 (in Arabic). This book is composed of lectures given by the author to students at the Institute of Public Administration in the Regulations Study program for the course of Criminal Law, in which the writer was a student.

⁵⁴⁸ Dr. Abdulfattah Khidher, *Treatise on Saudi Regulations of General Civil Service*, vol. 1, 1400 A.H.(1980), at p. 20-25 (in Arabic).

⁵⁴⁹ Dr. Ahmad Al-Alfi, *supra*, footnote 547, at 94.

⁵⁵⁰ Bribery statute, *supra*, footnote 545, article (9) specifies several types of employees that are subject to the statute. Among them are (a) temporarily appointed servants (b) arbitors, or

intention of the legislators to preserve the civil service from corruption. Yet, for the bribery law to be applied, the public employee must virtually have acted in his "official capacity," that is, within the scope of what he is employed to do as distinguished from being engaged in a self interested act.⁵⁵¹ In the latter case, he may be liable for another crime in the domain of Islamic law, such as deceit, swindling or skul duggery. Further, the statute does not apply in the case where the bribe or intermediary is not a public employee,⁵⁵² but if an Islamic Law judge is presiding on the case, the above charges may apply. Moreover, the bribery statute mandates that a public employee must have territorial⁵⁵³ and subject matter jurisdiction.⁵⁵⁴ However, in the case of a misallegation or misrepresentation of jurisdiction by a public employee, the bribery statute does not make a distinction, so that if a public employee misrepresents himself as the one who has jurisdiction on the subject matter, he will be prosecuted for taking a bribe, as long as he is judged to have taken positive action.⁵⁵⁵ The public employee may also be convicted of bribery, even though the action requested was not within the official's power to perform.⁵⁵⁶ Looking at the briber, the statute renders a person guilty of

experts appointed by the government or by a legal entity that has competent and exclusive jurisdiction (c) doctors and nurses (d) all who are in charge of doing things on behalf of government and the administrative authority(e) employees of publicly held corporations or corporations involved in public projects.

⁵⁵¹ Ibid

⁵⁵² In case No. 10840 on 5.6.1382 A.H. (1967), an employee in a private store took a bribe from a citizen for the purpose of not testifying before the court about selling a stolen animal. The case was filed for bribery before the Special Bribery Board (or Grievance Board) and not in the Sharia or Islamic Court. The Board decided the bribery statute was not applicable because the statute only applied to public employees.

⁵⁵³ Bribery statute, supra, footnote 545, article (1).

⁵⁵⁴ The requirement of territorial and subject matter jurisdiction is emphasized in the Saudi bribery statute. This is different from Egyptian law, on which most of the Saudi regulations are based. Egyptian law does not require territorial jurisdiction for the public employee who took the bribe. See Mohammed N.Husni, *Treatise on the Egyptian Penal Code* (1972), at 40-41 (in Arabic).

⁵⁵⁵ Bribery statute, supra, footnote 545, article (13).

⁵⁵⁶ Ibid., articles (1) and (2). See also Dr.Ahmad Al-Alfi, supra, footnote 547, at 119.

bribing a public official when the official accepts or agrees to accept any pecuniary benefit upon agreement or understanding that he will do some type of service in exchange for this pecuniary benefit.⁵⁵⁷

The Saudi bribery statute goes further to encompass the employees of public companies,⁵⁵⁸ or companies working for the public sector.⁵⁵⁹ In addition, an intermediary is considered by the act as a participant, and subject to the same penalties mentioned in the act for the bribee and the briber.⁵⁶⁰ In the situation where the beneficiary of the illegal payments is someone else who has been designated by the public official or employee to receive the gift or the bribe, and this designated party has accepted the bribe or any pecuniary benefit with knowledge, he will be punished by a jail sentence from one month to six months or by fine from one thousand Saudi Riyal to five thousand Saudi Riyal (SR) or by both.⁵⁶¹ This applies even if he has no task to perform as an intermediary, in which case he is considered a participant.⁵⁶²

⁵⁵⁷ The crime of bribery is completed when a public employee accepts a gift or service in exchange for breaching his fiduciary duty, even if he is not capable of performing the action he agrees to. See article (8).

⁵⁵⁸ A public company under Saudi corporation law is one that has been established in accordance with the law and offers shares to the public. See Saudi Corporation Law promulgated by Royal Decree m/6 on 22, 3, 1385 A.H.(1965).

⁵⁵⁹ See bribery statute, supra, footnote 545, article(9)(e).

⁵⁶⁰ Bribery statute, supra, footnote 545, article (6).

⁵⁶¹ article (10).

⁵⁶² article (6).

(iii) Action of the Recipient and Type of Consideration

The second element of bribery is the consideration or thing of value that is exchanged for the action by a public official in favour of the giver of the consideration. Since bribery, under the regulation, is considered to be the taking, acceptance or asking for anything of value, or the offer or promise of anything of value for the benefit of the bribee "public official" or someone else designated by him, the passiveness or activeness of the public employee is not a relevant factor in determining whether a crime has been committed.⁵⁶³ So the public employee is liable whether he took a consideration for his action,⁵⁶⁴ or whether he took it for merely abstaining from taking an action at the briber's request.⁵⁶⁵ In addition, the bribery law is also applied when a public employee or official takes a bribe to use his influence, whether real or not, to get or attempt to get a decree, licence, decision or agreement relating to import or export that will benefit the giver of the consideration.⁵⁶⁶ The consideration need not be of monetary value under the statute.⁵⁶⁷ It may be something such as a service that cannot actually have a value put to it, and has no limit. Hence, under the law, if the thing given is seemingly a bribe, the parties involved are still liable, so long as the public employee has been influenced to breach his fiduciary duties.

⁵⁶³ Dr. Ahmad Al-Alfi, *supra*, footnote 547, at 116.

⁵⁶⁴ Bribery statute, *supra*, footnote 545, article (1).

⁵⁶⁵ *Ibid.*, article (2).

⁵⁶⁶ *Ibid.*, article (5).

⁵⁶⁷ *Ibid.*, article (11).

(iv) **Intent of the Recipient**

For the crime of bribery to be completed, the public employee must have the state of mind of committing a crime.⁵⁶⁸ This means that the public employee knew or had reason to believe that the gift or services given or promised to him, or to someone else as his beneficiary, was in exchange for his passive or active role for the benefit of the giver. Liability remains even though the employee may not have continued his role, as long as he agreed or accepted the offer of the briber.⁵⁶⁹ This concept of intent must exist at the time the offer is made, because bribery, although illegal, is a contract, which entails an offer and an acceptance. For example, if the public employee thought at the time the gift was given that it was an honest gift, or that the service was complimentary, he is not liable, so long as he does not use his position to compensate the giver for his services or gift at public expense, and does not breach his fiduciary duty.⁵⁷⁰

This element of corrupt intent is very important, and a public employee's state of mind must not be influenced by the authority's action. This is a crucial point when the authority tries to entrap a public official, and then examine his intent. Such entrapment is not mentioned in the Saudi bribery statute,⁵⁷¹ though it is considered to be a traditional defence in most common law jurisdictions. It prevents conviction of a person induced to commit a crime unless the prosecution can establish the person's predisposition to commit the crime.⁵⁷² This defence

⁵⁶⁸ *Ibid.*, articles (1) and (2).

⁵⁶⁹ Mohammed N. Husni, *supra*, footnote 554, at 92.

⁵⁷⁰ Nabil M. Salim, *Treatise on Criminal Law* (1973), at 26 (in Arabic).

⁵⁷¹ Bribery statute, *supra*, footnote 545, however, it is generally prohibited to influence a public employee to do anything illegal, or not to do the job required by him by the law, under the general principle of Islamic law.

⁵⁷² See *Amato v. The Queen* [1982], 69 C.C.C.(2d) 31, affirmed 51 C.C.C. (2d) 401 (C.C.C.). Although the Supreme Court of Canada held by a five to four majority that the appeal should be dismissed on the ground that the defence did not rest on the facts, it was finally decided in this case that when a crime is committed only as the result of instigation and per-

exonerates a defendant who has engaged in criminal behaviour because a government agent has implanted in the mind of an innocent person the disposition to commit an offence.⁵⁷³ While this is the state of the law in most common law jurisdictions and jurisprudence, the United States Court, in what is commonly referred to as the ABSCAM case,⁵⁷⁴ did not admit this defence because the accused congressmen did not assert the defence in trial, claiming only that bribery had not occurred at all.⁵⁷⁵ The judges of the United States Court of Appeal for the Second Circuit went on to say that

... we do not doubt that when an entrapment defence is raised by evidence of inducement, either through cross examination or affirmative evidence, a defendant is entitled to have a court assess, as with every other element of an offence, whether the record contains sufficient evidence from which a reasonable jury can conclude beyond a reasonable doubt... that the prosecution has proved the defendant's predisposition to commit the offence...⁵⁷⁶

sistent importuning of the police, the defence of entrapment is available as mens rea is absent. In the United States the Supreme Court, in *Sherman v. United States*, 356 U.S. 369, 78 S.Ct. 819 (1958), reversed the indictment of the defendant for unlawful sale of narcotics, because the criminal conduct charged against the defendant was the product of the creative activities of law enforcement officials. In England, on the other hand, this defence of entrapment was not accepted. See Michael I. Stober, *Entrapment In Canadian Criminal Law*, (1985), at 55. See also Paul Macus, "The Development of Entrapment Law" (1986), 33 *The Wayne L.Rev.*, 37, at 5.

⁵⁷³ *C.V. Sorrells v. United States* 287 U.S. 435, 535 S.Ct. 210 (1932), in which the defendant was convicted and indicted for processing and selling intoxicating liquor in violation of the National Prohibition Act after he was instigated to do so by a prohibition agent. Although he pleaded not guilty and relied upon the defence of entrapment, the lower court refused to sustain the defence. This decision was affirmed by the United States Court of Appeal for the Fourth Circuit: 57F. 2d 973 (4th Cir. 1932). The Supreme Court reversed on the ground that "It is not [the official's] duty to incite to and create a crime for the sole purpose of prosecuting and punishing it" At 443.

⁵⁷⁴ Cited as *U.S. v. Myer* 692 F. 2d 823 (2nd Cir. 1982). The case was a scheme set up by FBI agents who posed as employees of Arab sheiks who tried to lure several U.S. congressmen to some investing with them on favourable terms in exchange for pulling some influence in the U.S. Congress for the Arabs.

⁵⁷⁵ *Ibid.*, at 836.

⁵⁷⁶ *Ibid.*

The court finally concluded:

... we hold that a defendant who fails to assert entrapment as a factual defence at his trial cannot assert it as a legal defence to his conviction...⁵⁷⁷

In the writer's view, the reasoning of the court for not allowing the defence to be asserted in the final stage is not convincing, because the entrapment action was being set up for the purpose of inducing the congressmen to commit the alleged offence, and the FBI selectively implanted several methods of entrapment to convince the jury of the illegality of the congressmen's action, in spite of some ambiguity of the evidence and media influence upon the issue.

⁵⁷⁷ Ibid

(v) **Penalty and Enforcement**

When the elements of the crime of bribery are satisfied under the Saudi bribery statute, the penalty for the convicted official is imprisonment from one to five years, or a fine from five thousand SR to one hundred thousand SR, or by both.⁵⁷⁸ The statute applies whether the public employee's role was active or passive, and whether the employee had a specific jurisdiction or merely pretended to take an action.⁵⁷⁹ Moreover, the Statute applies equally whether the bribe took place before or after the employee's action, whether or not the employee executed the action he was paid for by the bribe giver, and in the case where he accepted the bribe but intended not to take an action. These penalties apply to the briber, the intermediary and anyone who assists with knowledge in the committing of the crime.⁵⁸⁰

Since the bribery statute exists for the purpose of preserving the trust placed in public servants and to warn those servants against doing anything that could be construed as a breach of their fiduciary duties to the public, the statute also makes a public employee liable if he takes an action as a result of an entreaty or a supplication, or because of a liaison he has with the person asking the favour. This applies even if no ostensible gift changes hands. The penalty for this influence peddling is imprisonment for a period not to exceed one year, or a fine of 10,000 SR, or both.⁵⁸¹

⁵⁷⁸ Bribery statute, *supra*, footnote 545, article (1).

⁵⁷⁹ In contrast, the Egyptian penal code article, 103, differentiates between the passive and active action of a public employee. The employee gets a severe penalty for an active role (hard labour, imprisonment for life and a fine), while he gets only a prison term and a fine if he takes a bribe, but does not intend to take action (article [104]). See Hassan S. Almersafawi, *Penal Code*, 1978, at 47 (in Arabic).

⁵⁸⁰ Bribery statute, *supra*, footnote 545, article (6).

⁵⁸¹ *Ibid.*, article (4).

It is worthwhile to note here that the Saudi statute considers the fine to be fixed, and not proportionate, which means that if several employees are convicted of bribery in the same case, everyone has to pay the prescribed fine: the amount is not shared.⁵⁸²

Furthermore, as a consequence of conviction of the crime of bribery, the statute prescribes an ancillary penalty the dismissal of the public employee or official or other participant from the public service, and in the case of one who is not a public official, a barring from ever assuming a public position.⁵⁸³ If the convicted person is a legal entity such as an MNC, the statute prohibits the company from entering public bidding,⁵⁸⁴ but reserves that the cabinet ministers may remove this prohibition after five years from the date of conviction.⁵⁸⁵ Conviction of bribery will result in the confiscation of the property, the privilege or the money that constituted the bribe, when practical.⁵⁸⁶

The penalty for a quasi-public employee, such as one who works for a public corporation or has executed work for the public sector, is the same as for the civil servant.⁵⁸⁷ The statute contains an incentive to disclose bribery by stating that the briber and/or the intermediary may be excused from penalty if he informs the authority of the crime,⁵⁸⁸ provided that this avowal precedes the authority's

⁵⁸² In contrast, the Egyptian legislation makes fines proportionate. When several employees are involved, they are fined in accordance with each one's degree of participation in the crime. See Hassen S. Al Mersafawi supra, footnote 579, at 48.

⁵⁸³ Bribery statute, supra, footnote 545, article (12).

⁵⁸⁴ Ibid

⁵⁸⁵ Ibid Although the bribery statute so states in article (12), the conviction and indictment of Hyundai Corporation for bribing a public official does not comply. The sentence was severe in the amount of fine levied, as it was more than the statute mandated, and light in the prohibition aspect, as it only prevented the corporation from entering bids and doing business in the country for a period of two years. See supra, footnote 60 and accompanying text.

⁵⁸⁶ Bribery statute, supra, footnote 545, article (13).

⁵⁸⁷ Ibid., articles (6) and (9).

⁵⁸⁸ Ibid., article (14).

discovery of the crime.⁵⁸⁹ In such a case, the intended bribe money is not confiscated, nor are any privileges withdrawn.⁵⁹⁰ The purpose, of course, is to encourage the discovery of those who have abused their public position for the sake of personal gain. To further this goal, the bribery statute also prescribes an award for those who give any information about a crime of bribery,⁵⁹¹ provided that this information leads to the conviction or proves, establishes or confirms the illegal action of a public official or employee. Under the statute, this award cannot go to a briber, intermediary or participant.⁵⁹² It also has a maximum and minimum limitation.⁵⁹³ In addition, the statute also mandates that when a cabinet minister has material evidence of a public employee's uprightness and integrity in resisting subordination to or incitement by those who tried to lure him into bribery, the cabinet minister shall see that the employee is rewarded, either with money or a significant promotion.⁵⁹⁴

The investigation and the prosecution of those involved in the crime of bri-

⁵⁸⁹ The language of article (14) clearly permits the pardon, even after discovery of the crime:

The briber or intermediary shall be pardoned from penalty if he informs the authority of the crime or avows it, even though this avowal is after the discovery by the authority (translated by author from original Arabic text).

The language was amended by Royal Decree No. 35/D on 13, 10, 1388 A.H. (1968), which restricts and limits the pardon to those instances where the authority is informed before discovery.

⁵⁹⁰ *Ibid.*, article (14). An example of the pardon is contained in Ministerial Resolution No. 11/R on 18, 1, 1393 A.H. (1973), for acting in an intermediate role in bribery. They conferred to the crime before discovery and they helped to expose the others involved. Also Ministerial Resolution No. 18135 on 1, 8, 1386 A.H. (1966) pardoned twenty bribers from penalties when they avowed the crime after it was discovered. This pardon came before the amendment of article (14).

⁵⁹¹ Bribery statute, *supra*, footnote 545, article (15).

⁵⁹² *Ibid.*

⁵⁹³ *Ibid.* The award prescribed is no less than 50,000 SR, and no more than half of the bribe or confiscated property. The statute also provides that if the amount of the bribe is less than the minimum amount mentioned in this article, the public treasury will bear the difference, or the full amount if no mandatory value can be assessed. The assessment of the award is made by the special board presiding on the case.

⁵⁹⁴ *Ibid.*, article (16).

bery are delegated to a special committee,⁵⁹⁵ under the direction of a member of the Grievance Board and a police officer.⁵⁹⁶ After completing the investigation, the committee refers the case to a special board composed of the head of the Grievance Board or his deputy, who preside over the case, a legal professional from the Grievance Board, and a legal counsellor specially appointed by the prime minister.⁵⁹⁷ The members of this special board must not have participated in the investigation process, nor given any opinions on the case.⁵⁹⁸ The decision of the special board is not final until it is indicated and approved by the King, who is also the Prime Minister.⁵⁹⁹ The enforcement of the penalty is always left to the police, as in any other criminal case.

⁵⁹⁵ The Grievance Board has been given special jurisdiction in this area. It was established by Royal Decree No. 2/13/9759, dated 9/17/1374 A.H. (May 10, 1955). It assembles an administrative court in the civil law system. The authority for the establishment of the Grievance Board is attributed to the right of the sovereign under Islamic law to deal with all litigation and alleviate any injustice.

⁵⁹⁶ Bribery statute, supra, footnote 545, article (17) provides that offences, "... shall be investigated by an official of the Grievance Board and a police investigation."

⁵⁹⁷ In recent times the structure of the government has been such that the King and the Prime Minister are one and the same.

⁵⁹⁸ Bribery statute, supra, footnote 545, article (17).

⁵⁹⁹ Ibid

3. Legal Sanction Under American Law

A. Background to the FCPA

The heavy and regrettable publicity that accompanied the revelation of the Watergate scandal raised the consciousness and perceptiveness of the United States Congress and of the government as a whole; there was a major thrust to improve the morality and the image of U.S. MNCs and businessmen abroad.⁶⁰⁰ Concomitant with this effort, and sometimes at cross purposes with it, was the need to preserve the United States' share of the multinational market.⁶⁰¹ Although at the time of the revelation of the illegal or questionable payment there were no laws directly sanctioning bribes to foreign officials, the deceptive manner of recording the payments and the complexity that had been associated with the illegal political contributions made the Securities and Exchange Commission (SEC) move quickly to require full disclosure of all questionable payments made in the United States and abroad.⁶⁰² This initiated a program by which corporations voluntarily disclosed bribes, questionable illegal payments and political contributions in exchange for amnesty by the SEC.⁶⁰³

Nonetheless, specific sections of the United States federal laws can be utilized to prosecute MNCs for making illegal payments, for example the Mail Fraud Statute,⁶⁰⁴ which prohibits the use of the postal service to perpetrate fraud. There

⁶⁰⁰ Michael E. Murphy, "Payoffs to Foreign Officials: Time for More National Responsibility" (April 1976), 62 *Am. Bar. Assoc. J.*, 480-483, at 482.

⁶⁰¹ Walter Sterling Surrey, "The Foreign Corrupt Practice Act: Let the Punishment Fit the Crime" (1979), 20 *Harv. Int'l L.J.*, 293-303, at 293.

⁶⁰² See *supra*, footnote 325 and accompanying text.

⁶⁰³ See statement by SEC Chairman Roderick M. Hill before the subcommittee of Priorities and Economy in Government, of the Joint Economic Committee, Congress of the United States, on the subject of "Abuses of Corporate Power, Bribes, Kickbacks, Political Contributions and Other Improper Payments," on January 14, 1976, Washington, D.C. Reprinted in [1975-76, Transfer Binder] 80 *Fed. Sec. L. Rep.*, 364-380, 365.

⁶⁰⁴ 18 U.S.C. Sec. 1341 (1976). This statute could conceivably be used by the government

is also the Wire Fraud Act,⁶⁰⁵ which prohibits the use of wire, radio or television communications to perpetrate fraud. Also, the Bank Secrecy Act of 1970 monitors the flow of money into and out of the U.S.⁶⁰⁶ Other acts exist to control improper MNC activities committed abroad, such as the U.S. Export Import Bank regulations.⁶⁰⁷ The Internal Revenue Service⁶⁰⁸ and federal tax law⁶⁰⁹ also have some effect on bribery. Even though the Securities and Exchange Act of 1934 does not prohibit the making of bribes and illegal payment, it does require their disclosure and any related information that is considered material as defined.⁶¹⁰

Apparently none of these statutes directly prohibits bribery in international business. So when U.S. congress was astonished by the degree of MNC involvement, the magnitude of their illegal political contributions in the U.S., and the attendant disclosure of bribes to foreign officials, it moved forward to curb such illegal activities. Two views emerged: one was that MNCs should be required to

to prosecute those companies that have somehow involved the mails as an instrumentality of interstate commerce in their questionable activities.

⁶⁰⁵ 18 U.S.C. 1343 (1966).

⁶⁰⁶ Bank Secrecy Act of 1970, 31 U.S.C. Sec.1101(b) (1970) requires any person transporting over \$5,000 in monetary instruments on one occasion either out of or into the United States to file a report with the United States Customs Service stating the amount, origin, destination, and route of transportation of the money. Monetary instruments are defined as including among other things, currency, traveller's cheques, money orders, and bearer negotiable instruments.

⁶⁰⁷ 12 C.F.R. Sec. 401.3 (c) (1981). The Export Import Bank of the United States regulate American firms that enter into sales contracts abroad, but only if the sales are financed with loans from the Export Import Bank.

⁶⁰⁸ E.C. Lashbrooke, Jr., "The Foreign Corrupt Practices Act of 1977: A Unilateral Solution to an International Problem" (1979), 12 *Cornell Int'l L.J.*, 227-243, at 230.

⁶⁰⁹ C.R.C. Sec. 162(C) prohibits tax payers from deducting bribes or kickbacks in determining taxable income if the payments are unlawful in the United States. See Morgan Chu and Daniel Magraw, "Deductibility of Questionable Foreign Payments" (1978), 87 *Yale L.J.*, 1901-1124. The article analyses the application of Sec. 162(C) of the tax law through a set of hypothetical business transactions involving bribery or similar payments.

⁶¹⁰ The securities law does not prohibit the making of illegal payments to foreign officials; however, it requires their disclosure under appropriate circumstances when the payments are considered to be "material" for investors and shareholders, as defined by the regulation promulgated by the commission in 17 C.F.R. Sec. 230.405(1) (1977). See Gerald T. McLaughlin, "The Criminalization of Questionable Foreign Payments by Corporations: A Comparative Legal Systems Analysis" (1978), 46 *Fordham L. Rev.*, 1071-1114, at 1101.

fully disclose any payment made abroad, whether legal or of questionable legality, revealing the recipient's name and the country where it was made; the second view was to make it a crime for an MNC to bribe a foreign official either directly or indirectly in order to acquire business.⁶¹¹ Finally, after three years of debate the U.S. Congress enacted the Foreign Corrupt Practices Act (FCPA),⁶¹² which made it a crime for the U.S. MNCs to acquire business abroad through bribery. This crime is punishable by fine or imprisonment or both, as we will see. The view favouring mere disclosure was rejected by Congress on the grounds that this might be construed as condoning bribery, so long as it is not conducted covertly. It was also perceived that disclosure might not achieve Congress's goal of discouraging the practice, and might result in the embarrassment of officials of foreign governments that are friendly to the U.S.⁶¹³

The goal of making bribery in international business a crime is to reduce public discontent and to improve an image that the MNCs perceive as having been oversimplified as to their role in corrupting the officials of underdeveloped countries, and in framing U.S. foreign policy.⁶¹⁴

⁶¹¹ Steven M. Morgan, "In Search of an International Solution to Bribery: The Impact of the Foreign Corrupt Practices Act of 1977 on Corporate Behaviour" (1979), 12 *Vand. J. Transnat'l L.*, 359-390, at 360-368.

⁶¹² Pub. Law. no. 95-213. Tit. I, Sec. 102, 91 Stat. 1494, Codified at 15 U.S.C. Sec. 78M(b) (Supp. I.1977) [amending Sec. 13(b) of the Securities Exchange Act of 1934]; Sec. 103(a), 91 Stat. 1495 codified at 15 U.S.C. Sec. 78dd 1 (Supp. I, 1977) [amending Sec. 30(a) of the Securities Exchange Act of 1934]; Sec. 103(b), 91 Stat. 1496, codified at 15 U.S.C. Sec. 78ff (a)(Supp. I. 1977) [amending Sec. 32(a) of the Securities Exchange Act of 1934; Sec. 104, 91 Stat. 1496 (codified at 15 U.S.C. Sec. 78dd 2 (Supp. I 1977). Tit. II, Sec. 202, 91 Stat. 1498; codified at 15 U.S.C. Sec.78m(d) (Supp. I. 1977) [amending Sec. 13(d) of the Securities Exchange Act of 1934]; Sec. 203, 91 Stat.1499, codified at 14 U.S.C. Sec. 78m(g) (h) (Supp. I.1977) [amending Sec. 13(g), (h) of the Securities Exchange Act of 1934. See Appendix II infra.

⁶¹³ Scott J. Lochner, "The Criminalization of American Extraterritorial Bribery: The Effect of the Federal Corrupt Practices Act of 1977" (1981), 13 *N.Y.U.J. Int'l L. & Pol.*, 645-674, at 649.

⁶¹⁴ Fredrick B. Lesser, "Corruption and the Federal Corrupt Practices Act of 1977" (1979), 13 *U.Mich. J.L. Ref.*, 158-195, at 162.

The development of the FCPA was also spurred by American MNCs' use of foreign subsidiaries to launder money for illegal political contributions in the United States. The FCPA curbed such illegal activities by requiring detailed disclosures and providing criminal penalties for false reporting and standards of conduct for overseas activities.⁶¹⁵

Thus the United States became the first country in the world to pass a criminal statute that regulates the activities of MNCs abroad.⁶¹⁶ Nonetheless, the effectiveness of such a unilateral action is weakened by charges of ambiguity in some of the provisions of the act launched by officials in the U.S. administration⁶¹⁷ and some commentators,⁶¹⁸ and by pressure from the business community to refrain from strict enforcement of the act.⁶¹⁹

In spite of the criticism, the act has played a crucial role in generating independent audit committees and other internal remedies by MNCs, as discussed previously. The U.S. Congress, by passing the act, expected that illegal payments by the U.S. MNCs would cease and that the U.S. position would be stronger in any international negotiations concerning bilateral or multilateral agreements to ban the practice of illegal and questionable payments.⁶²⁰ It was the intention of the act to accomplish these purposes first by imposing accounting standards and internal control procedures upon reporting companies in accordance with the

⁶¹⁵ Walter Sterling Surrey, *supra*, footnote 601, at 294-295.

⁶¹⁶ Scott J. Lochner, *supra*, footnote 613, at 650.

⁶¹⁷ Jerry Landauer, "Anti-Bribery Law Uncertainties Persist, Despite President's Call for Clarification," *Wall Street Journal*, May 30, 1979, at 12, col. 2.

⁶¹⁸ Hurd Baruch, "The Foreign Corrupt Practices Act" (1979), 57 *Harv. Bus. Rev.*, 32-50. Also Howard T. Sprow and James N. Benedict, "The Foreign Corrupt Practices Act of 1977: Some Practical Problems and Suggested Procedures" (1978), 1 *Corp. L. Rev.*, 357-365. Also Michael C. Jensen, "Anti-Bribery has Some Teeth," *New York Times*, December 25, 1977, Sec. 4, at 2, col. 3.

⁶¹⁹ Robert Pear, "Payment by Raytheon Alleged" *New York Times*, October 15, 1980, Sec. D, at 5, col. 4.

⁶²⁰ Steven M. Morgan, *supra*, footnote 611, at 359.

Securities Exchange Act,⁶²¹ and secondly by criminalizing certain forms of bribery committed by U.S. citizens, MNCs and other entities.

⁶²¹ See Security Exchange Act of 1934, Sect. 13(b)(2), codified at 15 U.S.C., Sect. 78m(b)(2). See also Ronald P. Kane and Samuel Butler, III, "Improper Payments: The Second Half of Watergate"(1976), 8 *Loy. U. Chi. L.J.* 50, at 23.

B Dimensions and Effectiveness of the Accounting Provisions of the FCPA

The management stewardship of MNCs was brought into question after the disclosure that millions of dollars had been spent to bribe foreign officials and to furnish funds to consultants and subsidiaries which they then laundered for use as illegal political contributions in the U.S., thus avoiding accountability through false entries in the corporations' books and records. The logical response to these irregularities in recording corporate liabilities and expenditures and to the abuse of trust by corporate management is the stringent internal control of MNCs' spending to ensure that it is commensurate with legitimate corporation expenditures. These internal control requirements were the seed of the internal accounting provisions of the FCPA, which then became a more vigorous legal concept.⁶²² U.S. Congress visualized a broad objective by enacting accounting provisions to control and remedy corporate misconduct. Thus illegal payments were seen as a consequence of dishonest record keeping and ineffective accounting control.⁶²³ These accounting provisions constitute a separate amendment to the United States Securities Exchange Act of 1934,⁶²⁴ and are intended to be applied to all issuers⁶²⁵ registered with the SEC, whether or not they do business overseas.

The purpose of these provisions is to give the SEC more power to insure corporate accountability. Thus, the goal is not merely to stop illegal payments, but to

⁶²² Wallace Timmeny, "An Overview of the FCPA"(1982-83), 9 *Syracuse J. Int'l L. & Com.*, 235-244, at 237.

⁶²³ Daniel L. Goelzer, "The Accounting Provisions of the Foreign Corrupt Practices Act The Federalization of Corporate Record keeping and Internal Control" (1979), 5 *J. Corp. L.* 53, at 19.

⁶²⁴ See Security Exchange Act of 1934, Sect. 13(b)(2), 15 U.S.C. 78 q(b)(2)(A)(B). Also see Notes, "The Accounting Provisions of the Foreign Corrupt Practices Act: An Alternative Perspective on SEC Intervention in Corporate Governance"(1980), 89 *Yale. L.J.*, 1573-1594, at 1574.

⁶²⁵ Sec. 30(a)(8) of the Federal Securities law of the U.S. defines "issuer" as "any person who issues or proposes to issue any securities ..." 15 U.S.C. Sec.78(a)(8) (1976); "person" in turn means "any natural person, company, government, or political subdivision, agency, or instrumentality of a government." Sec.3(a)(2) 15. U.S.C., Sec. 78(a)(9) [1976 Supp. I. 1977].

encourage ideal corporate governance by requiring adherence to these provisions.⁶²⁶ The accounting provision of Sec. 102 of the FCPA⁶²⁷ magnifies the disclosure approach⁶²⁸ by requiring all companies that file reports under the Securities law to

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.⁶²⁹

The provisions of the act also require all issuers to devise and maintain a system of internal accounting control sufficient to provide reasonable assurance that transactions are executed in accordance with management authorizations,⁶³⁰ and that transactions are recorded as necessary to permit the preparation of financial statements and to maintain accountability for the corporation assets.⁶³¹ Moreover, it requires that any access to the corporation assets must be permitted by and only in accordance with management authorization.⁶³² Finally, the recorded accountability is compared to existing assets at reasonable intervals, with reasonable steps taken to correct any differences.⁶³³ These stringent accounting standards are intended to ensure that no MNC expenditures are made without the approval of the proper organ in the organization and without being accurately recorded.⁶³⁴ Such accuracy in the corporate books and records will further achieve another important goal, the

⁶²⁶ Lloyd H. Feller, "An Examination of the Accounting Provisions of the FCPA" (1982-83), 9 *Syracuse J. Int'l L. & Com.* 245-254, at 247.

⁶²⁷ Sec. 102 of the FCPA, amending Sec. 13(b) of the Securities Exchange Act of 1934 of the U.S., codified at 15 U.S.C. Sec. 78m.

⁶²⁸ Steven M. Morgan, *supra*, footnote 611, at 368.

⁶²⁹ 15 U.S.C. Sec. 78m(6)(2)(a).

⁶³⁰ 15 U.S.C. Sec. 78m(6)(2)(a)(i).

⁶³¹ 15 U.S.C. Sec. 78m(6)(2)(a)(ii).

⁶³² 15 U.S.C. Sec. 78m(6)(2)(a)(iii).

⁶³³ 15 U.S.C. Sec. 78m(6)(2)(a)(iv).

⁶³⁴ Fredrick B. Lesser, *supra*, footnote 614, at 184.

prevention of the longstanding practice of creating a slush fund for corrupt purposes.⁶³⁵ These provisions also require the MNC to maintain accurate records of its expenditures, which must correspond to generally accepted accounting standards, to reflect the corporate disposition of its assets.⁶³⁶ Thus the act takes direct aim at corporations that have been very creative in attempting to circumvent accounting standards in order to disguise dubious payments.⁶³⁷ The degree of MNC compliance with these record keeping requirements shall be evaluated in terms of the specific transactions that have caused problems in the past and have in fact given rise to such requirements.⁶³⁸

Because of such measures MNCs are making comprehensive evaluations of their control systems so as to detect any weaknesses and take reasonable corrective action to bring practices into line with the accounting requirements of the FCPA. The audit committee should play a leading role in determining the efficacy of the corrective action and whether it embraces all potential areas of illegal or questionable transaction.⁶³⁹ Incoming to its decision, the audit committee would rely largely on the independent auditor's opinion of management's efforts to adhere to the internal control requirements of the act,⁶⁴⁰ because auditors are required to bring any "material weaknesses" they may find in the course of the auditing process to the attention of the MNC management or its audit commit-

⁶³⁵ Charles N. Stabler, "Foreign Bribery Act Imposes Tough Rules on the Bookkeeping of All Public Firms," *Wall Street Journal*, July 28, 1978, at 30, col. 1.

⁶³⁶ Shelley O'Neill, "The Foreign Corrupt Practices Act: Problems of Extraterritorial Application" (1979), 12 *Vand J. Transnat'l L.*, 689-720, at 692.

⁶³⁷ Deborah Rankin, "Accounting Ruses Used in Disguising Dubious Payments," (Study of a hundred companies that used ingenious methods, including dummy invoices, that are difficult for outside auditors to detect) *New York Times*, February 27, 1978, Sec. D, at 1, col. 1.

⁶³⁸ For example, certain types of actions, whether lawful or not, require stringent controls, such as political contributions, payoffs to foreign officials, commercial bribes and kickbacks. See Howard Baruch, *supra* footnote 618, at 34.

⁶³⁹ Daniel L. Goelzer, *supra* footnote 623, at 46.

⁶⁴⁰ *Id.*, at 50.

tee.⁶⁴¹ Correspondingly, when the corporate auditor, either external or internal, identifies any material weakness in the MNC internal accounting control,⁶⁴² management is bound to take positive action to remedy the defect, or to put forward reasonable justification, on a cost benefit analysis basis, for abstaining from taking any action to correct the problem.⁶⁴³ The corporation that fails to take these measures can be held liable for violating the act. Although the accounting requirement of the act, with its record keeping provisions, was intended to be used as a tool to force MNCs to disclose illegal payments, the word "record" as used in the act has generated some interpretative controversies. One writer has suggested that "any tangible embodiment of information made or kept by an issuer is within the scope of Sec. 102 of the FCPA, at least if it pertains to the recording of 'economic events'."⁶⁴⁴ Another commentator contested this definition, saying that "the word 'record' does appear in the act, but the language does not limit the definition to 'accounting records'; the SEC's definition of the word is broader than was intended when the act was written."⁶⁴⁵ Notwithstanding this interpretative disagreement, the efficacy of the internal control system in an MNC depends not

⁶⁴¹ AICPA Staff, "Auditing Interpretations Internal Accounting Control and the Foreign Corrupt Practices Act" (October 1978), 146 *The Journal of Accountancy*, at 130.

⁶⁴² The accounting profession has an accepted definition of what constitutes a material weakness in internal control:

... a condition in which the auditor believes prescribed procedures or the degree of compliance with them does not provide reasonable assurance that errors or irregularities in amounts that would be material in the financial statements being audited would be prevented or detected within a timely period by employees in the normal course of performing their assigned functions. These criteria may be broader than those that maybe appropriate for evaluating weaknesses in accounting control for management or other purposes.

See American Institute of Certified Public Accountants, *Statement on Auditing Standards*, No. 1, Codification of Auditing Standards and Procedures, Sec. 320, 64-68(1972).

⁶⁴³ Barbara C. George and Mary J. Dundas, "Responsibilities of Domestic Corporate Management under the Foreign Corrupt Practices Act" (1980), 31 *Syracuse L.Rev.*, 865-905, at 879.

⁶⁴⁴ Daniel L. Goelzer, *supra*, footnote 623, at 23.

⁶⁴⁵ Lloyd H. Feller, *supra*, footnote 626, at 250.

only on the organizational structure of the corporation but also on the calibre of its employees and the parameters of the whole internal control system.⁶⁴⁶

Despite the apparent and essential thrust of the accounting provisions in fighting bribery and questionable payments by MNCs, the fact that the act excludes matters of national security⁶⁴⁷ emasculates its essential objective. This rather cryptic exemption permits MNCs that are involved with the CIA and its officials abroad⁶⁴⁸ to falsify their records and books to the extent necessary to conceal the illegal payments they make outside the country to foreign officials.⁶⁴⁹ This exemption also results in a loophole that may be used "to immunize the very aerospace and other defence related enterprises whose improper activities abroad led to the congressional passage of the statute."⁶⁵⁰

The responsibility for enforcing the accounting provisions of the FCPA has been granted to the SEC because of the incorporation of the FCPA into the Securities Exchange Act.⁶⁵¹ So the SEC has a wide and flexible array of regulatory and enforcement tools with which to carry out the implementation of these

⁶⁴⁶ Daniel L. Goelzer, *supra*, footnote 623, at 28.

⁶⁴⁷ 15 U.S.C. Sec. 78m (b)(3)(A) (Supp. I 1977) This provision exempts national security matters when the head of an agency or department dealing within such an area issues a written directive pursuant to presidential authority.

⁶⁴⁸ A special CIA office was created in Washington, D.C., in 1967 to place former CIA agents in the overseas offices of American based corporations. The retired CIA agents, who once made bribes "officially," carried out the same tasks in the private sector. One prominent example is Kermit Roosevelt, Jr., who became an international consultant for Northrop, bribing the same contacts in the Middle East he had bribed for the CIA. See J. Roebuck and S. Weeber, *Political Crime in the United States: Analyzing Crime by and against Government* (1978), at 88.

⁶⁴⁹ David Ignatius, "Foreign Bribery; Trials May Show U.S. Knew of Some Payments," *Wall Street Journal*, October 5, 1978, at 1, col. 6. The writer describes the involvement of the CIA in many foreign illegal payments by using corporate covers to place agents in foreign countries.

⁶⁵⁰ Terry E. Bathen, "A Congressional Response to the Problem of Questionable Corporate Payments Abroad: The Foreign Corrupt Practices Act of 1977" (1978), 10 *Law & Policy Int'l Bus.*, 1253-1304, at 1265.

⁶⁵¹ The FCPA is actually an amendment to the United States Federal Securities laws. See *supra*, footnote 612 for more details.

provisions.⁶⁵² It has brought several actions against corporations that violated the accounting provisions, although these cases have been settled through consent decrees before trial. For example, in *SEC v. Textron, Inc.*⁶⁵³ the SEC charged that employees of Textron altered company records to conceal \$5million in questionable payments to senior government officials in several countries and in the United States. The company consented to an injunction against further violations of antifraud and record keeping provisions. Also, in *SEC v. Sam P. Wallace Co.*⁶⁵⁴ the SEC charged that the Sam P. Wallace Co. paid \$1.4million to foreign officials to obtain or retain business in unnamed countries. It alleged that these payments were improperly accounted for and were in violation of the provisions of the FCPA. Further, the SEC charged the corporation with making misleading representations in financial statements and proxy-solicitations. The corporation finally consented to an injunction against further violations of the FCPA provisions. Seemingly, the wisdom behind the SEC's inclination to limit its action in many cases to court approved settlement of a consent decree rather than to pursue these cases to trial is to secure a wide range of remedies against defendants through management changes, and to give the MNC a chance to continue its internal remedies by self investigating any violation through an independent audit committee. There might also be certain pressure from the business community, with the complicity of some officials, to refrain from vigorously enforcing the act, as hinted in the words of Charles Nartman, a regional counsel of SEC: "Technically, it's possible to bring a pure FCPA suit. We just haven't to date."⁶⁵⁵ There has

⁶⁵² Daniel L. Goelzer, *supra*, footnote 623, at 31.

⁶⁵³ *SEC v. Textron, Inc.*, SEC Reg. and L.Rep.(BNA) No. 539, at A 2, (D.D.C. January 31, 1980).

⁶⁵⁴ *SEC v. Sam P. Wallace Corp.*, SEC Reg. and L.Rep. (BNA) No. 617, at A 4 (D.D.C. August 13, 1981).

⁶⁵⁵ Laurel Leff, "Internal Auditors Find Them selves Loved as Rules Stiffen for 'Clean' Sets of Books," *Wall Street Journal*, January 15, 1980, at 46, col. 2.

been a fair amount of debate about the ambiguity of several sections of the act.⁶⁵⁶ Several voices have called for an amendment to remove the books and records provision.⁶⁵⁷ Furthermore, the less than aggressive stance in the enforcement and interpretation of the act reflects the changing attitude of the American administration and the tendency of U.S. officials to maintain a low profile in the area of prosecuting illegal foreign payments by U.S. MNCs.⁶⁵⁸

⁶⁵⁶ Lloyd H. Feller, *supra*, footnote 626, at 252.

⁶⁵⁷ *Id.*, at 253.

⁶⁵⁸ John Sweeney, "The SEC Interpretative and Enforcement Program Under the FCPA" (1982-83), 9 *Syracuse J. Int'l L. & Com.*, 273-281, at 281.

C. Scope of the Anti-Bribery Provisions of the FCPA

Basically the FCPA is an attempt to regulate corporate behaviour in two major areas. One area, which we have discussed, is the maintenance of accurate records and books that reflect all the MNC's transactions, its liabilities and the disposition of its assets, thus guaranteeing the reliability of its auditing process and the disclosure to investors and to the public of all questionable or illegal transactions. The second related area in which the FCPA seeks to alter corporate behaviour is the securing of business by bribing foreign officials. The act contains two such prohibitions. Secs. 103.⁶⁵⁹ and 104.⁶⁶⁰ pin point the issue of bribery and explicitly prohibit the misuse of corporate assets and "directly criminalize the making of payments for the purpose of inducing foreign officials to misuse their positions to grant favorable treatment to the payor."⁶⁶¹

The anti-bribery provision of Sec. 103 is directed at the publicly held corporation (the issuer), that has a class of securities registered on the United States National Securities Exchange in accordance with the procedures of the Securities Exchange Act.⁶⁶² The requirement is perceived to be an attempt to avoid the extraterritorial reach of the act to foreign owned subsidiaries of American MNCs,⁶⁶³ although these limitations may be challenged under the agency theory,⁶⁶⁴ when the parent corporation may be held liable for the acts of its agents or subsidiaries if there is an authorization by the parent, or when the parent may

⁶⁵⁹ 15 U.S.C. Sec. 78dd

⁶⁶⁰ 15 U.S.C. Sec. 78dd

⁶⁶¹ Kathleen F. Brickey, *Corporate Criminal Liability* (1984), vol. 2, at 46.

⁶⁶² 15 U.S.C. Sec. 78dd 1(a). This section encompasses the class of securities that are registered pursuant to Sec. 12 of the Securities Exchange Act of 1934, 15 U.S.C. Sec. 78 L. It also encompasses issuers that are required to file reports under Sec. [15] d of the Exchange Act, 15 U.S.C. Sec. 780(d).

⁶⁶³ Frederick B. Lesser, *supra*, footnote 614, at 165.

⁶⁶⁴ See *infra*, Chapter 6.0.

have knowledge of or have reason to have knowledge of the payment or the portion of it used to bribe foreign officials.⁶⁶⁵ The anti-bribery provisions of Sec. 104 of the act are directed toward those individuals and companies that are not registered with the SEC. The prohibitions of this section extend to what are termed "domestic concerns,"⁶⁶⁶ which have been defined as any legal entities other than reporting companies.⁶⁶⁷ This section specifies that payments or bribes are prohibited for certain foreign officials if made for the purpose of influencing the official's act or his decision to abstain from acting,⁶⁶⁸ or for the purpose of inducing the recipient of the bribe to endeavour to influence a foreign official or government instrumentality in order to affect a government act or decision.⁶⁶⁹

The act makes it illegal for U.S. MNCs, both domestic concerns and those registered with the SEC, to pay bribes to certain foreign officials,⁶⁷⁰ to foreign political parties, to officials of foreign political parties, or to candidates for foreign political office.⁶⁷¹ Also, the language of the act suggests that an MNC is liable for the act of any person connected with the MNC who has paid a bribe, provided that the MNC knows of or has reason to know of the payment as being a bribe to a foreign official.⁶⁷² However, if the employee of the MNC acted on his own in

⁶⁶⁵ 15 U.S.C. Sec. 78dd 1 (a)(3); 15 U.S.C. Sec. 78dd 2 (a)(3).

⁶⁶⁶ 15 U.S.C. Sec. 78dd 2(d)(1), which defines a "domestic concern" as:

... any individual who is a citizen, national or resident of the United States, or any corporation, partnership, association, joint stock company, business trust, unincorporated organization, or sole partnership which has its principal place of business in the United States, or which is organized under the law of a state of the United States, or a territory, possession, or commonwealth of the United States.

⁶⁶⁷ Wallace Timmeny, *supra*, footnote 622, at 239.

⁶⁶⁸ 15 U.S.C. Sec. 78dd 1(a)(1)(A), (a)(2)(A), (a)(3)(A); 15 U.S.C. Sec. 78dd 2(a)(1)(A), (a)(2)(A), (a)(3)(A).

⁶⁶⁹ 15 U.S.C. Sec. 78dd 1(a)(1)(B), (a)(2)(B), (a)(3)(B); 15 U.S.C. Sec. 78dd 2(a)(1)(B), (a)(2)(B), (a)(3)(B).

⁶⁷⁰ 15 U.S.C. Sec. 78dd 1(a)(1); 15 U.S.C. Sec. 78dd 2(a)(1).

⁶⁷¹ 15 U.S.C. Sec. 78dd 1(a)(2); 15 U.S.C. Sec. 78dd 2(a)(2).

⁶⁷² 15 U.S.C. Sec. 78dd 1(a)(3); 15 U.S.C. Sec. 78dd 2(a)(3).

making such an offer or promise, the liability of the MNC depends on the circumstances surrounding the payment, which would take into account the employee's position in the company, the degree of supervision that the board of directors exercises over the management of the company, and the degree of supervision that the management exercises over the employee involved.⁶⁷³ The act defines the term "foreign official" narrowly to include only officers and employees of foreign governments or government departments, agencies and instrumentalities.⁶⁷⁴ It also includes any person who is acting in an official capacity on behalf of such government or its entity,⁶⁷⁵ and this suggests the inclusion of officials of state industries and enterprises.⁶⁷⁶ The act specifically limits the term "official" to those officers in foreign governments who have decision making powers. It states:

Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical.⁶⁷⁷

⁶⁷³ Fredrick B. Lesser, *supra*, footnote 614, at 167.

⁶⁷⁴ What constitutes an "agency or instrumentality" is not defined under the act, which leaves the court with full discretion to define such terms by using definitions in other statutes. See *Id.*, at 179.

⁶⁷⁵ 15 U.S.C. Sec. 78 dd 1(b); 15 U.S.C. Sec. 78dd 2(d)(2).

⁶⁷⁶ Fredrick B. Lesser, *supra*, footnote 614, at 179.

⁶⁷⁷ 15 U.S.C. Sec. 78dd 1(b); 15 U.S.C. Sec. 78dd 1(d)(2). One writer suggests that, in determining whether the payment to a particular person is prohibited by the act, the focus should be on the nature of the foreign official's job, not on the particular act that he is paid to perform. See H.T. Sprow and J.N. Benedict, *supra*, footnote 618, at 357-61. Under this interpretation, a payment made to a civil servant whose duties involve the exercise of discretion would be unlawful, even if the act he was paid to perform was essentially ministerial or clerical. Moreover, there are many difficulties in applying this exclusion, because in many countries those holding official positions also own companies and work as businessmen. For example, in the Middle East, only one of Qatar's fourteen cabinet ministers has no known business ties, and similar situations exist in other countries such as Oman and the United Arab Emirates. Thus if an MNC pays fees to those who work as their agents or who benefit from a profit sharing agreement, the MNC risks making an illegal payment under the act. See L. Robert Primoff, "The FCPA: Implications for the Private Practitioner" (1982-83), 9 *Syracuse J. Int'l L. & Com.*, 325-337, at 335.

Under the act the discretionary power of a foreign official to make a decision is an essential factor for liability, so that when the "duties require the exercise of reason in the adaptation of means to end, and a choice in determining the course to be pursued,"⁶⁷⁸ the employees exercising those duties are foreign officials under the act. The focus here is on the specific status of the recipient, which might raise the argument that "a payment to a clerical officer would not be prohibited even where the officer performs a function for a payor which exceeds his normal clerical or ministerial duties."⁶⁷⁹

Congruently, the act prohibits payments made for the "corrupt" purpose⁶⁸⁰ of influencing a foreign official to act in favour of the payor for the purpose of obtaining or retaining business in the country where payment is made, or to cause the payment to be directed to achieve these purposes.⁶⁸¹ This limitation is called a "business purpose test,"⁶⁸² and it prohibits only those payments that are intended to influence a foreign official's decision to assist the payor in obtaining or retaining business.⁶⁸³ The act, therefore, contemplates a specific intent to make illegal payments on the part of the payor. The word "corruptly" serves as a limitation in order to make it clear that any gift, promise, or offer which does not have a corrupt intent is not embraced by the act, because those payments are not made to influence a foreign official's decision in favour of the giver. By stipulating corrupt intent on the part of the MNC, the limitation relieves MNCs from liability for payment resulting from extortion.⁶⁸⁴ While the general thrust of all attempts to

⁶⁷⁸ Fredrick B. Lesser, *supra*, footnote 614, at 179.

⁶⁷⁹ Steven M. Morgan, *supra*, footnote 611, at 373.

⁶⁸⁰ 15 U.S.C. Sec. 78dd 1(a); 15 U.S.C. Sec. 78dd 2(a).

⁶⁸¹ Wallace Timmeny, *supra*, footnote 622, at 240.

⁶⁸² Steven M. Morgan, *supra*, footnote 611, at 372.

⁶⁸³ 15 U.S.C. Sec. 78dd 1(a)(1), (2), (3); 15 U.S.C. Sec. 78dd 2(a), (1), (3).

⁶⁸⁴ Margaret H. Young, "A Comparison of the Federal Corrupt Practices Act and the Draft International Agreement of Illicit Payment" (1980) 13 *Vand. J. Transnat'l L.*, 795-823, at 802.

define the scope of the term "corrupt" is to remove certain types of payment from the ambit of prohibition, there are still difficulties in applying the exclusion.⁶⁸⁵ This is because first, the existing "corrupt" standard does not require either that the proscribed act be fully consummated or that it succeed in producing the desired outcome,⁶⁸⁶ second, such standard does not define what constitutes evidence of corrupt intent on the part of the payor and to what extent the MNC is allowed, for example, to entertain a visiting foreign official in connection with a demonstration of the company's goods or services.⁶⁸⁷ In addition, the act implicitly permits "grease" or "facilitating" payments to lower level employees or by excluding from the definition of "foreign official" those whose duties are clerical or ministerial.⁶⁸⁸ Ironically, it seems to suggest that such payments are permitted regardless of the amount involved and in spite of the fact that these employees may be used as a conduit to channel part of the grease payment to an official as defined in the act.⁶⁸⁹ This type of payment would foster corruption in lower level employees of the host country and would encourage them to abstain from performing their duties unless they receive bribery incentives. Also it encourages them to neglect service to their fellow citizens who do not pay and who rely on their work.

Furthermore, the standard of interpretation should not depart from what the nation considers to be corruption. In the writer's view, making different interpretations of the term on a multicultural basis does not serve the purpose of justice, which every nation strives to achieve and maintain, nor does it serve the acclaimed ethical standards that the act is intended to preserve.⁶⁹⁰ It is

⁶⁸⁵ Frederick B. Wade, "An Examination of the Provisions and Standards of the FCPA" (1982-83), 9 *Syracuse J. Int'l L. & Com.*, 255-272, at 270.

⁶⁸⁶ *Ibid.*

⁶⁸⁷ L. Robert Primoff, *supra*, footnote 677, at 335.

⁶⁸⁸ 15 U.S.C. Sec. 78dd 1(b); 15 U.S.C. Sec. 78dd 2(d)(2). See also Wallace Timmeny, *supra*, footnote 622, at 239; and Margaret H. Young, *supra*, footnote 684, at 802.

⁶⁸⁹ L. Robert Primoff, *supra*, footnote 677, at 334.

⁶⁹⁰ The revelation of monumental international illegal payments does give first impression

inconceivable to say that the concept of corruption varies from nation to nation,⁶⁹¹ or to make a distinction between "conventional" and "functional" corruption⁶⁹² to rationalize grease or facilitating payment on the ground that the payment is not corrupt in some countries, though considered corrupt in the U.S.⁶⁹³

that bribery is known everywhere, however, that does not mean that it is accepted as part of the philosophical or legal structure of any country on this earth. Steven M. Morgan, supra, footnote 611, at 362.

⁶⁹¹ Gerald T. McLaughlin, supra, footnote 610, at 1071.

⁶⁹² Arnold A. Rogou and H.D. Lasswell, "The Definition of Corruption," in *Political Corruption: Readings in Comparative Analysis* (Arnold J. Heidenheimer, editor, 1978), at 54

⁶⁹³ See supra, footnote 82 and accompanying text.

D. Enforcement and Penalty Under the FCPA

The administration of the FCPA is divided between the SEC and the United States Department of Justice. The FCPA envisioned that the SEC would continue its role as investigator of foreign bribery⁶⁹⁴ and have enforcement authority over FCPA violators because of its role in overseeing compliance with the accounting provisions of Sec. 102 of the FCPA,⁶⁹⁵ and the antibribery provisions of Secs. 103 and 104 of the act against issuers.⁶⁹⁶ The SEC has authority over all registered MNCs (issuers), regardless of nationality or the extent of their contract with the U.S., which may be as minimal as trading stock on the U.S. exchange market.⁶⁹⁷

The commission has two available remedies: civil injunction against violators⁶⁹⁸ and suspension of professionals, such as attorneys and accountants, that are licensed to practice before it.⁶⁹⁹ The Department of Justice has criminal enforcement responsibility with respect to those companies that violate the accounting provisions. Once the SEC has gathered evidence sufficient to take criminal action

⁶⁹⁴ The SEC assumed its role as investigator of foreign bribes by MNCs right after the Watergate scandal. It initiated the voluntary disclosure program and laid down injunctions against several MNCs who had violated the reporting requirement under the Securities Exchange Act of 1934, when the amounts of the bribes and illegal political contributions were material. Although when the SEC entered the game the amounts were trivial, it was astonished at the participation of top management, and the total of the payments made. For more detail on the earlier participation of the SEC, see Lloyd N. Cutler, "Watergate, International Style" (1976), 24 *Foreign Policy*, 160-171.

⁶⁹⁵ 15 U.S.C. 78m (b)(2)(b) requires record keeping and the maintenance of firm internal control.

⁶⁹⁶ John W. Bagby, "Enforcement of Accounting Standards in The Foreign Corrupt Practices Act" (1982), 21 *Am. Bus. L.J.*, 213-235, at 220.

⁶⁹⁷ The SEC has examined secret payments by foreign companies made in the U.S. to win or maintain airline business. Staff reporter, "Aloha Airlines Puts Off a Proposed Takeover by International Air, *Wall Street Journal*, March 8, 1979, at 6, col. 4.

⁶⁹⁸ See *SEC v. Int'l System Control Corp.*, (1979) 838 Fed. Sec. L. Rep (CCH) 7-8 (D.D.C. December 27, 1979).

⁶⁹⁹ Fredrick B. Lesser, *supra*, footnote 614, at 182.

against violators of the accounting provisions, the commission will refer the case to the Department for criminal prosecution.⁷⁰⁰ The Department, under the act, has enforcement authority for both civil and criminal prosecution with respect to "domestic concerns," which includes corporations not registered with the SEC (that is, companies other than reporting companies), partner ships, and individuals.⁷⁰¹

Essentially, there must be a jurisdictional nexus as a basis for conviction or prosecution of the violators. The act requires that a jurisdictional means had to be used to establish the violation of the statute. It provides that the mail or another instrumentality of interstate commerce had to have been used in furtherance of the illegal payments.⁷⁰² This broad basis of jurisdiction encompasses all corrupt foreign activities abroad by MNCs, save the national security exception provided by the statute.⁷⁰³ Accordingly, "if one were to use the jurisdictional means to cover up payment or to send a message to get to the point where one was going to make an improper payment, that could well be in furtherance of the payment."⁷⁰⁴ Thus, notwithstanding the act does not appear to have an extraterritorial reach extending to foreign subsidiaries of American MNCs, it may have some consequences on the U.S. parent company, if it can be proved that the parent knew or had reason to know that its foreign subsidiaries relied on the payment of bribery to do business abroad. In such a case the parent company would be subject to

⁷⁰⁰ Frederick B. Wade, *supra*, footnote 685, at 268.

⁷⁰¹ 15 U.S.C. Sec. 78dd 2(d)(1). Also see *supra*, footnote 666 and accompanying text.

⁷⁰² 15 U.S.C. Sec. 78dd 2(d)(3). What constitutes instrumentality of interstate commerce is any

trade, commerce, transportation, or communication among the several states, or between any foreign country and any state or between any state and any place or ship outside thereof. Such terms include the interstate use of a) a telephone or other interstate means of communication, or b) any other interstate instrumentality.

⁷⁰³ Shelley O'Neill, *supra*, footnote 636, at 695.

⁷⁰⁴ Wallace Timmeny, *supra*, footnote 622, at 240.

prosecution and to the penalty prescribed by the act.⁷⁰⁵

Intrinsically, the FCPA prescribes stringent penalties for those who violate its provisions. The penalties for violating the anti-bribery provisions are severe indeed. Under the Act: a) any corporation, "issuer" or domestic concern upon conviction may be fined up to one million dollars;⁷⁰⁶ b) any individual who is a domestic concern and who wilfully violates the antibribery provisions may be fined up to \$10,000, and/or be imprisoned for up to five years;⁷⁰⁷ c) any officer or director of any issuer or domestic concern, or any stockholder acting on behalf of the issuer or domestic concern who wilfully violates the provisions of the act may also be fined up to \$10,000, and/or be imprisoned for up to five years;⁷⁰⁸ d) any employee or agent of a company subject to the jurisdiction of the United States who wilfully carries out an act constituting violation of the provisions of the FCPA is subject to the same penalties, but only when the company itself is found to have violated the anti-bribery provision of the act.⁷⁰⁹

An example of the above situation is the case of *United States v. McLean*.⁷¹⁰ The Fifth Circuit of the United States Court of Appeals affirmed the District Court dismissal of action against the defendant employee for violation of the FCPA on the ground that the employee of the issuer could not be prosecuted in his indivi-

⁷⁰⁵ Stanley J. Marcuss, "Extraterritoriality: U.S. Anti-Boycott Law and the Foreign Corrupt Practices Act" (1983), 15 *Law & Pol'y Int'l Bus.*, 1135-1146, at 1144.

⁷⁰⁶ 15 U.S.C. Sec. 78ff(c)(1)(b). Although Sec.102 of the FCPA does not include any specific penalties against violation of the accounting provisions of the act, the SEC chairman, in 1978, stressed that this section can be enforced "by the same tools as the balance of the Federal Security laws," Address by SEC Chairman Harold M. William before the American Accounting Association in Denver, Colorado. (August 22, 1978) quoted in Terry E. Bathen, *supra*, footnote 650, at 1261.

⁷⁰⁷ 15 U.S.C. Sec. 78dd 2(b)(1)(B).

⁷⁰⁸ 15 U.S.C. Sec. 78ff(c)(2); 15 U.S.C. Sec.78dd 2(6)(2).

⁷⁰⁹ 15 U.S.C. Sec. 78ff(c)(3); 15 U.S.C. Sec.78dd 2(6)(3).

⁷¹⁰ *United States v. McLean*, 738 F.2d 655 (5th Cir., 1984), cert. denied, 105 S.ct. 1748 (1985).

dual capacity as a domestic concern, because the government plaintiff was unable to satisfy the requirement of showing that the issuer the employer was in violation of the act. The case involved two criminal prosecutions stemming from an investigation of an alleged foreign bribery scheme involving International Harvester Company, Crawford Enterprises, Inc., and Pemex, Mexico's national petroleum company. The Solar division of Harvester was the dominant worldwide supplier of turbine compressor equipment from Solar and Crawford Enterprises.⁷¹¹ A forty-nine count indictment charged that George S. McLean, vice president of the Solar division, and Luis A. Uriarte, Solar's Latin American regional manager, conspired to bribe and did bribe officials of Pemex in violation of 15 U.S.C. Secs. 78dd 2(a)(1) & (3), 78dd 2(b).⁷¹² Harvester was not charged in that indictment.⁷¹³ Shortly after the indictment was issued, Harvester pleaded guilty under a one count information item charging the company with conspiring to violate the FCPA. In exchange for Harvester's guilty plea, the government agreed not to prosecute Harvester further in connection with the compressor equipment sales. Following Harvester's plea, Mc Lean and Uriarte moved to dismiss the indictment against them because, as employees of Harvester, they could be held responsible for violating the FCPA only if Harvester were also found to have violated the act. The district court agreed that the substantive counts should be dismissed, but let the conspiracy count stand.⁷¹⁴ Then the government appealed the dismissal, arguing that a) the "found to have violated" provision does not require that the

⁷¹¹ Crawford Enterprises, a broker and lessor of gas compression systems, often purchased equipment from Harvester for resale or lease. During the mid '70s Harvester, as prime contractor, had supplied equipment to Pemex. In the late 1970s, Crawford contracted with Pemex to build compression plants, and Harvester acted as subcontractor for Crawford. See Ibid. at 656.

⁷¹² The conspiracy charge was brought under the general Federal Conspiracy Statute, 18 U.S.C. Sec. 371. See Ibid

⁷¹³ Ibid. at 657.

⁷¹⁴ Ibid

employer be convicted of an FCPA violation, because this requirement may be satisfied by establishing at the employee's trial that the employer violated the act; and b)Mc Lean, as an individual domestic concern, may be charged with aiding and abetting Crawford Enterprises, Inc.⁷¹⁵ The Fifth Circuit, after reviewing the legislative history underlying the "found to have violated" requirements and the language of the act, concluded that it was the legislators'

... clear intent to impose criminal sanctions against the employee who acts at the behest of and for the benefit of his employer only where his employer has been convicted of similar FCPA violations...⁷¹⁶

The court's concern was that agents and low level employees might be made scapegoats for the corporation and used as shields against institutional liability. Such interpretation might provide an incentive for the corporation to assist employees in their defence.⁷¹⁷ The court finally held that

... in order to convict an employee under the FCPA for acts committed for the benefit of his employer, the government must first convict the employer. Because the government failed to convict Harvester and under the plea agreement will be unable to indict Harvester and try it with McLean, the act bars McLean's prosecution...⁷¹⁸

Eventually, if the employee, director, stockholder, officer, or agent of the company is convicted and fined, the act prohibits the corporation the issuer for paying restitution directly or indirectly. ⁷¹⁹ KIC was convicted in an FCPA criminal

⁷¹⁵ Ibid

⁷¹⁶ Id. at 659.

⁷¹⁷ Ibid

⁷¹⁸ Id. at 660.

⁷¹⁹ 15 U.S.C. Sec. 78dd 2(6)(4); 15 U.S.C. Sec.78ff(c)(4). To date there has been only one successful criminal prosecution under the act. In *U.S. v. Kenny International Corporation United States v. Kenny International Corporation*, Crim. No. 79-372 (D.D.C., August 2, 1979);and Civ. No. 79-2038 (D.D.C. August 2, 1979). Both actions were settled by the imposition of civil penalties and injunctive relieves. Commented upon by Kenneth I. Juster, "Multinational

prosecution and was fined \$50,000. As part of a guilty plea bargain, KIC entered into an agreement with the government of the Cook Islands⁷²⁰ whereby the corporation obtained the exclusive rights to the distribution and sale of the Islands' postage stamps outside the Cook Islands. KIC and its founder and chief executive, Fibar B. Kenny, believed that the stamp distribution agreement could be assured only if the country's premier and the leader of the Cook Islands Party was reelected. A representative of the Islands' premier solicited \$NZ 337,000 from KIC to pay the transportation costs for flying party supporters from New Zealand to the Cook Islands to vote in favour of the premier. F. Kenny agreed to provide such funds on behalf of KIS. When the premier won the election, his opponent contested the result and the High Court of that country overturned the election results, because such a voter subsidy is illegal under Cook Islands law. The U.S. Department of Justice charged that the acts of F. Kenny and KIC were in violation of the antibribery provision of the FCPA. According to the provision, the bribery in this case was a "domestic concern,"⁷²¹ because KIC was organized and existed under the laws of the State of New York, and used an instrumentality of interstate commerce, namely the mails and commercial aircraft. After pleading guilty on a plea bargain agreement, F. Kenny and KIC were fined only \$50,000, with F. Kenny acceding to several of the Department of Justice's conditions, among them to appear before the High Court of the Cook Islands and to plead guilty to a pending criminal charge.⁷²² The success of the prosecution in this case is attributable to its political nature, and to the cooperative effort of the foreign government,

Corporations: Foreign Corrupt Practices Act of 1977" (1979), 20 *Harv. Int'l L.J.*, 716-720.

⁷²⁰ The Cook Islands are located 2,700 km off the coast of New Zealand. They are an independent South Pacific nation freely associated with New Zealand for purposes of external affairs and defence. See *Political Handbook of the World* (A. Bank, ed., 1978), at 321.

⁷²¹ 15 U.S.C. Sec. 78dd 2(d)(1).

⁷²² Kenneth I. Juster, *supra*, footnote 719, at 718.

which brings us to the conclusion that the enforcement of the act requires maximum cooperation by the government of the country where the bribe taker resides, because any criminal prosecution requires evidence to prove beyond reasonable doubt that the act was violated.⁷²³ Japan 27 U.S.T. 946, T.I.A.S. No. 8233 (Bilateral agreement on Exchange of Information)

From the two cases we have just presented the only ones that have ever been brought under the statute there is evidence of weakness in the act and problems surrounding enforcement of its provisions. One commentator has advanced three reasons for the SEC's and the Department of Justice's lack of zeal in enforcing the act:

- (a) the difficulty that the prosecutors face in proving violation, because of the extraterritorial situs of the criminal action, and the delicate methods of concealing the illegal payments;
- (b) foreign policy implication and the problems that may accompany the enforcement efforts, especially when the recipient is attached to a government that is friendly to the U.S., because the enforcement may offend other officials of that country, and consequently harm other U.S. interests; and
- (c) the negative effect to the U.S. MNC of losing business abroad as a result of the enforcement of the act, especially when competitors from other countries are willing to pay bribes.⁷²⁴

In spite of these enforcement difficulties and notwithstanding the fact that the FCPA does not specifically provide for the right of private action, nor could one

⁷²³ Shelley O'Neill, *supra*, footnote 636, at 717. The cooperative efforts to deal with the problem of illegal payments were demonstrated by the agreement between the United States and Japan when the two governments agreed to procedures for mutual assistance in the Lockheed scandal, March 23, 1976. United States

⁷²⁴ William L. Larson, "Effective Enforcement of the Foreign Corrupt Practices Act" (1980), 32 *Stan. L.Rev.*, 561-580, at 569.

infer from the legislative history of the act and the surrounding circumstances that there was a desire to have an implied right of action,⁷²⁵ the SEC contemplates a private right of action for those injured by prohibited illegal foreign payments on the ground that such an action would unquestionably benefit enforcement of the act.⁷²⁶ In taking this position the SEC does not anticipate the harm that can be done when competitors use such a course of action to frustrate the defendant's business activities and tarnish its reputation,⁷²⁷ in the hope of taking the defendant's place in the international business market.

⁷²⁵ Mary F. Lyle, "The Foreign Corrupt Practices Act of 1977: Private Right of Action?" (1979), 12 *Vand. J. Transnat'l L.*, 735-755, at 750.

⁷²⁶ See letter from Frederick B. Wade (SEC special Counsel Office of the General Counsel) to M. Raymond Garcia, Emergency Committee for American Trade, Washington, D.C., May 16, 1978, asserting the existence of a private course of action, reprinted in [1978 Transfer Binder] *Fed. Sec. Reg. L. Rep.* (CCH) #81, 701.

⁷²⁷ William L. Larson, *supra*, footnote, 724, at 576.

E. Compliance Problems and the Effectiveness of the FCPA

The fundamental purpose of the FCPA was to deal with the continuing problem of illegal foreign payments by United States corporations. However, during the many years since the act was passed, numerous complaints have arisen⁷²⁸ from the intentionally perhaps deceptively concise wording of provisions that have not yet been defined by the legislator,⁷²⁹ or by court decision.⁷³⁰ The ambiguity of the accounting provision's language enables the administrative agency, the SEC, to interpret the act to extend as far as possible into management decision making.⁷³¹ Such terms as "accurately and fairly" and "reasonable assurances"⁷³² have brought about confusion that maybe forcing the management of MNCs to select the most stringent and expensive control systems rather than to risk violating the act. The requirement to provide "reasonable details" gives the SEC a wide range of latitude to define the objective of MNC internal control to encompass all assets and expenditures, regardless of the level of the administrative authorities within the corporation.⁷³³ Moreover, the "reason to know" standard, which has been designed to cover the channelling of illegal payments to foreign officials

⁷²⁸ Bartley A. Brennan, "Amending the Foreign Corrupt Practices Act of 1977: 'Clarifying' or 'Cutting' a Law?" (1984), 11 *J. Legis.*, 56-89, at 57.

⁷²⁹ William C. George, "The Foreign Corrupt Practices Act Review Procedures: A Quest For Clarity" (1981) 14 *Cornell Int'l L.J.*, 57-93, at 59.

⁷³⁰ Most of the cases that have been investigated have been settled before going to trial. For example *SEC v. Textron, Inc.*, SEC. Reg. and L. Rep.(BNA) No. 539, at A 2, (D.D.C. January 31, 1980); and *SEC v. Sam R. Wallace Corp.*, SEC. Reg. and L. Rep.(BNA) No. 617, at A 4 (D.D.C. August 13, 1981). This demonstrates the unwillingness of the authorities to enforce the act stringently, as evidenced by the elimination of the Multi-National Branch of the Criminal Fraud Division of the U.S. Department of Justice, which has reviewed hundreds of cases for criminal prosecution. See Brooks Jackson, "Overseas Bribery Gets a Lot Less Attention after Cutbacks by the Justice Department," *Wall Street Journal*, February 22, 1983, at 33, col. 4.

⁷³¹ Notes, "The Accounting Provisions of the Foreign Corrupt Practices Act: An Alternative Perspective on SEC Intervention in Corporate Governance" (1980), 89 *Yale L. J.*, 1573-1594, at 1575.

⁷³² 15 U.S.C. Sec. 78m(6)(2)(A) (B).

⁷³³ Notes, *supra*, footnote 731, at 1577.

through agents and subsidiaries of the parent corporation,⁷³⁴ may increase the MNC's liability; so far no court decision has interpreted this phrase.⁷³⁵ Further, the act has no precise definition of a "facilitating" or "grease" payment.⁷³⁶

Besides the problems arising from imprecise language, the SEC has not made it clear what the consequences will be if "grease" payments increase corruption among lower level employees of foreign government, nor dealt with the impact of allowing such payments to foreign employees when the employee's government has laws prohibiting bribery of such a nature. Also the problem of dual enforcement author by the SEC and the U.S. Department of Justice may raise the possibility of inconsistent enforcement of the act.⁷³⁷

All these problems have rationally provoked arguments about the effectiveness of the act, and have motivated several groups to seek its amendment.⁷³⁸ These voices have found listening ears among the U.S. administration, in the form of pressure to amend the Act⁷³⁹ or at least direct the Department of Justice and the SEC to provide a guideline to delineate the enforcement policy and priorities for a proposed transaction.⁷⁴⁰

Though resenting the pressure,⁷⁴¹ the Department of Justice has issued the

⁷³⁴ Frederick B. Wade, *supra*, footnote 685, at 271.

⁷³⁵ Bartley A. Brennan, *supra*, footnote 728, at 64.

⁷³⁶ *Ibid.*, at 66.

⁷³⁷ John W. Bagby, *supra*, footnote 696, at 214.

⁷³⁸ Bartley A. Brennan, *supra*, footnote 728, at 56.

⁷³⁹ See *supra*, footnote 404 and accompanying text.

⁷⁴⁰ Philip Taubman, "U.S. Seen Clarifying Bribery Law. Foreign Payoff Guides Possible" *New York Times*, May 29, 1979, Sec. D, at 1, col. 3.

⁷⁴¹ Richard Beckler, then chief of the fraud section of the Criminal Division of the U.S. Department of Justice, stated that "providing guidelines for business review is certainly not a role a criminal prosecutor can easily play." Quoted by P. Taubman, *Ibid.*, at 1, col. 2. The Justice Department feared that such guidelines would be used as a "road map for fraud." Its officials stated frankly that "all[businessmen] want to know is who they can bribe and who they cannot. Well, we are not going to tell them. We will go down kicking and screaming on this one." See R. Berry, "Justice is Reluctant Guide on New Bribe Legislation," *Washington Post*, October 10, 1978, Sec.D, at 7, col. 3.

FCPA Review Procedures to provide some guidance to the business community concerning the application of the act to specific transactions.⁷⁴² Initially, the SEC declined to participate in such a process, claiming that such review procedures would only help MNCs to circumvent the FCPA's provisions,⁷⁴³ but the SEC finally announced that it would not bring an enforcement action for bribery violations against any party receiving clearance under the Review Procedures scheme prior to May 13, 1981.⁷⁴⁴ However, despite the issuance of a guideline, most MNCs are reluctant to use it to screen their proposed business dealings with foreign governments for fear that such screening would uncover damaging documents or leak information contained in these documents to other competitors.⁷⁴⁵ Further, such "a review procedure is simply not an appropriate mechanism to provide general guidance on a statute."⁷⁴⁶ This criticism and reluctance to participate

⁷⁴² A review requisition for a proposed transaction must be submitted to the Criminal Division of the U.S. Department of Justice for review at the Department's discretion. It may state its enforcement intention under the act or decline to do so. It will only screen and consider the requisition for clearance. The requisition must afford all relevant information relating to the proposed transaction. The Department of Justice then issues a letter of its enforcement intention. For example, when Lockheed and the Olayan Group, a Saudi Arabian trading and investment company, proposed to enter into an agreement together to do business with the government of Saudi Arabia and with Saudi Arabia Airlines Corporation [Saudia], the two partners sought Department of Justice guidance on the FCPA implication of the fact that Olayan's chairman, Mr. Suliman S. Olayan, was also an outside director of Saudia. After determining that Mr. S. Olayan had taken significant steps to disclose his joint affiliation, and to refrain from any action that might cause Saudia or the government of Saudi Arabia to be influenced in favour of Lockheed or Olayan Group, the Department of Justice declared its intention to take no enforcement action on the basis of Mr. S. Olayan's joint affiliation. This implied, however, the reservation that if Lockheed or Olayan Group appeared to benefit from the affiliation, the Department of Justice would not be bound by this review decision. See U.S. Department of Justice, Foreign Corrupt Practices Act Review Procedure Release No. 80-04 (October 29, 1980).

⁷⁴³ At the outset, the SEC considered some of the act's ambiguities to be desirable, in that they made MNCs hesitant to attempt to circumvent the law. John Walcott, "Business Without Bribes" *News Week*, February 19, 1979, at 63. Also see William C. George, *supra*, footnote 729, at 70.

⁷⁴⁴ See Securities Exchange Release No. 34-17099, statement of the Commission policy concerning Sec. 30 A of the Securities Exchange Act of 1934. See U.S. Fed.Reg. 59, 001, 59, 003 (1980).

⁷⁴⁵ William C. George, *supra*, footnote 729, at 85.

⁷⁴⁶ *Id.*, at 82.

in the review procedure weakens the statute's effectiveness in fighting illegal payments in international business. This leads us to conclude that the best solution to the problem is an international one.

4. Appraisal and Conclusions

It should be remembered that illegal payments flourished as a result of MNCs' efforts to maintain their economic power in developing countries. To accomplish this goal, they exploited foreign officials whose foremost concern was greed and personal enrichment to the detriment of their fellow citizens, because the national economy finally bears the cost of illegal payments, not the MNCs themselves.⁷⁴⁷ Bribery resembles the black market. Its prosperity depends on supply and demand, to use Adam Smith's economic theory. Although almost every country has laws or regulations banning such illegal activity, the enforcement of such laws may be hindered in situations where the law breaker is supposedly the guardian of the law. This is most true in developing countries that have no democracy to make it possible for other citizens to serve as watchdogs for those acting on behalf of the government. The perpetuity of the de facto state of dictatorship in most of these countries is thus supported to the advantage of outsiders and of international politics, which manage to keep these countries under their sphere of influence.

The United States, as the biggest economic power in the world, took a positive step to rebuild an image that had been tarnished by the revelation of illegal payment by certain MNCs to foreign officials abroad. This step was the enactment of the FCPA, which was directed at punishing those MNCs. However, the FCPA has several weaknesses that may hinder its effectiveness, such as the National Securities Exemption, which allows the use of bribes to foreign officials to keep

⁷⁴⁷ Mr. Haughton, Lockheed chairman, testified before the Senate Foreign Relations Committee of the U.S. in connection with excessive agent fees paid to Mr. A. Khashoggi to facilitate the sale of company aircraft to one of the Middle Eastern countries. He said that the sale commission and alleged bribe was added to the price of the airplanes. See Robert Smith, "Lockheed Document Discloses \$106 million Saudi Payout, Agent's Fees Cited in Testimony at Senate Panel," *New York Times*, Sept. 13, 1975, at 31, col. 1 and at 33, col. 1.

them in line with U.S. policy. In addition, the FCPA raises the possibility of having extraterritorial consequences in its application, where U.S. MNCs have foreign subsidiaries who depend on bribes for doing business abroad, or who have knowledge of agents in foreign countries who pay such bribes.⁷⁴⁸ The extent of a U.S. MNC's liability for the act of its subsidiary or agent under the FCPA depends upon whether the MNC itself "knew or had reason to know" of illegal payments. It might be a direct liability if the corporation's management authorized the agent or subsidiary to give money for corrupt purposes, or it might be an indirect liability, in a case when the MNC has not directly participated in the illegal payment, but has knowingly assisted in the violation and the impropriety. This knowledge can be actual or constructive knowledge, as we will discuss in the next chapter. These extraterritorial consequences have raised some doubt about the effectiveness of the act, which brings us finally to conclude that the effectiveness of the legal sanction of illegal payments depends on the full cooperation of international communities, as we will discuss in Chapter 7.0.

⁷⁴⁸ Jennifer L. Miller, *Accounting for Corporate Misconduct Abroad: "The Foreign Corrupt Practices Act of 1977"* (1979) 12 *Cornell Int'l L.J.*, 293-307, at 302.

CHAPTER 6.0

POLICY DILEMMA AND EXTRATERRITORIAL CONSEQUENCES OF LEGAL SANCTION OF MNCS' ILLEGAL PAYMENTS ABROAD

1. General Remarks

Before addressing the policy dilemma of national sanction of illegal payments abroad, we should first briefly look at the concept of corporate criminal liability its development, its scope when corporate management exercises "due diligence" to prevent the violation of the law, and the extent to which an MNC can be held liable for the acts of its agents and subsidiaries abroad.

The common law courts have taken the lead in developing the doctrine of corporate criminal liability⁷⁴⁹ to deter corporations from abusing their economic power.⁷⁵⁰ This doctrine of liability has been fashioned to seek the widest possible effect on illegal corporate behaviour, especially when such behaviour is carried out by giant corporations. The all encompassing nature of this doctrine is attributable to growing public concern about corporate criminal liability. While the doctrine of corporate criminal liability originates from tort law,⁷⁵¹ the idea that a corpora-

⁷⁴⁹ Several rationales have been advanced to justify the imposition of criminal sanctions on corporations that infringe on or break the law among them rehabilitation, incapacitation, deterrence and retribution. The first three rationales are referred to as consequentialist theories, because they are consequences of punishment. The last is justified only if the offender is morally culpable. Deterrence is the major rationale, because economic regulations are aimed at controlling corporate activities rather than punishing morally culpable violators. See note, "Corporate Crime: Regulating Corporate Behavior Through Criminal Sanction" (1978-79), 92 *Harv. L. Rev.*, 1227-1375, at 1235.

⁷⁵⁰ L.H. Leigh, "The Criminal Liability of Corporations and Other Groups" (1977), 9 *Ottawa L.Rev.*, 247-302, at 247.

⁷⁵¹ Gerhard O. W. Mueller, "Mens Rea and the Corporation: A Study of the Model Penal Code Position on Corporate Criminal Liability" (1957-58), 19 *U. Pitt.L. Rev.*, 21-50, at 21.

tion as an abstraction can commit a criminal act for which it can be punished has only gradually made its way into common law.⁷⁵² The general tenet in common law used to be that corporations were not criminally liable because they were incapable of carrying out the illegal acts and having a *mens rea*, or guilty mind, to think and act in violation of the law.⁷⁵³ This position was defended by legal writers who claimed that penalizing individual actors is more effective because "there is absolutely no evidence that corporate criminal liability is any more effective than personal criminal liability,"⁷⁵⁴ and "the deterrent effects of corporate criminal liability" have not fully been proven.⁷⁵⁵ In addition, such imposition of liability on a corporate entity would punish innocent shareholders, the ultimate bearers of fines imposed on their corporation.⁷⁵⁶ Another school of writers upheld the concept of corporate criminal liability, claiming that "an individual actor's motive cannot realistically be separated from the pressures brought to bear upon him by the corporation"⁷⁵⁷ to achieve corporate goals that may necessitate the commission of illegal acts. The agent or employee often confronts a hard choice either risk being viewed as failing to achieve corporate goals, or begin taking unethical or illegal shortcuts.⁷⁵⁸ Furthermore, confining criminal liability to the individual actors motivates corporations to take advantage of their employees' zeal by making them

⁷⁵² Henry W. Edgerton, "Corporate Criminal Responsibility" (1926-27), 36 *Yale L. J.*, 827-844, at 842.

⁷⁵³ Legal writers have argued as to whether corporate criminal liability should be recognized. Among others, see Henry W. Edgerton, *ibid* and Walter H. Hitchler, "The Criminal Responsibility of Corporations" (1923), 27 *Dick. L. Rev.*, 89-101, and 121-137. Also see Lee Frederic, "Corporate Criminal Liability" (1928), 28 *Colum. L. Rev.*

⁷⁵⁴ Gerhard O.W. Mueller, "Criminal Law and Administration" (1959), 34 *N.Y.U.L. Rev.*, 83-116, at 94.

⁷⁵⁵ Bruce Coleman, "Is Corporate Criminal Liability Really Necessary?" (1975), 29 *Sw. L. J.*, 908-927, at 927.

⁷⁵⁶ *Ibid.*, at 920.

⁷⁵⁷ Seth Maxwell, "The Foreign Corrupt Practices Act and Other Arguments Against a Due Diligence Defence to Corporate Criminal Liability" (1982), 29 *UCLA L.Rev.*, 447-503, at 453.

⁷⁵⁸ George Getschaw, "Overdriven Executives: Some Middle Managers Cut Corners to Achieve High Corporate Goals," *Wall Street Journal*, November 8, 1979, at 1, col. 6.

scapegoats.⁷⁵⁹ Also, the complex structure of today's giant corporations obscures individual responsibility, rendering it difficult to identify the culpable individual.⁷⁶⁰ Advocates of the concept of corporate criminal liability refute the notion that the imposition of fines would only punish innocent share holders, arguing that corporate managerial personnel are always known to shareholders, who can exert pressure to restrain them from committing illegal acts or seek their removal from the corporation.⁷⁶¹

The contribution of the United States Courts to the development of the doctrine of corporate criminal liability is highly regarded, because this concept has been "more extensively developed in the United States than elsewhere".⁷⁶² The Supreme Court of the United States recognized this doctrine for the first time in the case of *New York Central & Hudson River Railroad v. United States*⁷⁶³ in which the corporation was indicted and convicted for violating the law.⁷⁶⁴

In Canada, corporate liability can be traced to the original Combines Investigation Act of 1889⁷⁶⁵ and the 1892 Criminal Code,⁷⁶⁶ which made corporations liable for punishment if they did not adhere to such laws.⁷⁶⁷ The Canadian court first held such liability in the case of *Regina v. Corporation of the City of London*,⁷⁶⁸ when the court held that a corporation was liable for nuisance.⁷⁶⁹

⁷⁵⁹ John C. Coffee, Jr., "No Soul to Damn: No Body to Kick: An Unscandalized Inquiry into the Problem of Corporate Punishment" (1981), 79 *Mich. L.Rev.*, 386-459, at 410.

⁷⁶⁰ Notes: "Structural Crime and Institutional Rehabilitation: A New Approach to Corporate Sentencing" (1979-80), 89 *Yale L. J.*, 353-375, at 358.

⁷⁶¹ Gerhard O. Mueller, *supra*, footnote 751, at 39.

⁷⁶² L.H. Leigh, *supra*, footnote 750, at 266.

⁷⁶³ *New York Central & Hudson River Railroad v. United States*, 212 U.S. 481 (1909).

⁷⁶⁴ The law that was violated was the Etkin Act, a law that imputed violation of the Interstate Commerce Act by a corporate agent to the corporation itself. 49 U.S.C. Sec. 41(1).

⁷⁶⁵ Canada Combines Investigation Act, S.C. 1889, C.41.

⁷⁶⁶ Canada Criminal Code, S.C. 1892, C.29.

⁷⁶⁷ L.H. Leigh, *supra*, footnote 750, at 250.

⁷⁶⁸ *Regina v. Corporation of the City of London*, [1900] 32 O.R. 326-28 C.L.J. (H.C. 1900).

⁷⁶⁹ Also in Canada, the Supreme Court, in *Union Colliery Co. v. the Queen*, [1900] 4: C.C.C. 400, affirmed the conviction of a corporation for having omitted to perform its duty of

There is, however, a difference in the way the two systems derive this liability. The United States Courts impose liability upon corporations by equating corporate liability to vicarious liability.⁷⁷⁰ While Canadian courts have acknowledged and appreciated the experience of the Americans courts, they have developed the principle of identification, which allows for the attribution of mens rea to a corporation, where the actor concerned is of such a status that he represents the controlling mind and will of the company within the sphere of responsibility allotted to him.⁷⁷¹ Further, in the case of *Rex v. Fana Robinson Ltd.*⁷⁷² the court established that a corporation can be guilty of a criminal offence of which mens rea is an essential element. Therefore, the principle of identification, as developed by the Canadian Courts, is the basis of liability, rather than liability being imposed upon the "respondent superior."⁷⁷³

avoiding danger to human life by anything in its charge or under its control without lawful excuse. A number of people had been killed in a train accident caused by the company's neglect to properly care for a bridge over which the company owned train had passed.

⁷⁷⁰ L.H. Leigh, *supra*, footnote 750, at 266.

⁷⁷¹ *Ibid.*, at 255.

⁷⁷² *Rex v. Fana Robinson Ltd.*, [1941] 2 W.W.R. 235, 76 C.C.C. 196, [1941] 3 D.L.R. 409 (Alta. C.A.). The facts in this case were: Pursuant to an agreement with an insurance adjuster, the two directing officers of an auto repair company fraudulently added a certain sum to a repair bill on an insured automobile, and on receipt of the money from the insurer paid part of the inflated sum to the adjuster, the balance being retained by the company. The Alberta Court of Appeal affirmed the conviction on the ground that the culpable intention and illegal act of the two officers were the intention and act of the company, which should accordingly be convicted on both counts of an indictment charging conspiracy to defraud and obtaining money under false pretenses. In this case the court applied the doctrine of identification, which means the corporation can generally be held liable on ordinary doctrine of vicarious liability, save for exceptions made by the statute. See L.H. Leigh, *supra*, footnote 750, at 251.

⁷⁷³ *Regina v. St. Lawrence Corp.*, [1969] 2 O.R. 305, 5 D.L.R. (3d) 263 (C.A.), in which the court held that officers are vital organs of a corporation, and their actions and intent are the very actions and intents of the company when they act within the sphere of their duty. Also see *Canadian Dredge & Dock Co. v. the Queen*, [1985], 1 S.C.R. 662. in which several corporations were held

... criminally liable in the circumstances by operation of the identification theory. The underlying premise of this theory is that the identity of the directing mind and the identity of the company coincide...

Also see generally Harvey Yarosky, "The Criminal Liability of Corporations" (1964), 10 *McGill L. Rev.*, 142-157.

It is noteworthy that common law has long ceased thinking in terms of vicarious liability when corporations breach the law, except in limited cases where corporate directors who have broken the law were elected to the board by the shareholders, who subsequently failed to supervise their activities.⁷⁷⁴ But the civil law of Quebec regards a corporation as a person who has rights and bears obligations except those which the statute exempts when it considers a partnership as a legal entity,⁷⁷⁵ and vicarious liability has been imposed upon partnerships.⁷⁷⁶ Moreover, in France and some other countries, though the notion is still rejected that a corporation could be criminally liable, in limited circumstances corporations may be convicted of committing criminal offences.⁷⁷⁷

Although it is settled in common law that an inanimate entity such as a corporation can be subject to criminal sanction and criminal liability, the debate continues in regard to the scope and extent of such liability, and who should be liable for corporate illegal activities.⁷⁷⁸ The common law courts have consistently regarded corporations as liable for any violations of the law that are committed by their servants and agents in furtherance of a corporate goal,⁷⁷⁹ and courts have not

⁷⁷⁴ Gerhard O. Mueller, *supra*, footnote 751, at 39.

⁷⁷⁵ Art. 1838 C.C.L.C. as amended (1974).

⁷⁷⁶ *Prices. Board v. Cote, et al.*, [Que. 1947] 5.C.R.237. In this case, the partners of a commercial firm were tried under part XV of the Criminal Code with violating the War Time Prices and Trade Board Regulations, the lower court dismissed the charge, but the appeal was allowed and defendants were held liable for the offence committed by their employee, acting as such in the ordinary course of business.

⁷⁷⁷ L.H. Leigh, *supra*, footnote 750, at 265. It shall be remembered that the emergence of the principle of *defense sociale*, however, justifies some of the criminal liability of corporations for violation of economic regulations, because of the lack of reasonable means of checking corporate activities, especially after World War II. Examples of these legislations are foreign exchange violations law, tax fraud law and foreign investment violation law.

⁷⁷⁸ John B. McAdams, "The Appropriate Sanction for Corporate Criminal Liability: An Eclectic Alternative" (1977), 46 *Cinn. L. Rev.*, 989-1000, at 992.

⁷⁷⁹ See *Canadian Dredge & Dock Co. v. the Queen*, (1985), 1 S.C.R. 662. Also see Law Reform Commission of Canada, *Criminal Responsibility for Group Action* (1978) Working Paper No. 16, at 24-28. Also see *Egan v. United States* 137.F.2d 369 (8th Cir. 1943), Cert. denied, 88 L. Ed. 474 (1943), *supra*, footnote 208 and accompanying text. However, the U.S. Court held that even when servants do not act with a view to furthering the corporation's interests, the company may still be held criminally liable if superior agents were aware of the

recognized "due diligence" as a defence for offences requiring mens rea⁷⁸⁰ Some legal writers have maintained that such a defence should not be admitted because it would give the corporations an opportunity to avoid liability for illegal acts and to shield their complicity by claiming the exercise of due diligence to prevent illegal payment.⁷⁸¹

We have taken a cursory look at the development of the concept of corporate criminal liability. We will now proceed to examine the jurisdictional bases upon which national corporations can be indicted and convicted when illegal acts have been taken by their agents or subsidiaries outside the boundary of national laws. We will also look at the policy dilemma and the implications associated with the assertion of such jurisdiction.

violation and did nothing to report or prevent the agent's violations of the law. See *Stearns Tank Lines, Inc. v. United States*, 330 F.2d 719 (5th Cir. 1963). Also see *Standard Oil Corp. v. United States*, 307 F.2d 120 (5th Cir. 1962), rev'g. sub. nom., and *United States v. Thompson Powell Drilling Corp.*, 196 F. Supp. 571 (N.D. Tex. 1961), which proved that where the offence does not involve mens rea, corporations may be held liable for crimes of strict liability if these are committed by an employee while acting in the course of his employment, whether or not he intended to benefit the corporation.

⁷⁸⁰ See Law Reform Commission of Canada, *Criminal Responsibility for Group Action*, Id., at 24-28. For offences requiring mens rea, the U.S. federal courts do not recognize due diligence as a defence. The fact that the actor disobeyed corporate instructions in acting as he did will not prevent his intent from being imputed to the corporation. See *United States v. Armour & Co.*, 168 F.2d 342 (3rd Cir. 1948). The rationale is to prevent corporations that have violated the law from shielding themselves from liability on the ground that they had exercised sufficient care to prevent illegal activities from occurring.

⁷⁸¹ Seth Maxwell, supra, footnote 757, at 450.

2. Jurisdictional Basis for Applying National Law

Under international law, the term "jurisdiction" generally refers to the state's power and authority to prescribe and enact rules of law that affect the legal interests of its citizens.⁷⁸² However, the state's jurisdiction under international law depends upon the state's interest, and the nature and significance of such interest depend on the nature of the transaction in question, and on the persons who are affected.⁷⁸³ When enacting laws, the state must have the legislative power to do so, because the court, to determine the extent of a particular statute, must be convinced that the application is consistent with the principles of international law.⁷⁸⁴ Congruently, it is a generally recognized principle that a state does not have the right to enact a criminal law that has extraterritorial reach,⁷⁸⁵ because asserting jurisdiction over conduct in the ambit of another country's jurisdiction is an infringement of the latter's sovereignty and an impairment to its independence.⁷⁸⁶

The validity of any law and the exercise of jurisdiction⁷⁸⁷ rest upon the

⁷⁸² The U.S. Restatement (Second) of Conflict of Laws, Sec. 9 provides that where two states have jurisdiction to prescribe and enforce rules of law, the rules they prescribe are required by international law to be in good faith, and they must moderate the exercise of their enforcement jurisdiction in the light of such factors as:

- (a) the vital national interests of each of the states,
- (b) the extent and nature of the hardship that inconsistent enforcement action would impose upon the persons involved,
- (c) the extent to which the required conduct is to take place in the territory of the other state,
- (d) the nationality of the persons involved, and
- (e) the extent to which enforcement by action of either state can reasonably be expected to achieve compliance with the rules prescribed by that state.

See also D.P. O'Connell, *International Law* (1965), vol.2, at 655.

⁷⁸³ *Id.*, at 659.

⁷⁸⁴ Shelley O'Neill, *supra*, footnote 636, at 707.

⁷⁸⁵ The term "extraterritorial jurisdiction" refers to "juridical power which extends beyond the physical limits of a particular state or country." *Black's Law Dictionary* (5th edition, 1979), at 528.

⁷⁸⁶ Shelley O'Neill, *supra*, footnote 636, at 710.

⁷⁸⁷ Shalom Kassan, "Extraterritorial Jurisdiction in the Ancient World" (1935), 29 *Am. J. Int'l L.*, 237-247.

interpretation of three theories of legislative power and the assertion of jurisdiction within international law.⁷⁸⁸ The first recognized basis for jurisdiction under international law is nationality. It is generally accepted that in its sovereign power, a state has the right to prescribe laws to control the conduct of its nationals whenever such conduct occurs. The basis of this is personal jurisdiction, by which a state court will rely on de facto power⁷⁸⁹ over a person bearing state nationality, whether a natural or a juristic person. A juristic person can be a corporation, which, for the purpose of this jurisdictional basis, bears the nationality of its incorporating state.⁷⁹⁰ A problem arises when this juristic person (the corporation) has subsidiaries abroad, one or more of which has committed an illegal act under the law of its parent's state of incorporation. In such a case the exercise of a state's

⁷⁸⁸ See generally Harvard research in International Law "Jurisdiction with Respect to Crime." (Supp.1935), 29 *Am. J. Int'l. L.*, 435-447, at 445. The exercise of jurisdictional power in a manner inconsistent with international law or comity would trigger counter measures by the country whose jurisdiction is being infringed upon, to protect its national interest. This takes the form of "blocking statutes," which are enacted to impede the operation of foreign law. For example, Canada's Foreign Extraterritorial Measures Act(FEMA), S.C. 1984-85, C.49, gives the Attorney General of Canada broad powers to restrict or prohibit the disclosure of documents and data, and to forbid a foreign judgment to be recognized or enforced. In general, the FEMA allows the government of Canada to respond to unacceptable claims of extraterritorial jurisdiction by foreign governments and courts. Another example is the Trading Interests Act of Great Britain, which was enacted in March 1980. See generally M.J. Danaher, "Antitrust Law: The Drawbacks and Other Features of the United Kingdom Protection of Trading Interests Acts" (1980), 12 *Law & Pol'y. Int'l. Bus.*, 947-972, at 948.

⁷⁸⁹ Erik Nerep, *Extraterritorial Control of Competition Under International Law* (1983), vol. 1, at 4.

⁷⁹⁰ U.S. Restatement (Second) of Conflict of Laws (Supp. 1971) Sec. 41 states that

- (a) a corporation's incorporation in a state provides a fair and reasonable basis upon which to base its amenability...;
- (b) incorporation in the state gives the state a basis for the exercise of personal jurisdiction over the corporation in any action that may be brought against it;

Also Sec. 43 states:

A state has power to exercise judicial jurisdiction over a foreign corporation which has consented to the exercise of such jurisdiction.

Sec. 44 states:

A state has power to exercise judicial jurisdiction over a foreign corporation which has authorized an agent or a public official to accept service of process in actions brought against the corporation in the state as to all courses of action to which the authority of the agent or official to accept service extends.

jurisdiction over its national abroad for acts committed in violation of its laws would be limited by consideration of international comity.⁷⁹¹

The second basis of jurisdiction is the territorial principle: A state has the right to prescribe rules of law attaching legal consequences to conduct occurring within its territory, whether or not the effect of that conduct falls within that territory.⁷⁹² This principle was applied by the United States court in the case of *American Banana Corp. v. United Fruit Corp.*⁷⁹³ in 1909. The court held that the Sherman Act (the major part of the American anti-trust law) did not apply in this case, because all the acts committed in furtherance of a conspiracy to restrain trade occurred outside the territorial limit of the United States, and were not considered inviolation of the laws of the foreign countries.⁷⁹⁴ However, today the United States FCPA,⁷⁹⁵ as a statute directed at criminalizing illegal payments abroad, is difficult to enforce because it involves acts that take place in another state's territory, which then raises the issue of extraterritorial application and enforcement of the act.⁷⁹⁶ The third basis of jurisdiction is the effect theory,

⁷⁹¹ Shelley O'Neill, *supra*, footnote 636, at 711.

⁷⁹² The territorial principle is set out in the U.S. Restatement (Second) of Foreign Relations Law, Sec. 17, as follows:

A state has jurisdiction to prescribe a rule of law

(a) attaching legal consequences to conduct that occurs within its territory, whether or not such consequences are determined by the effects of the conduct outside the territory; and

(b) relating to a thing located, or a status or other interest localized, in its territory.

See 18 U.S.C. Sec. 17 (1965).

⁷⁹³ *American Banana Corp. v. United Fruit Corp.*, 213 U.S. 347 (1909) 29 S.Ct. 511, 53 L. Ed. 826 (1909). At the defendant's instigation, the Supreme Court of the United States affirmed the dismissal of a complaint against the Costa Rican government for seizure of part of the plaintiff's plantation. A senior Costa Rican official subsequently obtained title to the property in an irregular ex parte judicial proceeding, and sold it to agents of the defendant. In the opinion by the U.S. Supreme Court, the Sherman Act (under which the plaintiff sued) did not apply to actions occurring outside the U.S. or involving sovereign acts that were lawful in the country in which they were performed. At 357-359.

⁷⁹⁴ *Id.*, at 359.

⁷⁹⁵ Pub. Law no. 95-213, Tit. 1, 91. Stat. 1494(1977), Codified at 15. U.S.C. Secs. 78dd 1, 78dd 2, 78 FF. (Supp. I, 1977). For full text of the act see Appendix No. II *infra*.

sometimes referred to as the objective territorial principle, which maintains that a state has the power to prescribe rules of law relating to conduct occurring beyond its territorial limit if that conduct has effects within the territory of the prescribing state. This basis of jurisdiction was adopted by the Restatement (Second) of Foreign Relation Laws of the United States,⁷⁹⁷ which emphasizes that jurisdiction is limited to cases where:

- (a) the conduct and the effect of the conduct are generally recognized as constituent elements of a crime or tort;
- (b) the effect within the territory is substantial; and
- (c) the effect is a direct and foreseeable result of extraterritorial conduct. In addition, the exercise is to be consistent with the generally recognized principles of justice. Under this theory of jurisdiction the United States may seek to apply its own laws for conduct occurring outside its territorial limits, by claiming subject matter jurisdiction when there is a direct or foreseeable effect on U.S. commerce.⁷⁹⁸ This has been demonstrated by the holding of the Second Circuit of the United States Court of Appeals in the case of *United States v. Aluminum Co. of America (ALCOA)*,⁷⁹⁹ in which the appellate court recognized that the U.S. Congress has the power to attach liability to persons for their conduct outside the United States. The court held that

⁷⁹⁶ In Canada, the Law Reform Commission of Canada, Working Paper no. 37, *Extraterritorial Jurisdiction* (1984), at 8-9, emphasizes that the territorial principle should continue to be the basis for the application of its criminal law, augmented to a limited extent by other principles of public international law and international conventions.

⁷⁹⁷ Sec. 18 (1965) of the U.S. Restatement (Second) of Foreign Relations Laws.

⁷⁹⁸ Kenneth R. Feinberg, "Economic Coercion and Economic Sanctions: The Expansion of United States Extraterritorial Jurisdiction" (1981), 30 *Am. U. L.Rev.*, 323-348, at 326-332.

⁷⁹⁹ *United States v. Aluminum Corporation of America*, 148 F.2d 416 (2d Cir. 1945). The government alleged that an American company and a Canadian company conspired with European producers of aluminum ingots to impose quotas on imports into the United States. The American company was absolved, but the presiding judge held that the court had subject matter jurisdiction over the Canadian company.

the Sherman Act applied extraterritorially where conduct outside the United States was intended to and did produce detrimental effects within the United States. The court stated that

... any state may impose liabilities, even upon persons not within its allegiance, for conduct outside its borders that has consequences within its borders which the state reprehends; and these liabilities other states will ordinarily recognize.⁸⁰⁰

This effect basis for jurisdiction has been re fined by the Ninth Circuit Court of Appeal in the case of *Timberlane Lumber Corp. v. Bank of America*⁸⁰¹ which, as the *Alcoa* case,⁸⁰² has all the qualities necessary to set a precedent in the field of foreign commerce by introducing the balance of interest approach test. The facts in this case were that Timberlane, an American lumber corporation entering the Honduran market in search of a source of lumber, brought suit against the Bank of America an American corporation based in California and having a wholly owned subsidiary operating a branch in Honduras as well as against several employees of the bank. The suit alleged that the latter conspired to prevent Timberlane from milling lumber in Honduras and exporting it to the United States, thereby helping to maintain control of the Honduran lumber export business in the hands of a few individuals backed by the bank. The plaintiff alleged that the defendant was restraining trade in violation of Secs. 1 and 2 of the Sherman Act.⁸⁰³ All the activities, as the court found, took place in Honduras.⁸⁰⁴ These activities included inducing Honduran courts and authorities to issue court

⁸⁰⁰ *Id.*, at 443, where upon cases were cited to support the "settled" principle of law as the court saw it.

⁸⁰¹ *Timberlane Lumber Corp. v. Bank of America, N.T. & S.A.* 549 F.2d 597 (9th Cir. 1976).

⁸⁰² *United States v. Aluminum Corporation of America*, 148 F.2d 416 (2d Cir. 1945).

⁸⁰³ *Id.*, at 597.

⁸⁰⁴ *Id.*, at 604.

orders crippling Timberlane's operations, arresting and imprisoning Timberlane's manager in Honduras, and causing a complete shutdown of Timberlane's business in Honduras.⁸⁰⁵ The defendant argued that Timberlane's injuries resulted from acts of the Honduran government in connection with the enforcement of a disputed security interest in a lumber mill held by the bank, and could not be reviewed under the act of state doctrine.⁸⁰⁶ The court, however, held that the act of state doctrine does not require dismissal of an action when the activities in question do not reflect official Honduran policy nor threaten relations between the U.S. and Honduras.⁸⁰⁷ The court, in searching for the basis of jurisdiction, analyzed and elaborated upon many of the commentaries in the doctrine as well as the relevant case laws, and reached the conclusion that the Sherman Act may apply to activities of aliens as well as American citizens in other nations, but that there comes a point at which the interests of the United States are too weak and the foreign harmony incentives for restraint are too strong to justify an extraterritorial assertion of jurisdiction.⁸⁰⁸ The court went further to conclude that the effect test as a basis for jurisdiction is incomplete because it fails to consider the interests of other nations involved, and the full nature of the relationship between foreign actors and the United States.⁸⁰⁹ The court introduced a tripartite analysis: First, does the U.S. court have subject matter jurisdiction? Second, is the effect of such a magnitude as to present a cognizable injury to the plaintiff? Finally, are the United States' interests and concerns including the magnitude of the effect on American foreign commerce sufficiently strong, vis-a-vis those of other nations, to justify an assertion of extraterritorial jurisdiction over the conduct?⁸¹⁰ The court

⁸⁰⁵ Ibid.

⁸⁰⁶ Id., at 605.

⁸⁰⁷ Id., at 615.

⁸⁰⁸ Id., at 609.

⁸⁰⁹ Id., at 612.

⁸¹⁰ Id., at 613.

found that the first and second conditions were satisfied, but that the last was not, and since no comprehensive analysis of the relative connections and interests of Honduras and the United States was presented in the lower court, the case was remanded without further inquiries.⁸¹¹

Seemingly, this balance of interest approach, reached by the United States courts in trying to accommodate the interests of foreign sovereigns, increased awareness of the international implication of national laws for foreign businesses. But it is no more satisfactory as a solution to the extraterritorial problem than are consultation procedures,⁸¹² because national courts tend to resolve disputes on the basis of the immediate short term interests involved in a given case. This makes it difficult to perceive and weigh the interests and values of other nations in an objective manner.⁸¹³

⁸¹¹ Id., at 615.

⁸¹² A.V. Lowe, "The Problems of Extraterritorial Jurisdiction: Economic Sovereignty and the Search for a Solution" (1985) 34 *Int'l & Comp. L.Q.*, 724-746, at 732.

⁸¹³ Harold G. Maier, "Extraterritorial Jurisdiction at a Cross Roads: An Intersection Between Public and Private International Law" (1982), 76 *Am. J. Int'l L.*, 280-320, at 317.

3. Liability of MNCs for Illegal Payments Made by Their Subsidiaries Abroad

As we have seen, one of the traditional principles of asserting jurisdiction is nationality, whereby under international law a state may punish the acts of its nationals whether natural or juristic persons wherever they are committed.⁸¹⁴ Nevertheless, a problem arises when a corporation, as a juristic national, has foreign subsidiaries, and one of those subsidiaries has committed an act prohibited by the parent corporation's laws. The question is: Do the parent's laws have extraterritorial reach to the subsidiaries?

No other country in the world has dealt with this question so thoroughly and claimed so wide an application of its laws as the United States. Although most of those claims and interests have centered on the enforcement of the U.S. anti-trust and securities laws, many of the conclusions reached in these cases will have analogous applications in other legal fields. The reaction outside of the United States has been one of resentment and acute criticism. In the summer of 1982, the extraterritorial application of the U.S. export control laws became the focal point of an international dispute.⁸¹⁵ Before that were the case of *Societe Fruehauf v. Massardy*⁸¹⁶ and that of *In re Uranium Antitrust Litigation, Westinghouse Electric*

⁸¹⁴ See generally, *supra*, Chapter 6.2.

⁸¹⁵ The dispute arose on June 22, 1982, when the U.S. Department of Commerce, pursuant to Sec. 6 of the Export Administration Act, Pub. Law no. 95-52, 91 Stat.235 (1977), amended Secs. 376.12, 385.2 of the Export Administration Regulations. The amendment implied an extension of U.S. controls on exports and re-exports of goods and technical data relating to oil and gas exploration, exploitation, transmission and refinement, and was particularly aimed at obstructing the progress of Soviet Union European pipeline construction. See generally Robert S. Wayne, "Extraterritorial Application of the Export Administration Amendments of 1977" (1978), 8 *Ga. J. Int'l & Comp. L.*, 741-761, and C.H. Peterson and A.G. Skol, "Export Control Laws and Multi-national Enterprises" (1977), 11 *Int'l Law.*, at 29.

⁸¹⁶ *Societe Fruehauf v. Massardy*, Judgment of May 22, 1965, Cour d'Appel, Paris, [1965], Recueil Dallaz Sirey, Jurisprudence 147, translated in 5 *Int'l Legal Materials*, (1966), at 476. In this case the U.S. sought to enforce The Trading with the Enemy Act, [Trading with the Enemy Act of 1917, 50 U.S.C. App. Sec. 1 et seq. (1976)], against Fruehauf France, S.A., a French subsidiary of an American corporation, because the subsidiary had contracted to sell

*Corp. v. Rio Algom Ltd.*⁸¹⁷ in which the foreign states were outraged, and all affected governments moved swiftly to block U.S. action, making the United States' extra territorial enforcement of its laws counterproductive.⁸¹⁸

The subject of extraterritoriality has not been settled yet. The U.S. FCPA⁸¹⁹ has also recently been subject to some discussion, although it is limited to corporations or any legal entities organized under United States law,⁸²⁰ and any "domestic concern" also defined to include all United States citizens.⁸²¹ It seemingly does not extend to the conduct of foreign-based subsidiaries of United States MNCs, or to corporations organized under foreign law. However, the act may have extraterritorial consequences in the case where an MNC's subsidiary has made illegal payments that ultimately have some benefit for the parent corporation.⁸²² For example, an MNC's foreign subsidiary might pay a bribe to a foreign official in connection with a deal between the subsidiary and the official's government, but later the parent might also gain a major contract with the official's government through its subsidiary, and the circumstances suggest that such a deal

and deliver goods made in France to the People's Republic of China. Fearing prosecution, the American parent corporation ordered its French subsidiary to suspend the performance of the contract upon the request of the U.S. government. The board of directors of the French subsidiary succeeded in instituting litigation in the French court that resulted in the appointment of an administrator to head the French subsidiary for three months, in order to preform the contract. The U.S. perceived the activities of the subsidiary as an American entity, but the French viewed the activities as subject to their own jurisdiction.

⁸¹⁷ *In re Uranium Antitrust Litigation, Westinghouse Electric Corp. v. Rio Algom Ltd.*, 617 F.2d 1248(7th Cir. 1980).

⁸¹⁸ Canada, Great Britain and Australia moved to enact laws to block the operation of American law. See generally supra, footnote 788 and accompanying text. Also see Robert R. Merhige, Jr., "The Westinghouse Uranium Case: Problems Encountered in Seeking Foreign Discovery and Evidence" (1979), 13 *Int'l Law.*, 19-26. Also see Jeffrey L. Wood and Victor M. Carrera, "The International Uranium Cartel: Litigation and Legal Implications" (1979), 14 *Tex. Int'l L.J.*, 59-114, at 92-100.

⁸¹⁹ Pub. Law. no. 95-213, Tit. I., 91 Stat. 1494(1977). (codified at 15 U.S.C. Secs. 78dd 1, 78dd 2, 78 FF (Supp. I. 1977). For the full text of the act see Appendix No. II infra.

⁸²⁰ 15 U.S.C. Sec. 78dd 2(d)(b) (1977).

⁸²¹ 15 U.S.C. Sec. 78dd 2(d)(a) (1977).

⁸²² David C. Gustman, "The Foreign Corrupt Practices Act of 1977: A Transactional Analysis"(1979), 13 *J. Int'l L. & Econ.*, 367-401, at 393.

would not have been possible had the subsidiary not bribed the official previously. In this case, it is presumed that the parent had sufficient knowledge of the bribe and its ultimate purpose. The liability under the act may also extend to illegal payments made by a joint venture or a prime contractor.⁸²³ Moreover, the act may apply to a United States citizen who sets up a foreign corporation and makes illegal payment.⁸²⁴ The act requires an MNC, as a parent corporation, to closely oversee the accounting practices of its foreign subsidiaries, thus curtailing illegal payment.⁸²⁵ Punishment under the act will extend to the parent corporation when any one of its officials had knowledge, whether actual or constructive, of the payment; the concepts of conspiracy and of aiding and abetting can be utilized to prosecute the participants to prevent the parent's officials from using the subsidiary as a conduit for illegal payments.⁸²⁶ Finally, the act imposes liability upon the U.S. parent corporation if it has constructive knowledge or "reason to know"⁸²⁷ that its subsidiaries made illegal payments to foreign officials. Such constructive knowledge can be inferred from the circumstances. For example, if the subsidiary spent a sum of money far beyond the original estimate, or used fictitious invoices to cover up the real disbursements of the money and its recipient or to withdraw a large sum of cash for a questionable purpose, then the parent corporation may be prosecuted for having reason to know the violation of the act.⁸²⁸

⁸²³ William C. George *supra*, footnote 729, at 62, note 15.

⁸²⁴ Jeffrey J. Hamilton, "The Foreign Corrupt Practices Act of 1977: A Solution or a Problem?" (1981), 11 *Calif. W. Int'l L.J.*, 111-139, at 120. Although Sec. 104 of the FCPA (78dd 2(d)(b) is limited to companies organized under U.S. law, either federal or state, the definition of the term "domestic concern" (78dd 2(d)(a) to include U.S. citizens when organized and owning companies in foreign states gives the act extraterritorial reach. An example of this situation is the civil injunction in the *United States v. Carver*, Cir. No. 79-1768 (S.D. Fla., filed April 9, 1979). See Richard Shine, "Enforcement of the FCPA by the Department Justice" (1982-83), 9 *Syracuse J. Int'l & Com.*, 283-300.

⁸²⁵ 15 U.S.C., Sec. 78m(b)(2) (Supp. I. 1977). See also *supra*, Chapter 5.3.B.

⁸²⁶ Morton A. Pierce, "The Foreign Corrupt Practices Act of 1977" (1980) 8 *Int'l Bus. Law.*, 13-18, 16.

⁸²⁷ 15 U.S.C. Sec. 78dd (a)(3).

⁸²⁸ Jennifer L. Miller, "Accounting for Corporate Misconduct Abroad: The Foreign Corrupt

However, despite the act's efforts to encompass every attempt to circumvent its application, MNCs still find ways to pay bribes through loopholes and exceptions to the act.⁸²⁹ This renders the FCPA problematic as a unilateral criminal prohibition, for it is not accomplishing the elimination of international payoffs and thus becomes ineffective in the absence of multinational efforts to curb corruption in international business.

Practices Act of 1977" (1979) 12 *Cornell Int'l L.J.*, 293-307, at 304.

⁸²⁹ See Shelley O'Neill, supra, footnote 636, at 719.

4. Liability of MNCs for Illegal Payments Made by Their Agents Abroad

As mentioned earlier, corporations cannot shield themselves from liability merely by taking the convenient path of imputing the committing of illegal acts to their employees or agents. It is now a precedent that common law courts will impose liability upon a corporation for the illegal act of its agent when the agent has committed the act within the scope of his employment, or when the act appears to be within his authority.⁸³⁰ Even if there is doubt about the agent's authority, the corporation may nevertheless be considered to have ratified the agent's illegal activity, and thus to have full responsibility for it,⁸³¹ because when a corporation accepts the benefit of an agent's employment, it places itself in the position of upholding the agent's authority.⁸³² Liability is attached to a corporation for the acts of its agent, even though the agent has violated express instructions and policy not to commit illegal acts,⁸³³ and even when corporate officers took reasonable and utmost care to prevent violations of the law,⁸³⁴ so long as the agent was acting for the benefit of and/or on behalf of the corporation. This traditional principle of agency law applies when an MNC agent abroad makes illegal payment in violation of the express policy of the corporation not to do so.⁸³⁵ The

⁸³⁰ Denis Houptly and Nancy L. Rider, "The Proposed Federal Criminal Code and White Collar Crime" (1979) 47 *Geo. Wash. L. Rev.*, 523-549, at 530.

⁸³¹ Joseph E. Claxton, "Agency and Business Associations" (1974), 26 *Mercer L. Rev.*, 21-43, at 30.

⁸³² *Builders Homes of Georgia, Inc. v. Wallace Pump & Supply Corp.*, 197 S.E. 2d 839 (1973).

⁸³³ *United States v. Cadillac Overall Supply Corp.*, 568 F.2d 1078, 1090 (5th Cir. 1978); *United States v. Hilton Hotels Corp.*, 467 F.2d 1000, 1004 (9th Cir. 1972), *Cert. denied*, 409 U.S. 1125 (1973). Congress may constitutionally impose criminal liability upon a business entity for acts or omissions of its agents within the scope of their employment, and such liability may attach without proof that the conduct was within the agent's actual authority, even though it may have been contrary to express instructions.

⁸³⁴ *United States v. A & P Trucking Corp.*, 358 U.S. 121, 125-26 (1958). Offences committed by corporate agents generally inculcate the corporation.

⁸³⁵ David C. Gustman, "Questionable and Illegal Payments by American Corporations" (1981), 19 *Am. Bus.L.J.*, 67-74, 146-152, at 149.

reason for this strict liability is to prevent MNCs from failing to supervise their agents' behaviour abroad.⁸³⁶

Notwithstanding this general principle of agency law, the question remains whether the United States FCPA confers extraterritorial jurisdiction over the actions of MNC agents overseas, and to what extent the interpretation of its provisions will give rise to strict liability for every illegal payment made by these agents. We should be aware that express authorization by MNCs to their agents to make illegal payments to foreign officials is unlikely, and because the major purpose of the FCPA is to encourage MNCs to be more responsible and to try to prevent the illegal conduct of their agents, accountability must be established on the basis of secondary liability.⁸³⁷ However, legal commentators following the legislative history of the FCPA find it difficult to determine whether an MNC is liable for the act of its agent when it had not authorized the agent's action nor issued a directive to its agent to make an illegal payment.⁸³⁸ A broadening of supervision by MNCs over the activities and practices of their agents abroad would no doubt be of great benefit in assisting MNCs against charges that they had knowledge, whether actual or constructive, and therefore complicity in making the illegal payment.⁸³⁹

Although the FCPA does not explicitly confer extraterritorial jurisdiction for the act of an MNC agent, and notwithstanding the fact that so far there has been no judicial interpretation of its provision,⁸⁴⁰ it appears from the language of the act that it has an extraterritorial reach over the activities of MNCs and their

⁸³⁶ David C. Gustman, *supra*, footnote 822, at 385.

⁸³⁷ Jennifer L. Miller, *supra*, footnote 828, at 301.

⁸³⁸ David C. Gustman, *supra*, footnote 835, at 148.

⁸³⁹ *Id.*, at 149.

⁸⁴⁰ *Ibid.*

agents. The act prohibits U.S. MNCs and other domestic concerns and their agents from making use of the mails or any other instrumentalities of "interstate commerce in furtherance" of making "corrupt payment."⁸⁴¹ The term "interstate commerce" is broadly defined to include "trade, commerce, transportation or communication among the several states or between a foreign country and any state, or between any state and any place or ship outside thereof."⁸⁴² According to this broad definition, as one commentator observes, the SEC would be able to prosecute anyone who uses such instrumentality in furtherance of any prohibited activities that the act is intended to prevent.⁸⁴³ The jurisdictional purpose is satisfied to allow prosecution even if the illegal payment was made wholly outside the U.S. by the agent of an MNC, for example through a transfer of money to the agent.⁸⁴⁴ However, in view of the fact that the FCPA conditions the liability with "knowing" or having "reason to know" that all or part of the payment will be passed on to bribe a foreign official, the court when presented with such a case would adhere to "the reason to know" test before rendering judgment against an MNC for the act of its agent.⁸⁴⁵ Although the phrase "reason to know" is not specifically defined in the act, the conclusion of MNC liability for having reason to know would depend upon the common sense of an ordinary man who may infer from the facts or circumstances surrounding the payment that part of the payment made by the MNC to its agent as fee or commission is to be passed on as a bribe

⁸⁴¹ 15 U.S.C. Sec. 78dd 2 (Supp. I, 1977).

⁸⁴² 15 U.S.C. Sec. 78dd 2(d)(3) Supp. I, 1977).

⁸⁴³ Notes, "American Adjudication of Transnational Securities Fraud" (1975-76), 89 *Harv. L. Rev.*, 553-572.

⁸⁴⁴ David C. Gustman, *supra*, footnote 835, at 148.

⁸⁴⁵ David C. Gustman, *supra*, footnote 822, at 386. The "reason to know" increases the potential liability of an MNC for an act of illegal payment committed by its agent or any closely affiliated third party, regardless of whether the company was able to control the agent's activities, especially since the court has not yet interpreted such language. See Bartley A. Brennan, *supra*, footnote 728, at 63.

to a foreign official.⁸⁴⁶ The "reason to know" test requires that an MNC investigate its agents' past employment and reputation in representing and conducting business abroad.⁸⁴⁷ This stringent requirement is a sensible interpretation of Sec. 102 of the act,⁸⁴⁸ aimed at preventing MNCs from "looking the other way" in regard to questionable activities of their agents.⁸⁴⁹ This presumption of knowledge can be imputed to an MNC for the act of its agent even though the MNC has acquired a written agreement in which the agent has pledged not to bribe foreign officials in the conduct of the company's business. An exception to this would be when other affirmative action was taken, such as the submission of the proposed sale or contract and the representation of the agent for review and approval by authorities of the U.S. Department of Justice.⁸⁵⁰

⁸⁴⁶ Morton A. Pierce, *supra*, footnote 826, at 16. One legal commentator maintains that the "reason to know" standard suggests that the issuer cannot ignore "red flags" that would lead the reasonable person to believe something may be amiss... The failure to investigate in the presence of danger signs should suffice to establish... liability..." See Wallace Timmeny, "SEC Enforcement of the Foreign Corrupt Practices Act" (1979), 2 *Loy. L.A. Int'l & Comp. L. Ann.*, 25-46, at 31. In addition, MNCs should infer that any excessive fees or commissions would be taken as a sign of complicity in illegal payment. To avoid such accusations they should take necessary precautions to ensure that these practices do not go on. However, other commentators have refuted this argument by stating that MNCs do not "violate the FCPA merely by transferring something of value with constructive knowledge that the recipient will use it to make a prohibited payment; the company must also act with a corrupt intent." See Gary M. Elden and Mark S. Sableman, "Negligence Is Not Corruption: The Scienter Requirement of the Foreign Corrupt Practices Act" (1980-81), 49 *Geo. Wash. L. Rev.*, 819-842, at 828.

⁸⁴⁷ David C. Gustman, *supra*, footnote 822, at 388.

⁸⁴⁸ 15 U.S.C. Sec. 78m(b) (Supp. I. 1977).

⁸⁴⁹ Jennifer L. Miller, *supra*, footnote 828, at 302.

⁸⁵⁰ William C. George, *supra*, footnote 729, at 77.

5. Political Reality and Judicial Restraint with Regard to Exercise and Enforcement of National Sanctions

International law, which governs relations among nations, is founded on the principles of sovereign right and equality among nations, which then mandates that one sovereign state may not exercise its power in any form in the territory of another. This was affirmed by the Permanent Court of International Justice in the *S.S. Lotus* case,⁸⁵¹ when it concluded that the assertion by a sovereign state of extraterritorial jurisdiction over acts that took place in another state will most certainly undermine these principals and will antagonize and infringe upon the other sovereignty. Furthermore, when a nation commits itself to a certain philosophy by enacting laws criminalizing and punishing acts outside its territorial limit, it shall not ignore the political reality of today's business world. In enforcing such laws its judicial organ shall exercise such restraint as to effectuate international cooperation and elevate respect for sovereignty and international comity, which has been defined by the common law court as a body of rules that reflects:

...the recognition which one nation allows within its territory to the legislative, executive or judicial acts of another nation, having due regard both to international duty and convenience, and to the rights of its own citizens or of other persons who are under the protection of its laws.⁸⁵²

The application of national law to MNC activities in another state may be perceived as particularly intrusive upon that state's sovereignty. The reaction was well and eloquently stated by Lord Viscount Dilhorn:

For many years now the United States has sought to exercise jurisdic-

⁸⁵¹ *S.S. Lotus (France v. Turkey)*, 1927 P.C.I.J.Reports, Series A. No. 10.

⁸⁵² *Hilton v. Gugat*, 159 U.S. 113, 164 (1895).

tion over foreigners in respect to acts done outside the jurisdiction of that country. This is not in accordance with international law and has led to legislation on the part of other states, including the United Kingdom, designated to protect their nationals from criminal proceedings in foreign courts, where the claims to jurisdiction by those courts are excessive and constitute an invasion of sovereignty...⁸⁵³

It is evident that, when the national law, such as the FCPA, prohibits illegal payments by MNCs, it may in some situations have extraterritorial reach that amounts to indirect infringement on the sovereignty of the country where the illegal payment is made, and may consider itself as having priority to regulate illegal payments and bribery within its jurisdiction.⁸⁵⁴ There is also the situation where the subsidiaries made illegal payments and there are documents and records that can prove that the parent company knew or had reason to know of the payment. The U.S. court would have no problem if the parent corporation has possession of the document and records to be produced as evidence in the trial. But a problem arises when the subsidiary has possession of the documents, and the U.S. court has no personal jurisdiction to compel their production.⁸⁵⁵ The U.S. court would have to issue a rogatory letter⁸⁵⁶ seeking the assistance of a foreign sovereign legal

⁸⁵³ *Rio Tinto Zinc Corp. v. Westinghouse Elec. Corp.* (1978) 1 All. E. Rep. 434, at 464 (H.L.).

⁸⁵⁴ Shelley O'Neill, *supra*, footnote 636, at 712.

⁸⁵⁵ It has been proven that any attempt involving the use by U.S. federal agencies of the compulsory process to force production of evidence situated in foreign jurisdictions will be directly challenged by the executive and judicial authority of the foreign state. Such challenge may take the form of political protest to the U.S. or the enactment of blocking statutes to protect against unwarranted unilateral application of U.S. extraterritorial law. An example of Canadian blocking statutes is the Foreign Extraterritorial Measures Act, proclaimed on February 14, 1985. See *supra*, footnote 788 and accompanying text. For more discussion of this subject, see A.V. Lowe, "Blocking Extraterritorial Jurisdiction: The British Protection of Trading Interests Act of 1980" (1981), 75 *Am. J. Int'l L.*, 275-282. Also see Sidney S. Rosdeitcher, "Foreign Blocking Statutes and U.S. Discovery: A Conflict of National Policies" (1983-84), 16 *N.Y.U.J. Int'l L. & Pol.*, 1061-1074.

⁸⁵⁶ A rogatory letter is a request to assist the administration of justice, issued by a court in one country to a court in another country, usually through diplomatic channels. See G.M.

system to compel production of such documents, based on the principle of cooperation and international comity.⁸⁵⁷ Inherent in international comity is reciprocal assistance among nations, but this does not compel testimony or production of incriminating documents in breach of the law and the public policy of the sovereign state.⁸⁵⁸

United States action to assert jurisdiction and enact law that govern conduct occurring in an other country and under the domain of its law certainly offends this principle of international comity.⁸⁵⁹ However, practical adjudication of the violation of national law prohibiting illegal payments abroad may be hard to achieve, because the application of national law to illegal activities by MNCs outside the adjudicating state's borders would depend on judicial analysis of the extent to which a foreign government official's conduct is a sovereign act.⁸⁶⁰ This act of state may be employed by the maker of the illegal payment as a defence, along with the defence of sovereign compulsion to make illegal payments, as we will see in the following analysis.

Whiteman, *Digest of International law*, (1968), at 204.

⁸⁵⁷ For discussion of this subject see Harry Leroy James, "International Judicial Assistance: Procedural Chaos and Program for Reform" (1953), 62 *Yale L.J.*, 515-562.

⁸⁵⁸ F.C. Lashbrooke, Jr., *supra*, footnote 608, at 238.

⁸⁵⁹ Shelley O'Neill, *supra*, footnote 636, at 711.

⁸⁶⁰ Charles R. McManis, "Questionable Corporate Payment Abroad: An Antitrust Approach" (1976), 86 *Yale L.J.*, 215-238, at 233.

A. The Sovereign Compulsion Defence

The sovereign compulsion defence is a judicial creation, as is the act of state doctrine defence.⁸⁶¹ We shall be cognizant of the fact that although the two defences are similar, they have different doctrinal underpinnings.⁸⁶²

Because the sovereign compulsion defence is used to evade prosecution for violating local law, the complex issue of causation is always raised. Courts permit only a narrow use of the defence, particularly in illegal payment issues.⁸⁶³ For the defence to be valid, it has to be established that the violation of national law clearly was compelled, rather than permitted or encouraged by foreign officials,⁸⁶⁴ and furthermore that the conduct took place within the territory of the foreign sovereign that instigated or ordered the law violation by the MNC.⁸⁶⁵ Under U.S. law, compulsion is accepted as a defence only if four conditions are met:

- (a) the compulsion order was lawful under the legal system of the issuing government;
- (b) the government issued the order in a sovereign rather than a commercial capacity;
- (c) the order was directed only at conduct within the border of the compelling government, and

⁸⁶¹ See Sigmund Timberg, "Sovereign Immunity and Act of State Defences: Transnational Boycotts and Economic Coercion" (1976), 55 *Tex. L. Rev.*, 37, at 20.

⁸⁶² The distinction between these doctrines has been recognized recently by the Deputy Assistant Attorney General of the United States in testimony before the U.S. Congress Subcommittee on International Economic Policy of the House Committee on International Relations, 5 *Trade Reg. Rep.* #50, 238, at 55.

⁸⁶³ Charles R. McManis, *supra*, footnote 860, at 232.

⁸⁶⁴ *Continental Ore Corp. v. Union Carbide & Carbon Cop.*, 370 U.S. 690, 707 (1962).

⁸⁶⁵ *United States v. Watchmaker of Switzerland Information Center, Inc.*, [1963] *Trade Reg. Rep. (CCH)* No. 70, 600 (S.D.N.Y. 1962); modified, [1965] *Trade Reg. Rep. (CCH)* No. 71, 352 (S.D.N.Y. 1965).

(d) the order was not induced by the private party claiming the defence.⁸⁶⁶

It is important to mention that the basic policy on which the defence of sovereign compulsion rests is fairness to the coerced party.⁸⁶⁷ Accordingly, for an MNC to avail itself of the defence of sovereign compulsion, it must be evident that the foreign government or official acted essentially to coerce the violation of the law, otherwise the defendant MNC could have legally refused to accede to the foreign official's request for illegal payment.⁸⁶⁸ One legal commentator has suggested that there should not be such an emphasis on the requirement of a government decree on participation in the payments for an MNC to invoke the defence of sovereign compulsion in the case of illegal payment. He maintains: "The litmus test of the defence should be the degree of the compulsion, not the form of the compulsion, [because] from the perspective of the company, it makes little difference whether pressure is exerted by formal decree or statute or by some informal customary practice."⁸⁶⁹ Regardless of what the commentators believe, the courts always tend to narrow the application of the sovereign compulsion defence⁸⁷⁰ to the point where for the defence to operate there must be evidence that foreign law compelled the defendant (the MNC) to violate the FCPA or any other law relevant to the transaction.⁸⁷¹

⁸⁶⁶ See James R. Atwood and Kingman Brewster, *Antitrust and American Business Abroad*, vol. 1 (2nd edition, 1981), at 268, Chapter 8.14.

⁸⁶⁷ Notes, "Extraterritoriality: Antitrust Law Development of the Defence of Sovereign Compulsion" (1971), 69 *Mich. L. Rev.*, 888-913, at 892.

⁸⁶⁸ Though the defence of sovereign compulsion is recognized when the party invoking it was conforming to a statute or decree, "the law is less clear in regard to conduct which is requested or induced by foreign officials." See Joel Davidow, "Antitrust, Foreign Policy, and International Buying Cooperation" (1974-75), 84 *Yale L.J.*, 268-292, at 282.

⁸⁶⁹ Gerald T. McLaughlin, *supra*, footnote 610, at 1107.

⁸⁷⁰ *Sabre Shipping Corp. v. American Presidential Lines, Ltd.*, 285 F. Supp. 949 (S.D.N.Y. 1968); *Cen. denied*, 407 F.2d 123 (2nd Cir.), *Cert. denied*, 395 U.S. 922 (1969).

⁸⁷¹ See Sigmund Timberg, *supra*, footnote 861, at 23.

Examples of relevant dicta are found in cases involving the violations by corporations of American antitrust law as a result of foreign sovereign compulsion. One example is the case of *Continental Ore Co. v. Union Carbide & Chemical Co.*⁸⁷² which involved acts in Canada by the Canadian subsidiary of a U.S. company. The charge was that the parent company (Union Carbide) had conspired with its Canadian subsidiary, (Electro Metallurgical Company of Canada, Ltd., or Electro Met), to monopolize vanadium production and sales in Canada.⁸⁷³ The plaintiff, Continental Ore, alleged that it, among others, had been eliminated from the vanadium business as a consequence of Union Carbide's restrictive practices in Canada. Electro Met had been appointed by the Canadian government as the exclusive agent of vanadium in Canada. Considering the involvement of the Canadian government, the question that arose was whether the acts of the Canadian subsidiary (which were attributed to its parent, Union Carbide) were shielded from the reach of the American antitrust law, namely, the Sherman Act. The United States Supreme Court held that Electro Met was not excused from refusing to deal with Continental Ore, an American Corporation that sold vanadium, simply because it was

...acting in a manner permitted by Canadian law...⁸⁷⁴

The court found no indication of involvement by any Canadian official in directing or ordering the cease of purchases from Continental; so Electro Met, though an agent of a foreign government, was acting on its own, without official approval. The court therefore did not permit the sovereign compulsion defence.⁸⁷⁵ Some

⁸⁷² *Continental Ore Co. v. Union Carbide & Chemical Corp.*, 370 U.S. 690, 82 S. Ct. 1404, 8 L. Ed.(2d) 777 (1962).

⁸⁷³ Vanadium is a rare metal used in producing a tough and durable steel alloy.

⁸⁷⁴ *Continental Ore Co. v. Union Carbide & Chemical Corp.*, 370 U.S. 690 (1962), at 706-707.

⁸⁷⁵ Ibid.

legal commentators have inferred from this that if there had been an actual order of involvement by the Canadian government, the court would have reached a different conclusion.⁸⁷⁶ Congruently, however, underlying the sovereign compulsion defence is the balance of the international comity interest.⁸⁷⁷ The court may not admit this defence if the foreign government action is of a commercial nature rather than one pertaining to the performance of a government function.⁸⁷⁸

It follows that MNCs are not able to invoke the sovereign compulsion defence merely for having acceded to an official's request for a bribe, because for the defence to operate there must be evidence that the MNC was compelled to violate its national law and pay a bribe. A case in point was the antitrust action of *United States v. Watchmakers of Switzerland Information Center, Inc.*⁸⁷⁹ The Swiss government had, strange encouraged Swiss watch firms and trade associations to execute and participate in an international agreement to limit exports of Swiss watch parts to the U.S., as well as to restrict United States export of compatible parts to the Swiss market in other countries.⁸⁸⁰ The complaint was filed in New York against several American and Swiss manufacturers for conspiracy and

⁸⁷⁶ Robert C. Barnard, "Extra Territoriality and Antitrust Law in the United States" (1963), No. 6 Supp. *Int'l & Comp. L.Q.*, 95-116, at 104; Anthony W. Graziano, Jr., "Foreign Governmental Compulsion as a Defence in United States Antitrust Law" (1967), 7 *Va.J. Int'l L.*, No. 21, 100-145, at 136-137; Wilbur L. Fugate, "Antitrust Jurisdiction and Foreign Sovereignty" (1962), 49 *Va. L. Rev.*, 925-937, at 934. Also see Pierre Vogelenzang, "Foreign Sovereign Compulsion in American Antitrust Law" (1980), 33 *Stan.L. Rev.*, 131-153, at 142-150.

⁸⁷⁷ Douglas E. Rosenthal, "Sovereign Compulsion Defence in Antitrust Litigation: New Life for the Act of State Doctrine?" (1978), 72 *Am. Soc'y Int'l L.Proc.*, 97-118, at 117.

⁸⁷⁸ Donald I. Baker, "Antitrust Remedies Against Government Inspired Boycotts, Shortages, and Squeezes: Wanderings on the Road to Mecca" (1976), 61 *Cornell L.Rev.*, 911-949, at 927.

⁸⁷⁹ *United States v. Watchmakers of Switzerland Information Center, Inc.*, [1963] Trade Case no. 77, at 414 (S.D.N.Y. 1963). The original complaint was filed in October, 1954. Issues regarding personal jurisdiction were argued in *United States v. Watchmakers of Switzerland Information Center, Inc.*, 133 F. Supp. 40(S.D.N.Y., 1955), re argument denied, 134 F. Supp. 710(S.D.N.Y., 1955).

⁸⁸⁰ The case was subsequently dismissed as regards some defendants, while others signed a consent decree. For more discussion and background of the case, see G. Winthrop Haight, "The Swiss Watch" in *Common Market and American Antitrust: Overlap and Conflict* (1970), at 311-363.

restraint of trade in violation of the American anti-trust law. The court, nevertheless, found that the Swiss government's approval of the arrangements did not shelter the Swiss defendants from antitrust liability, because Swiss law had not required that participation.⁸⁸¹ The court held that the defendants were liable for their participation in the convention, which resulted in the restrictive practices, even though such practices were permitted under Swiss law.⁸⁸² The presiding judge distinguished this case from the situation where a foreign government compels a business to engage in activities that violate American laws by saying that:

...if, of course, the defendants' activities had been required by Swiss law, this court could indeed do nothing...^{883*}

Seemingly, in both cases that we have just presented, the courts indicated in dicta that sovereign compulsion may immunize MNCs from liability for violation of national law. This was also borne out by the court holding in *Inter-american Refining Corp. v. Texaco Maracaibo, Inc.*⁸⁸⁴ in which the court recognized that compulsion by a foreign government can justify the corporation's violation of national law and shield it from liability.⁸⁸⁵ The rationale stems from the fact that when a foreign nation compels a corporation to follow certain patterns of trade practice in conducting business in that country, the act becomes in effect not the act of the corporation accused of violating national law, but of the foreign sovereign where the corporation operates and is compelled to act according to

⁸⁸¹ *United States v. Watchmakers of Switzerland Information Center, Inc.*, [1963], Trade Cases #77, at 426. The core of the conspiracy was the collective convention, a private agreement among associations of Swiss Manufacturers and some individual American manufacturers. One of the purposes of the convention was to regulate the flow of Swiss watch parts to the American market.

⁸⁸² *Id.* at 456.

⁸⁸³ *Ibid.*

⁸⁸⁴ *Inter-american Refining Corp. v. Texaco Maracaibo, Inc.*, 307 F. Supp. 1291 (D. Del. 1970).

⁸⁸⁵ *Id.* at 1298.

those patterns.⁸⁸⁶ The court held that:

It requires no precedent, however, to acknowledge that sovereignty includes the right to regulate commerce within the nation. When a nation compels a trade practice, firms then have no choice but to obey. Acts of business become effectively acts of the sovereign.⁸⁸⁷

Although several legal writers accept this conclusion, which effectively excuses the corporation from liability for violating national law,⁸⁸⁸ others consider the *Inter-american* case wrongly decided on the ground that the foreign sovereign decree compelling the corporation to act in violation of national law was not carried out in the sovereign's territory but was taking place wholly in the territory of the United States.⁸⁸⁹

Finally, in the recent case of *Associated Radio Serv. Co. v. Page Airways, Inc.*⁸⁹⁰ the court affirmed a jury verdict for the plaintiff, finding that the defendants had restrained and monopolized trade, including export trade, in avionics for a particular type of business aircraft. Part of the claim was based on evidence that the defendants had bribed foreign government officials to secure their government's business. In an instruction approved by the court of appeal for the Fifth Circuit, the jury was informed that it could find a foreign government compulsion defence if:

⁸⁸⁶ Gerald T. McLaughlin, *supra*, footnote 610, at 1105.

⁸⁸⁷ *Inter-american Refining Corp. v. Texaco Maracaibo, Inc.*, 307 F. Supp. 1291 (D. Del. 1970), at 1298.

⁸⁸⁸ See Wilbur L. Fugate, *Foreign Commerce and Antitrust Law*, (2d ed., 1973), at 80. Also see Robert C. Barnard, *supra*, footnote 876, at 103.

⁸⁸⁹ See Douglas E. Rosenthal, *Antitrust Jurisdiction and the Activities of Foreign Government*, Department of Justice press release, at 8 (January 29, 1976) (address before the World Trade Institute, New York City). The writer acquired a photostat copy of the speech from Professor Jonathan Fried during the course in International Economic Law in which the writer was enrolled at the University of Ottawa, Ottawa, Canada.

⁸⁹⁰ *Associated Radio Serv. Co. v. Page Airways, Inc.*, 624 F. 2d 1342 (5th Cir. 1980).

...the "foreign bribe" is a cost of doing business in the particular country and failure to make the payment results in the competitor inevitably losing the business.⁸⁹¹

Notwithstanding the dicta in the cases that we have just discussed in relation to the validity of the defence of sovereign compulsion, courts may be reluctant to allow sovereign compulsion in its widest application, because the acceptance of illegal payments is not considered to be an act of state, and is outside the realm of official conduct. So, allowing such a defence protects MNCs from violating national law, thus inducing such conduct by foreign officials even though it is against the law of their country.⁸⁹² Therefore, illegal payment cases seem to fall outside the protective scope of this defence.

⁸⁹¹ Id., at 1360. Note no. 27 in the judge's instructions to the jury.

⁸⁹² Joel Davidow, supra, footnote 868, at 284.

B. The Act of State Doctrine Defence

Generally, when a national court contemplates an action by a sovereign state, attention is inevitably focused on the act of state doctrine as developed by the American courts, which have undeniably contributed greatly to the development of the common law system.⁸⁹³ This approach has also been recognized by other major common law countries such as Great Britain,⁸⁹⁴ Australia and Canada.⁸⁹⁵ The essence of this doctrine is that national courts will not pass judgment upon the validity of the acts abroad of a recognized foreign sovereign state effected in or by virtue of the sovereignty capacity. This is distinct from the sovereign immunity doctrine in that the latter exempts a party from suit by virtue of its statutes, while the act of state doctrine is an application of the conflict of law principle.⁸⁹⁶

This doctrine was first enunciated by the U.S. Supreme court in the *Underhill v. Hernandez* case⁸⁹⁷ The court held that the judiciary could not inquire into the legality of an action taken by a Venezuelan leader whose government was later recognized by the U.S., stating that:

Every sovereign state is bound to respect the independence of every other sovereign state, and the courts of one country will not sit in

⁸⁹³ There have been voluminous commentaries on the act of state doctrine. For examples of recent writing, see Peter A. Longa, "Limiting the Act of State Doctrine: A Legislative Initiative" (1982), 23 *Va. J. Int'l L.*, 103-133; Brian S. Fraser, "Adjudicating Acts of State in Suits Against Foreign Sovereigns: A Political Question Analysis" (1983), 51 *Fordham L.Rev.*, 722-746.

⁸⁹⁴ English courts have followed the American approach by recognizing the act of state doctrine *Halsbury's Laws of England* (1977), vol. 18, at 793.

⁸⁹⁵ "In relation to Australia in general and the Trade Practice Act of 1974 in particular, every reason and logic and policy would seem to compel adoption of the U.S. approach." See Graham R. Taylor, "The Extraterritoriality of the Australian Antitrust Law" (1979), 13 *J. Int'l L. & Econ.*, 273-310, at 307.

⁸⁹⁶ See *Halsbury's Laws of England* (1977), vol. 18, at 793.

⁸⁹⁷ *Underhill v. Hernandez*, 168 U.S. 250 (1897).

judgement on the acts of the government of another done within its own territory.⁸⁹⁸

Since this case, the courts have consistently refrained from adjudicating issues that involve the actions of a foreign sovereign.⁸⁹⁹ This absolute abstention has been moderated by the balancing approach test to determine whether application of the doctrine is appropriate.⁹⁰⁰ In spite of this reformulation of the act of state doctrine, most courts prudently limit their role, and refrain from interfering in issues that would provoke foreign policy problems, and have upheld the doctrine in several recent cases.⁹⁰¹ For example, in *Occidental Petroleum v. Buttes Gas and Oil Co.*,⁹⁰² the court adhered to the view that a national court shall not pass judgment upon the acts of another sovereign in its own territory. The case was a

⁸⁹⁸ *Id.*, at 252.

⁸⁹⁹ See, for example, *Ricaud v. American Metal Co.*, 246 U.S. 304, 309 (1918) (court will not inquire into the legality of a sovereign's act committed within its boundaries); *Oetjen v. Central Leather Co.*, 246 U.S. 297, 303-04 (1918) (act of state doctrine helps preserve amicable relations between governments and peace among nations); *American Banana Co. v. United Fruit Corp.*, 213 U.S. 347, 352 (1909) (act of state doctrine compelled by comity of nations and sovereign authority).

⁹⁰⁰ *In Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964). This suit related to the Cuban government's expropriation of the assets of an American owned corporation in Cuba. The court, after discussing the separation of power and the U.S. constitution, and whether hearing cases involving foreign sovereign acts would interfere with foreign policy (at 427-28), concluded that the purpose of the act of state doctrine would be best promoted by the use of a flexible balancing approach to determine whether to invoke the doctrine in a particular case rather than by strict judicial abstention (at 428). The court finally upheld the doctrine after finding that international law provided the court with little guidance concerning the rights of those whose property a sovereign state had expropriated, "Rights of victims of expropriated property vary greatly from nation to nation" (at 428-430). Also the court noted that discussion of the expropriation would have raised a sensitive ideological debate concerning private vs. state ownership of a nation's means of production (*ibid.*), and concluded that judicial action on this issue, therefore, could result in injury to foreign relations and foreign policy objectives (*Ibid.*, at 430).

⁹⁰¹ As a result of the court's holding in the *Sabbatino* case, the U.S. Congress, concerned that such holding would preclude American victims of illegal expropriation from obtaining any redress, responded to the court holding by enacting an amendment to the Foreign Assistance Act of 1964 (Pub. Law no. 88-663 Secs. 301(d), 78 stat. 1013 codified as amended at 22 U.S.C. Sec. 2370[e][2] [1982]). See Veronica A. DeBerardine, "Foreign Corrupt Practices: Creating an Exception to the Act of State Doctrine" (1984), 34 *Am. U. L.Rev.*, 203-243, at 210.

⁹⁰² *Occidental Petroleum v. Buttes Gas and Oil Co.*, 331 F. Supp. 92 (C.D. Calif. 1971), *aff'd* 461 F.2d 1261 (9th Cir.) [per curiam] Cert. denied, 409 U.S. 950 (1972).

private antitrust suit alleging that the defendants (Buttes Gas and Oil Company and Clayco Petroleum Corporation) who had an oil concession from the Trucial State of Sharjah⁹⁰³ to cover its territorial and offshore waters, conspired with officials in that state to deprive the plaintiffs from winning the concession. Buttes allegedly bribed the state ruler to pass a decree to extend its territorial waters to cover an area that was supposed to be covered by a concession held by the plaintiff (Occidental) for the sister Trucial state of Um Al-Qaywayn.⁹⁰⁴ The court discussed whether there was "a substantial anti-competitive effect on American commerce," hoping to find basis for jurisdiction.⁹⁰⁵ The court found that the complaint was insufficient to invoke the Sabbatino balancing approach test.⁹⁰⁶ The court concluded that, although the ruler was motivated by his own personal gain and benefit

...the act of state doctrine precludes [this] court from further adjudication of the instant complaint.⁹⁰⁷

According to this holding, courts may continue to hold this position of refraining from inquiring into the motivations of foreign government officials to distinguish between legal payments and bribes prohibited under the U.S. FCPA.⁹⁰⁸

Notwithstanding this, the Supreme Court of the United States recognizes an exception to the act of state doctrine when the sovereign's conduct is essentially commercial in nature, as the court held in the case of *Alfred Dunhill of London*,

⁹⁰³ Sharjah and um Al-Qaywayn united with several other Gulf Trucial sheikdoms to form the United Arab Emirates.

⁹⁰⁴ *Occidental Petroleum v. Buttes Gas and Oil Co.*, 331 F. Supp. 92 (C.D. Calif. 1971), aff'd 461 F.2d 1261 (9th Cir.); Cert. denied 409 U.S. 950 (1972), at 98-101.

⁹⁰⁵ *Id.*, at 102-108. However, there have been no agreed upon criteria for what constitutes a substantial effect. See Erik Nerep, *supra*, footnote 789, vol. 2, at 581.

⁹⁰⁶ *Occidental petroleum v. Buttes Gas and Oil Co.*, 331 F. Supp. 92 (C.D. Calif. 1971), at 112.

⁹⁰⁷ *Id.*, at 113.

⁹⁰⁸ Shelley O'Neill, *supra*, footnote 636, at 714.

*Inc. v. Republic of Cuba*⁹⁰⁹ The plaintiff, an importer of cigars, complained that the Cuban government had refused to return funds that the plaintiff had mistakenly paid to Cuban interveners for cigars the plaintiff had purchased prior to the Cuban seizure and the nationalization of cigar companies.⁹¹⁰

The former owners of the Cuban companies, most of whom had fled to the United States, brought an action in the U.S. court to collect the purchase price of cigars that had been shipped to importers from these ized Cuban plants. Correspondingly, the intervenors and the Republic of Cuba brought separate litigation against the prior owners' attorneys, seeking to restrain the further prosecution of the suit. The actions were consolidated for trial. The District Court concluded that the former owners, rather than the interveners, were entitled to collect the whole amount due and unpaid with respect to shipments made after the date of intervention, but not to the accounts owing at the time of confiscation without compensation. This conclusion brought to the fore the importers' Alfred Dunhill and others claim that their payment of the preintervention accounts had been made in error and that they were entitled to recover these payments from interveners by way of set off and counter claim, because they had paid this sum subsequent to intervention on the assumption that the interveners were entitled to collect the accounts receivable of the intervened business.⁹¹¹

Although the government of Cuba argued that its refusal was an act of state barred from adjudication,⁹¹² the Supreme Court declined to invoke the act of state doctrine⁹¹³ on the ground that the Cuban government was operating a cigar busi-

⁹⁰⁹ *Alfred Dunhill of London, Inc. v. Republic of Cuba*, 425 U.S. 682 (1976).

⁹¹⁰ *Id.*, at 684

⁹¹¹ *Id.*, at 687-688.

⁹¹² *Id.*, at 687.

⁹¹³ *Id.*, at 697

ness for profit, an activity that is not sovereign.⁹¹⁴ In accordance with this holding, the court may rationalize that payment of a bribe to a foreign official to gain some business advantage is a purely commercial action and the adjudication of such illegal conduct is not barred by the act of state doctrine,⁹¹⁵ because the doctrine is an untenable defence in every case involving illegal conduct by a foreign official.⁹¹⁶ Nonetheless, this restrictive view has applied only in cases in which the defendants were state owned or operated commercial ventures, and "since most overseas payment suits are likely to be brought against corporations... even an expansive view of the [act of state doctrine] would not pose a major obstacle to... action against overseas payment"⁹¹⁷ by U.S. Corporations. Regardless of this view, the act of state doctrine may effectively prevent a successful challenge to any payments to foreign officials acting in their official capacity, because the act precludes judicial inquiry into the action and the motivations underlying the activities of a foreign sovereign and its officials.⁹¹⁸

The act of state doctrine has been successfully asserted by private MNCs as a defence to their being involved in illegal payments to foreign officials. The first case in point is *Hunt v. Mobil Oil Corp.*⁹¹⁹ in which an American company producing oil in Libya brought an antitrust suit against another American company similarly engaged.⁹²⁰ The plaintiff charged that the defendant had agreed to

⁹¹⁴ *Id.*, at 706. However, because sovereign acts are essentially those of private citizens, adjudication is "unlikely to touch very sharply on 'national nerves'." *Id.*, at 704 (quoting *Banco Nacional de Cubav. Sabbatino*, 376 U.S. 398, 428 (1964)).

⁹¹⁵ Shelley O'Neill, *supra*, footnote 636, at 715-716.

⁹¹⁶ Charles R. McManis, *supra*, footnote 860, at 236.

⁹¹⁷ *Id.*, at 234-235.

⁹¹⁸ *Occidental Petroleum v. Buttes Gas & Oil Co.*, 331 F. Supp. 92 (C.D. Calif. 1971), *aff'd* 461 F.2d(9th Cir.); *Cert. denied* 409 U.S. 950 (1972). The court invoked the act of state doctrine to preclude inquiry into the granting of an offshore oil concession.

⁹¹⁹ *Hunt v. Mobil Oil Corp.*, 550 F.2d 68 (2nd Cir. 1977); *cert. denied*, 98 S.Ct. 608, 434 U.S. 984 (1978).

⁹²⁰ Several oil companies were implicated in this suit (including the seven major oil corporations which are sometimes referred to as the seven sisters): Mobil Oil Corporation; Exxon Corporation; Shell Petroleum Corporation Ltd.; Texaco, Inc.; Standard Oil Company of Califor-

bargain jointly with the Libyan government concerning the terms of its oil concessions.⁹²¹ Among the several claims of Hunt, a small, independent producer, was the allegation that the defendant had manipulated the negotiations with the foreign government by bribing several government officials to cause the Libyan government to nationalize Hunts' Libyan operation and properties.⁹²² The U.S. court of appeal for the Second Circuit affirmed the lower court decision and rejected the plaintiff's argument, stating that:

There is no allegation expressed or implied here that representatives of Libya were seduced or enticed in any manner by the payment of bribes or boodle to take the action complained about. On the contrary, ... Libya is depicted as the innocent dupe of a domestic conspiracy.⁹²³

The court of appeal affirmed the dismissal of the plaintiff's claim on the ground that the act of state doctrine rendered the claim nonjustifiable, even though Libya was not named a defendant or designated as a co-conspirator.⁹²⁴ The court went on to say:

This appeal therefore is not the proper vehicle for consideration of international commercial bribery in so far as it affects the act of state doctrine.⁹²⁵

This holding demonstrates how an MNC that made an illegal payment can invoke the act of state doctrine as a defence against prosecution.⁹²⁶

nia; The British Petroleum Company, Ltd. and Gulf Oil Corporation; Occidental Petroleum Corporation's; and Grace Petroleum Corporation as the defendants, and *Hunt Oil Company*, an independent oil producer, as the plaintiff. See *Id.*, at 70.

⁹²¹ *Id.*, at 70.

⁹²² *Id.*, at 72.

⁹²³ *Id.*, at 79.

⁹²⁴ *Id.*, at 72.

⁹²⁵ *Id.*, at 79.

⁹²⁶ Gerald T. McLaughlin, *supra*, footnote 610, at 1104.

However, it could be argued that the request or receipt of a bribe by a foreign official is not a sovereign act, and therefore cannot be defended under the act of state doctrine. This is demonstrated in the case of *Sageintern, Ltd. v. Cadillac Gage Co.*⁹²⁷ which involved claims by the various plaintiffs that the defendant interfered with their plans to market an armored car by conspiring with foreign and domestic sales agents to receive illegal kickbacks from these agents for eliminating the plaintiffs from the armored car market.⁹²⁸ The defendant moved for a summary judgment to dismiss all the claims on the ground that the decisions to purchase these military cars are made by foreign government officials or their direct agents, and that this is a sovereign act, so the act of state doctrine bars any inquiry into the reasons for the purchase.⁹²⁹ The court rejected the defendant's argument on the ground that in considering the act of state doctrine as a defence, attention is focused not on the purpose of the act but on its nature, and the goal of the inquiry is to determine whether the denial of such defence will thwart or support the policy consideration in which the doctrine is rooted.⁹³⁰ The court found little conflict with foreign policy; because there were no extraterritorial impacts since the parties were all domestic corporations, there were not any long range foreign relations implications on the hearing and the adjudication of the case.⁹³¹ The court finally concluded that the plaintiff's claims were not barred by the act of state doctrine. Because the allegations related largely to the domestic action of the defendant, the act of state doctrine was being used simply as a shield, because the defendant had joined foreign sovereign purchasing acts into its alleged anti-trust conspiracy against the plaintiffs.⁹³²

⁹²⁷ *Sageintern, Ltd. v. Cadillac Gage Co.*, 534 F. Supp. 895 (1981).

⁹²⁸ *Id.*, at 898.

⁹²⁹ *Ibid.*

⁹³⁰ *Id.*, at 905.

⁹³¹ *Id.*, 909.

⁹³² *Id.*, at 911.

Several voices have been raised to urge the courts to recognize an exception to the act of state doctrine defence when it involves illegal payments to foreign officials by American MNCs, because there is an international consensus that illegal payments and bribery are repugnant and should be punished.⁹³³ These views do not pay much heed to the complexities involved, the risk to U.S. foreign policy, and the consequences associated with any litigation involving illegal payments to foreign officials by MNCs.⁹³⁴

Nevertheless, the U.S. appellate courts still adhere to the view that the act of state doctrine bars U.S. courts from inquiring into the motivation and conduct of foreign officials. This view was recently affirmed in the case of *Clayco Petroleum Corp., v. Occidental Petroleum Corp.*⁹³⁵ In 1979, the board of directors of Occidental, the defendant, published a report in the Oakland Tribune in which it admitted Occidental had made illegal payments amounting to \$30million dollars to foreign officials overseas.⁹³⁶ Among these illegal payments was one to the petroleum minister of Um Al-Qaywayn,⁹³⁷ Sheik Sultan, who was also the son of the ruler.⁹³⁸ Two of those payments, one in London and one in Switzerland, totalled \$417,000, and were part of a \$1.7 million deal with the petroleum minister for an oil and gas concession.⁹³⁹ Clayco, the plaintiff, brought an action against Occidental, after the information about illegal payments was revealed by the defendant, alleging that the petroleum minister had promised the oil concession to

⁹³³ For more discussion of writers' views on making bribery and corruption exceptions to the act of state doctrine, see Veronica Ann DeBerardine, supra, footnote 901, at 235-238.

⁹³⁴ James R. Atwood and Kingman Brewster, supra, footnote 866, vol. 1, Chapter 8.14, at 252.

⁹³⁵ *Clayco Petroleum Corp., v. Occidental Petroleum Corp.*, 712 F.2d 404 (9th Cir. 1983); cert. denied, 104 S.Ct. 703 (1984).

⁹³⁶ Id., at 405.

⁹³⁷ See supra, footnote 903.

⁹³⁸ *Clayco Petroleum Corp. v. Occidental Petroleum Corp.*, 712 F.2d 404 (9th Cir. 1983); cert. denied, 104 S.Ct. 703 (1984), at 405.

⁹³⁹ Ibid.

Clayco earlier in 1969, but that it was awarded to an Occidental subsidiary, Occidental of Um Al-Qaywayn, Inc., in 1979. Clayco claimed to have been aware in 1979 that the petroleum minister was motivated by a bribe.⁹⁴⁰

The action was based on violation of the antitrust law, which prohibits price discrimination and any restriction on competition.⁹⁴¹ The district court granted Occidental's motion to dismiss the action on the ground that an adjudication of the case was barred by the act of state doctrine.⁹⁴² The court reasoned that allowing adjudication of the case would require Clayco to prove that the bribe caused it injuries, which would in turn require the court to examine the "ethical validity" of the Um Al-Qaywayn officials.⁹⁴³ The plaintiff appealed on the ground that the FCPA created a corruption exception to the act of state doctrine, and that entitled the plaintiff to have the court adjudicate the claim under the corruption exception or under a commercial exception, because the granting of an oil concession is a commercial act.⁹⁴⁴ The plaintiff's argument was two pronged: first, the doctrine should not apply in a private action against a bribing corporation, because this would undermine the purpose of enacting the FCPA;⁹⁴⁵ second, there would not be any further embarrassment to the United States or threat to foreign relations, because information about the illegal payments had already been disclosed, which exposed the recipient foreign official and identified him.⁹⁴⁶ However persuasive this argument might have been, the Ninth Circuit of the United States Court of

⁹⁴⁰ Ibid.

⁹⁴¹ The plaintiff alleged violation of the Sherman Act, 15 U.S.C. Sec. 1 (1982) (Contracts, combinations, and conspiracies in restraint of trade or commerce among U.S. states or with foreign nations are illegal), and Sec. 2(c) of the Robinson Patman Act, 15 U.S.C. Sec. 13(c) (1982) (payment of commission or other compensation other than for services rendered in connection with sale or purchase of goods is illegal). Id., at 405.

⁹⁴² Id., at 406.

⁹⁴³ Ibid.

⁹⁴⁴ Ibid.

⁹⁴⁵ Id., at 408.

⁹⁴⁶ Id., at 409.

Appeal affirmed the lower court decision to dismiss the claim on the ground of the act of state doctrine, and rejected the plaintiff's assertion of bribery exception to the doctrine.⁹⁴⁷

The court decision has been the subject of several commentaries.⁹⁴⁸ One commentator said that the court's decision was correct, because allowing the adjudication of the case would have amounted to a potential interference with U.S. foreign relations.⁹⁴⁹ Others criticized the decision, stating that the court failed to recognize that foreign relations were not at risk so long as there was no involvement in the negotiations by any U.S. executive branch.⁹⁵⁰ They claimed the decision was wrong because it failed to apply the balancing approach test,⁹⁵¹ which was enunciated by the court in *Banco nacional de Cuba v. Sabbatino*⁹⁵² and in *Timberlane Lumber Co. v. Bank of America*⁹⁵³

The writer acknowledges the sensitive position in which U.S. courts find themselves in dealing with issues involving the acts of foreign officials on behalf of their governments, especially in cases related to natural resources.⁹⁵⁴ In the cases that we have just discussed, however, the act of state doctrine should not have been invoked, because with the bribe being admitted and the name of the recipient foreign official disclosed, there were no ill effects or embarrassment to

⁹⁴⁷ Ibid.

⁹⁴⁸ Janet E. Ritenbaugh, "The Act of State Doctrine: A Shield for Bribery and Corruption" (1984-85), 16 *Inter American L. Rev.*, 167-176; Joel Simon, " *Clayco Petroleum Corp. v. Occidental Petroleum Corp.* : Should There be a Bribery Exception to the Act of State Doctrine?" (1984), 17 *Cornell Int'l L.J.*, 407-423; Veronica A. DeBerardine, supra, footnote 901, at 203-242.

⁹⁴⁹ See Joel Simon, supra, footnote 948, at 415.

⁹⁵⁰ See Janet E. Ritenbaugh, supra, footnote 948, at 174.

⁹⁵¹ Id., at 175.

⁹⁵² *Banco nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964).

⁹⁵³ *Timberlane Lumber Co. v. Bank of America*, 549 F.2d 597 (9th Cir. 1976).

⁹⁵⁴ *International Association of Machinists and Aerospace Workers v. OPEC*, 649 F.2d 1354 (9th Cir.1981).

the U.S. The courts should have allowed the cases to be adjudicated. The courts' decisions have had the adverse effect of "immunizing the conduct [of MNCs] who are able to implicate a foreign sovereign in their anticompetitive schemes,"⁹⁵⁵ and of concealing corruption, that is, illegal payments to foreign officials. This is a clear abuse of the act of state doctrine and its objective.

⁹⁵⁵ Jo Rachel Backer, "Sherman Act Jurisdiction and the Acts of Foreign Sovereign" (1977), 77 *Colum. L.Rev.*, 1247-1265, at 1248.

6. Appraisal and Conclusion

Needless to say, today's giant corporations control a large part of the business of the world. The rise of such giant entities has alerted the legislature and the courts to take steps to control behaviour that would have an adverse effect on the social structure and to achieve fairness in conducting their designated responsibilities. We have examined the doctrines of criminal liability that have been developed through the years by the common law courts, and how they were fashioned to seek the widest possible control over corporate misconduct. The application of such controlling power upon giant corporations by the legislature of the country of incorporation must rest upon a solid ground of authority that is generally known. This is the jurisdictional basis from which a state can apply its national law to corporations bearing its nationality.

This issue of rights and jurisdiction becomes vital when a state intends to enact laws that have extraterritorial reach, thereby resulting in unsolvable dilemmas and threats to international harmony, as in the case when a national corporation has several subsidiaries around the world. The question is: to what extent does national law binding a parent corporation effect the activities of its subsidiaries in other countries, especially when these activities are motivated by the parent corporation's desire to achieve certain objectives for the benefit of both. The obvious example of such law is the American antitrust competition "law," which has been the subject of several arguments and case laws around the world for its infringement on the activities of subsidiaries of American owned corporations. Also, there was the enactment of the FCPA, which seeks to impose U.S. corporation morality on areas where the United States has no jurisdiction.

Notwithstanding the FCPA does not have a clear extraterritorial reach, an examination of the act's language reveals that its consequential effect is inevitable,

especially when the prosecutor needs to examine some of the documents of the subsidiary, or requires the parent corporation to produce records required by the act that may reveal a wrongdoing by the subsidiary that then the parent may be held accountable for. Or, the parent corporation's constructive knowledge of illegal payments and other misconduct by the subsidiary may subject it to prosecution.

Unfortunately, the fear of prosecution may drive U.S. corporations to find inventive means of circumventing the law and rendering the FCPA ineffective. For example, a corporation might induce a foreign official to accept a form of illegal payment that obscures the intent of both parties, then claim sovereign compulsion as a defence. Or it might resort to the act of state doctrine defence in an attempt to shield the payment of the bribe as the act of a sovereign state, as we have seen in several of the cases discussed. Another counter productive effect is that some American corporations will refrain from doing business abroad for fear of violating the FCPA, and that other international corporations will take their place in the world market.

These considerations lead the writer to conclude that there is only one way for the United States to avoid the policy dilemma that may result from applying its national law to bribery and corruption of foreign officials abroad, and to avoid losing its share in international business. It must first adhere to a consistent policy in every area pertaining to the conduct of MNCs. The U.S. should make a compromise with developing countries and Eastern block countries, to reach a workable and practical solution, for most issues that related to MNCs and its behaviour in host countries, to reach an agreement for a compulsory code of conduct. It must push forward for international agreements that will be adhered to by all nations. The United States and the other western powers have the economic

power to make such agreements a reality.

PART FOUR: IN SEARCH OF INTERNATIONAL SOLUTIONS TO THE CONTROL OF ILLEGAL PAYMENTS

CHAPTER 7.0

INTERNATIONAL COOPERATIVE EFFORTS TO SOLVE THE PROBLEM OF ILLEGAL PAYMENTS

1. General Remarks

Certainly, the attention brought to bear on the problem of illegal payments has been the result of a long and slow process. Today's giant MNC, with its power to dominate world wide economy by virtue of its capital and vast resources, finds itself under the close scrutiny of various international organizations.⁹⁵⁶ This scrutiny was sharpened by the mid '70s revelations of illegal payments in the United States, which disclosed the method by which most giant corporations conduct their business regardless of ethical standards and fairness in international trade.⁹⁵⁷ As we have seen earlier, the U.S. was the first country in the world to enact law⁹⁵⁸ forbidding national corporations to bribe foreign officials when conducting business abroad. Such a unilateral action by a country can have negative consequences for its national corporations in that it may create a competitive disadvantage vis-a-vis other nations' corporations that have no such legal restrictions.⁹⁵⁹ Furthermore, as has been discussed earlier,⁹⁶⁰ the longevity and

⁹⁵⁶ See Peter P. Gabriel, "Management of Public Interests by the Multinational Corporation" (1977), 11 *J. World. Trad. L.*, 15-36, at 19.

⁹⁵⁷ *Id.* at 20.

⁹⁵⁸ Pub. Law no. 95-213, 91 Stat. 1494. See Appendix II, *infra*

⁹⁵⁹ Norman C. Ankers, "The Foreign Corrupt Practices Act of 1977" (1978), 19 *Harv. Int'l L. J.*, 726-730, at 729.

⁹⁶⁰ See *supra*, Chapter 5.3.

effectiveness of any unilateral sanction of illegal payments abroad by national corporations depends on the extent of the cooperation of other nations in particular⁹⁶¹ and the international community in general. This type of cooperation would activate and effect the implementation of national law and international agreements against bribery, for when crimes are committed abroad, no effective prosecution would be possible without their investigation beyond national borders. Such action requires the cooperation of the government of the country where the wrongdoer made the illegal payment, and inevitably the judicial and executive assistance of other states.⁹⁶²

So, paradoxically, the nation's unilateral sanction of illegal payment may in the long run yield counter productive results, when other nations view it as an incriminating factor and as an infringement of their national sovereignty. This leads us to the conclusion that the effectiveness of any unilateral action in curbing illegal payment and bribery will be slim unless it is "matched by similar action by other nations."⁹⁶³ Thus far this seems unpredictable, owing to the varying interests of nations. We are led to conclude, therefore, that the only solution is a treaty to which all nations would adhere.

In pursuit of this goal several international associations and regional organizations have addressed the problem in various fora. Their efforts have created an atmosphere that is conducive to working together to eliminate illegal payments.⁹⁶⁴ However, we shall be cognizant of the fact that other independent efforts by regional and international organizations fall short because their voluntary nature

⁹⁶¹ See supra, footnote 719 and accompanying text.

⁹⁶² An example is the Canada-U.S.A. Mutual Legal Assistance Treaty in Criminal Matters of March 18, 1985, which mandated that the U.S.A. use the treaty mechanism, rather than unilateral measures such as extraterritorial subpoenas, to obtain evidence from Canada. This obligation, of course, is a reciprocal one.

⁹⁶³ Steven M. Morgan, supra, footnote 611, at 385.

⁹⁶⁴ Jeffery J. Hamilton, supra, footnote 824, at 124.

robs them of any enforceable momentum. An international treaty would obviate the adverse effect of unilateral sanctions and the potential extraterritorial consequences of enforcing them.⁹⁶⁵ Also, it would eliminate the potential negative effect on foreign relations because any foreign official accused of demanding or accepting illegal payment would have a chance to defend himself before a national court. Also, when a foreign official is convicted, the MNC would not have to fear retaliation for exposing him.⁹⁶⁶ Moreover, such an international treaty would ensure "judicial assistance whenever evidence or witnesses are in another country."⁹⁶⁷ This judicial assistance must be an essential part of any international treaty combatting bribery, and would guarantee and "protect the accused's fundamental rights to a greater extent than they are currently safeguarded in international investigation."⁹⁶⁸

We will accordingly in the following pages shed some light on the efforts of regional organizations and international bodies.

⁹⁶⁵ E.C. Lashbrook, Jr., supra, footnote 608, at 240.

⁹⁶⁶ id., at 241.

⁹⁶⁷ Ibid.

⁹⁶⁸ Id., at 242.

2. The Organization for Economic Cooperation and Development (OECD) Guidelines for MNCs.

The OECD is the successor institution to the Organization for European Economic Cooperation, (OEEC) which distributed aid and managed the Marshall project following World War II.⁹⁶⁹ The new name was proclaimed at the organization's convention on December 14, 1960.⁹⁷⁰

The OECD recognized the important role MNCs played in its reconstruction and development. To improve development in member countries, it strove to create a suitable climate for maximum investment by MNCs, and to reduce any difficulties that might arise in conducting their various operations. The OECD realized that cooperation among member states⁹⁷¹ was of essential importance to further MNC contribution and advance of international trade.

However, in 1974 the OECD started to look beyond its basic objective, when its ad hoc committees began to consider guidelines for governmental policies and standards of behaviour for MNCs. This work gained momentum when it established a committee on International Investment and Multinational Enterprises.⁹⁷² A code of conduct was formulated and then adopted by the OECD Council at a ministerial meeting in June of 1976.⁹⁷³ In spite of the ambiguous role played by

⁹⁶⁹ James Scott Glascock, "Legislating Business Morality: A Look at Efforts by Two International Organizations to Deal with Questionable Behavior by Transnational Corporations" (1977), 10 *Vand. J. Transnl. L.*, 459-473, at 459.

⁹⁷⁰ [1961]. 12 U.S. T. 17-28, T. I.A.S. No. 4891.

⁹⁷¹ Member states are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Federal Republic of Germany, Greece, Iceland, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Portugal, Spain, Switzerland, Turkey, the United Kingdom and the United States.

⁹⁷² Resolution of the council establishing a Committee on International Investment and Multinational Enterprises, adopted January 21, 1975; see OECD Doc. C(74) 247. (1975).

⁹⁷³ Declaration on International Investment and Multinational Enterprises, adopted June 21, 1976. Annex and Decision of Council, OECD Doc. 21 (76) 04/1(1976); reprinted in 15 *Intl Leg. Mat.*, at 967; also see: OECD Doc. Press/A (76) 20 (1976).

the U.S. in guiding the formulation of the code so as not to create a stricter environment for U.S. MNC direct investment.⁹⁷⁴ The members were concerned with organizing MNC operations to avoid concentration of economic power and to ensure that MNCs served and promoted national economic and social welfare.⁹⁷⁵

Notwithstanding that the code is voluntary and not legally binding,⁹⁷⁶ a portion of the guidelines deals with illegal payment. The general policies of the code indicate that corporations should

... not render and they should not be solicited or expected to render any bribe or other improper benefit, direct or indirect, to any public servant or holder of public office;⁹⁷⁷

... unless legally permissible, not make contributions to candidates for public office or to political parties or other political organizations.⁹⁷⁸

One commentator criticized the guideline's effectiveness in combatting illegal payment, holding that besides the guidelines' voluntary nature, "the strength of [the antibribery] provision is vitiated by the operation of the following provision allowing political contributions where legally permissible. Sanctioned political contributions often obtain the same or similar results as bribes or other improper benefits. Thus, the provision allowing political contributions severely restricts the scope of the provision directly addressing the bribery issue."⁹⁷⁹ However, the guidelines do require the disclosure of certain pertinent information relating to MNC operations and activities in the host state for the purpose of improving

⁹⁷⁴ James S. Glascock, *supra*, footnote 969, at 464.

⁹⁷⁵ See *supra*, footnote 966, 15 *Int'l Leg. Mat.*, at 969.

⁹⁷⁶ The OECD Guidelines for MNCs state in paragraph 6: The guidelines set out below are recommendations jointly addressed by Member Countries... Observance of the guidelines is voluntary and not legally enforceable.", at 970.

⁹⁷⁷ *Id.*, paragraph 7, at 972.

⁹⁷⁸ *Id.*, paragraph 8.

⁹⁷⁹ James S. Glascock, *supra*, footnote 969, at 463.

public understanding, and this disclosure might lead to the curtailment of illegal payment for fear of negative reactions from either the host or the home country.⁹⁸⁰ Also, even though the code is voluntary, MNCs "would probably make a serious mistake if they were to act contrary to the guidelines or not seek positively to abide by them."⁹⁸¹ Nonetheless, such guidelines may place MNC management in a better position to combat requests for illegal payments and may influence host governments to enact local laws or enhance existing ones to curtail illegal payment and consequentially enhance the host government's bargaining power.⁹⁸²

In-sum, although their language may offer a wide scope for interpretation, the effectiveness of the guidelines is apparent from their influence on the behaviour of MNCs and those others addressed, because "legal enforcement does not exclusively constitute effectiveness."⁹⁸³ The OECD guidelines are meant to be an expression of good will "without stipulating strict legal commitments on the part of the participating states".⁹⁸⁴ The OECD Committee on Investment and Multinational Enterprises in its Review Report of 1979⁹⁸⁵ recommended that MNCs express their policies with regard to the adherence to the guidelines in their annual reports.⁹⁸⁶ The committee also reported that sentiment toward respecting the guidelines had been reflected in the Badger case, introduced by the Belgian government on March 30,

⁹⁸⁰ *Id.*, at 466; also see OECD Guidelines, 15. *Int'l Leg. Mat.*, at 973.

⁹⁸¹ Daniel J. Plaine, "The OECD Guidelines for Multinational Enterprises" (1977), 11 *Int'l Law.*, 339-346, at 343.

⁹⁸² George W. Combe, Jr., "Multinational Code of Conduct and Corporate Accountability: New Opportunities for Corporate Counsel" (1980), 36 *Bus. Law.*, 11-43, at 25.

⁹⁸³ Sten Niklasson, "The OECD Guidelines for MNCs and the U.N. Draft Code of Conduct: Some Political Considerations," in *Legal Problems of Codes of Conduct for Multinational Enterprises* (ed. Norbert Horn, 1980), 141-144, at 144.

⁹⁸⁴ Norbert Horn, "International Rules for Multinational Enterprises: The ICC, OECD, and ILO Initiatives," (1980-81), 30 *Am. U. L. Rev.*, 923-940, at 926.

⁹⁸⁵ Organization for Economic Cooperation and Development, Report of the Committee on International Investment and Multinational Enterprises on the Review of the 1976 Declaration and Decisions, OECD Doc. C (79)102, June 5, 1979, reprinted in 18 *Int'l Leg. Mat.*, at 986 (1979).

⁹⁸⁶ *Id.*, paragraph V 77, at 1008.

1977,⁹⁸⁷ when the business community encouraged the corporation to accept the solution consistent with the guidelines.

⁹⁸⁷ Roger Blanpain, "The OECD Guidelines and Labour Relations: Badger and BEOND," in *Legal Problems of Codes of Conduct for Multinational Enterprises* supra, footnote 983, at 145-154.

3. International Chamber of Commerce (ICC) Efforts

The disapprobation of a number of spectacular cases of illegal payments and bribery in international business transactions spurred the Executive Board of the ICC to set up a commission to study the problem of corruption in international business, and simultaneously to recommend a solution. The ad hoc commission was set up in December 1975 under the chairmanship of Lord Shawcross, a former United Kingdom attorney general and a leading figure in the business community, and was composed of representatives from both developed and developing countries. The commission investigated the extent to which individual states had enacted and enforced laws to combat illegal payment, bribery, extortions and illegal political contribution, and the scope of MNC voluntary involvement in such activities.⁹⁸⁸

The commission's report indicated that illegal payments and bribes were being taken and given despite the existence of laws to the contrary.⁹⁸⁹ Consequently, the Commission urged governments and the business community to endeavour to eliminate such illegal practices by pressing for the enactment of stringent laws prohibiting and sanctioning all forms of corruption.⁹⁹⁰ It also urged that the business community, represented largely by MNCs, carry out its corresponding responsibility toward the effective elimination of such unethical practices.⁹⁹¹ Correspondingly, the ICC, in Part II of its report, presented a self regulatory international code of conduct to combat such unethical and corrupt practices.⁹⁹² The ICC report strongly recommended the prohibition of all aspects

⁹⁸⁸ See Shawcross Report on Ethical Practices in Commercial Transactions, adapted by 131st Sess. of the Council of the ICC, November 29, 1977. ICC Doc. No. 192/36 (March 14, 1977), reprinted in 16 *Int'l Leg. Mat.*, 686 (1977). (Herein after cited as Shawcross Report)

⁹⁸⁹ *Id.*, at 687.

⁹⁹⁰ *Ibid.*

⁹⁹¹ *Id.*, at 688.

of both the giving and taking of illegal payments and bribes, including solicited and so called facilitating payments.⁹⁹³ This language makes the ICC report a pioneer in prohibiting grease payment, in contrast with the FCPA of the U.S., which allows payment to lower level employees⁹⁹⁴ on the grounds that such employees in developing countries where such illegal payments dominate are underpaid by their government, and that such acts are not corrupt because the term "corrupt behavior" varies in meaning from one legal system to another.⁹⁹⁵ Furthermore, the ICC report recommended that both parties to a bribe the MNC as giver and the public official as receiver be punished for such illegal conduct.⁹⁹⁶

In summary, the ICC's contribution has been primarily to set a moral tone for MNCs, as is clearly shown from the voluntary nature of the rules of conduct as a method of self regulation.

⁹⁹² Id., at 692.

⁹⁹³ Id., at 689, and 695.

⁹⁹⁴ 15 U.S.C. Sec. 78 dd 1(b) and Sec. 78 dd 2(d)(2).

⁹⁹⁵ See Fredric Bryan Lesser, supra, footnote 614, at 175.

⁹⁹⁶ Shawcross Report, supra, footnote 988, at 691.

4. Organization of American States (OAS) Efforts

As with the other regional organizations discussed, the concerns of the OAS about MNC activities began in 1974, when its General Assembly approved Resolution 167 to study the nature and legal structure of MNCs and the impact of their activities on member states' economical, social and political structures.⁹⁹⁷ This attention was intensified by the news stories that uncovered a raft of immoral conduct and a manifest interference by MNCs in the domestic political affairs of member states. The Permanent Council, as a result of these concerns, unanimously approved Resolution 154, which emphasized the need for a code of conduct.⁹⁹⁸ The council articulated its condemnation of MNC illegal activities and their consequential effect on the political and economic relations among member states.⁹⁹⁹ Correspondingly, the council resolved:

- (a) to urge the member states to cooperate in the exchange of information for the purpose of achieving effective control of the activities of transnational enterprises conforming to the economic and social goals of the host state;¹⁰⁰⁰
- (b) to make a study of the principles that should govern the activities of transnational enterprises for the purpose of preparing a draft code of conduct which such enterprises should observe. In the preparation of this code, account will be taken of the work being carried out in this regard within the sphere of the United Nations.¹⁰⁰¹

⁹⁹⁷ OAS, AG/RES. 167 (IV O/74) OEA/Ser. P/IV.0.2 (1974).

⁹⁹⁸ "Behavior of Transnational Enterprises Operating in the Region and Need for a Code of Conduct to be Observed by Such Enterprises," OAS. CP/Res. No. 154. (167/75), Corr. 1 (July 10, 1975), reprinted in 14 *Int'l Leg. Mat.*, at 1326.

⁹⁹⁹ *Id.*, at 1327.

¹⁰⁰⁰ *Ibid.*

¹⁰⁰¹ *Id.*, at 1328.

Nonetheless, the OAS categorically pronounced its condemnation of illegal payment and bribery in a separate section of the resolution and resolved:

- (a) to condemn in the most emphatic terms any act of bribery, illegal payment or offer of payment by any transnational enterprise; any demand for or acceptance of improper payment as well as any act contrary to ethics and legal procedures; and
- (b) to urge the governments of the member states, insofar as necessary, to clarify their national laws with regard to the a fore mentioned improper or illegal acts.¹⁰⁰²

Yet, from the wording of this resolution one could infer its voluntary nature,¹⁰⁰³ and conclude that this resolution is merely a policy statement that has no enforcement power.¹⁰⁰⁴ However, one may attribute the mild language of the resolution to the dominating economic power of the U.S. in the OAS, which, at the time of the Resolution, was not interested in taking positive steps to hinder its economic interests in the regions where U.S. owned MNCs were heavily active.

¹⁰⁰² Ibid.

¹⁰⁰³ James S. Glascock, supra, footnote 969, at 469.

¹⁰⁰⁴ Steven M. Morgan, supra, footnote 611, at 386.

5. Scope and Content of the United Nations Draft Agreement on Illicit Payments

At the outset it shall be mentioned that the U.N.'s attempts to control MNC activities that have a detrimental effect on the economy of host countries began as early as 1972, when Chile, through its representative in the U.N., charged that the International Telephone and Telegraph (I.T.&T.) Company had interfered in the Chilean political process.¹⁰⁰⁵ This allegation, and the subsequent surfacing of other corrupt activities, increased the U.N. member efforts to push for an international code of conduct for MNCs.

The U.N. General Assembly Resolution 3514, of December 15, 1975,¹⁰⁰⁶ was the first to acknowledge and reaffirm every country's right to enact laws and regulations to control corrupt activities of MNCs.¹⁰⁰⁷ Also, it called for cooperation among member states to help facilitate the exchange of information concerning such corrupt practices.¹⁰⁰⁸ In addition the resolution requested that the Economic and Social Council (ECO/SOC) study the issue of corrupt practices and suggest the appropriate preventive measures that could effectively eliminate such corrupt activities.¹⁰⁰⁹

The ECO first established an ad hoc Intergovernmental Working Group "to conduct an examination of the problem of corrupt practices, in particular bribery in international commercial transactions by transnational and other corporations, their intermediaries and others involved, to elaborate in detail the scope and

¹⁰⁰⁵ Hans W. Baade, "Codes of Conduct for Multinational Enterprises: An Introductory Survey," in *Legal Problems in Codes of Conduct for Multinational Enterprises* *supra*, footnote 983, 407-441, at 414.

¹⁰⁰⁶ G.A. Res. 3514, 30 U.N. GAOR, supp. (No. 34) 69-709 U.N. Doc. A/10034 (1975).

¹⁰⁰⁷ *Id.*, paragraph (a).

¹⁰⁰⁸ *Id.*, paragraph (c).

¹⁰⁰⁹ *Id.*, paragraph (d).

content of an international agreement, to prevent and eliminate illicit payments, in whatever form..."¹⁰¹⁰ The Working Group's report¹⁰¹¹ to the ECO included provisions prohibiting bribery and other illicit payment in international business.¹⁰¹² One year later the Working Group was dissolved when the ECO established a "preparatory" committee¹⁰¹³ to work for on the preparation of a diplomatic conference to conclude an international agreement concerning illegal payments by MNCs. By May 18, 1974, the committee adopted the draft report,¹⁰¹⁴ which contained both text of the agreement¹⁰¹⁵ and notes by delegates expressing their views on some controversial provisions of the agreement.¹⁰¹⁶

The draft agreement provided for the criminalization and sanctioning of illegal payments by MNCs, and utilized the disclosure approach to unveil suspected illegal payments. Specifically, the agreement states:

Each contracting state shall ensure that enterprises or other juridical persons established in its territory maintain, under penalty of law, accurate records of payments made by them to an intermediary, or received by them as an intermediary, in connection with an international commercial transaction. These records shall include the amount and date of any such

¹⁰¹⁰ E.S.C. Res. 2041, 61 U.N. ESCOR, supp. (No. 1) 17, U.N. Doc. E/5889 (1976).

¹⁰¹¹ U.N. Doc. E/6006 of July 5, 1977), reprinted in 16 *Int'l Leg. Mat.*, 1236.

¹⁰¹² *Id.*, at 1239-1240.

¹⁰¹³ The member countries of the committee were: Argentina, Australia, Belgium, Brazil, Canada, Central African Empire (now the Republic of Central Africa), Dominican Republic, Egypt, Ethiopia, France, Federal Republic of Germany, Greece, Italy, Jamaica, Japan, Kenya, Madagascar, Mali, Mexico, the Netherlands, Nigeria, Panama, Somalia, Sudan, Sweden, Switzerland, Syria, Arab Republic, Trinidad and Tobago, Turkey, Uganda, The United Kingdom and North Ireland, United Republic of Cameroon, the U.S. and Venezuela.

¹⁰¹⁴ Report of the Committee on an International Agreement on Illicit Payments and its First and Second Sessions (2d Regular Sessions, agenda item 9), 21, U.N. ESCOR, U.N. Doc. E/1979/104 (1979).

¹⁰¹⁵ Draft International Agreement on Illicit Payments, U.N. Doc. E/1979/104 (May 25, 1979) (Herein after cited as Agreement), reprinted in 18 *Int'l Leg. Mat.*, 1025.

¹⁰¹⁶ *Id.*, at 1031.

payments and the name and address of the intermediary or intermediaries receiving such payments.¹⁰¹⁷

This provision ensures that no off record slush funds are allowed the practice most MNCs use to cover-up their illegal activities and maintain the secrecy of the recipient's identity.

The agreement also defines an "intermediary" as any enterprise or any legal or natural person who in connection with an international business transaction deals or negotiates any sort of commercial contract with a public official on behalf of an MNC or any natural or juridical person.¹⁰¹⁸ Concurrently, the agreement contains antibribery provisions that specify certain types of payment as prohibited in the context of international business transaction. Accordingly, every contracting state shall undertake to prohibit:

... the offering, promising or giving of any payment, gift or other advantage by any natural person, on his own behalf or on behalf of any enterprise or any other person whether juridical or natural, to or for the benefit of a public official as undue consideration for performing or refraining from the performance of his duties in connection with an international commercial transaction.¹⁰¹⁹

The agreement also prohibits a public official¹⁰²⁰ from soliciting, demanding either directly or indirect or receiving anything of value to perform or withhold performance of his duties in connection with any international commercial transac-

¹⁰¹⁷ Agreement, art. 6, at 1028.

¹⁰¹⁸ *Id.*, art. 2(c), at 1027.

¹⁰¹⁹ *Id.*, art. 1(a), at 1026.

¹⁰²⁰ Art. 2(a) of the Agreement defines a public official as: "...any person, whether appointed or elected, whether permanently or temporarily, who at the national, regional or local level holds a legislative, administrative, judicial or military office, or a public or governmental authority or agency who otherwise performs a public function.", at 1027.

tion.¹⁰²¹ Additionally, the contracting state must

undertake to make the acts referred to [previously] punishable by appropriate criminal penalties under its national law when committed by a juridical person, or, in the case of a state which does not recognize criminal responsibility of juridical persons, to take appropriate measures, according to its national law, with the objective of comparable deterrent effects.¹⁰²²

Moreover, the contracting state must also punish the offending public official,¹⁰²³ and take appropriate and practicable measures to prevent any violations of the antibribery provisions of the agreement.¹⁰²⁴ Essentially, no punishment can be declared before jurisdictional requirements are satisfied,¹⁰²⁵ which the contracting states must establish to deal with the offender when it is a public official of the contracting state,¹⁰²⁶ or when the payment is proffered by one of its own nations.¹⁰²⁷ In addition, it must be established that the bribery or other offence mentioned in the agreement is committed within the state territory,¹⁰²⁸ or has effects within the state.¹⁰²⁹ The prosecution of the offenders is mandated by the agreement, which states:

¹⁰²¹ Id., art. 1(1)(b), at 1027.

¹⁰²² Id., art. 1(2).

¹⁰²³ Id., art. 1(1), at 1026.

¹⁰²⁴ Id., art. 3, at 1027.

¹⁰²⁵ Id., art. 4.

¹⁰²⁶ Id., art. 4(1)(b), at 1028.

¹⁰²⁷ Id., art. 4(1)(c). Each contracting state [must] establish its jurisdiction ... (c) over the offence... relating to any payment, gift or other advantage in connection with ...an international commercial transaction when the offence is committed by a national of the State, provided that any element of that offence, or any act aiding or abetting that offence, is connected with the territory of that State.

¹⁰²⁸ Id., art. 4(1)(a), at 1027.

¹⁰²⁹ Id., art. 4(1)(d), at 1028. This provision is bracketed in the Draft Agreement, which indicates the lack of agreement among delegations.

A contracting state in whose territory the alleged offender is found shall, if having jurisdiction under article 4, paragraph 1, be obliged without exception whatsoever to submit the case to its competent authorities for the purpose of prosecution, through proceedings in accordance with the laws of the state.¹⁰³⁰

When the offences are within the scope of the agreement, such offenses "shall be deemed to be included as extraditable offences in any extradition treaty existing between contracting states,"¹⁰³¹ and shall likewise be included in any future treaty.¹⁰³² The agreement stresses the cooperation needed between contracting states to execute the agreement the mutual assistance required in connection with the criminal investigation and proceedings to aid in the enforcement of the provisions.¹⁰³³ There is the need to ensure that all information is kept confidential¹⁰³⁴ and is used solely for the purpose for which it has been obtained and only by the requesting state.¹⁰³⁵ These mutual aid provisions shall not affect any other bilateral or multilateral treaty for mutual assistance in criminal matters between contracting states.¹⁰³⁶

Although the agreement's basic intention is to eliminate illegal payments in international and commercial transactions, several criticisms have been levelled against it, some of a practical nature¹⁰³⁷ and others pertaining to the fact that the agreement seems to permit political contributions because it does not mention

¹⁰³⁰ Id., art. 5, at 1028.

¹⁰³¹ Id., art. 11 (1), at 1030.

¹⁰³² Ibid.

¹⁰³³ Id., art. 10, at 1029.

¹⁰³⁴ Id., art. 10 (3).

¹⁰³⁵ Id., art. 10 (5), at 1030.

¹⁰³⁶ Id., art. 10 (6).

¹⁰³⁷ For example art. 7(3) requires each contracting state to submit its annual report to the Secretary General of the United Nations. Ibid., at 1028.

them it as a prohibited offence.¹⁰³⁸ Furthermore, the agreement has not been ratified to have enforceable power, because for any U.N. agreement or MNC code of conduct to be effective, it must be a mandatory code enforceable by all nations. While this is a logical from a theoretical point of view, the ratification was not achieved mainly, because of the attitudes and positions of the participants. First, the U.S.A. has insisted, in this area, on the mandatory nature of the code. This position is inconsistent with its policy towards other code of conduct related to MNCs,¹⁰³⁹ for example, the U.S. position on code of conduct dealing with restrictive business practices, is that such code should be voluntary rather than mandatory.¹⁰⁴⁰

However, the U.S. position is perfectly consistent with its own internal policy on illegal payments. If the FCPA is enforced, American MNCs will find themselves in an unfavorable competitive situation compared to other MNCs whose home countries do not prohibit illegal payments abroad. Thus, it is to the advantage of American based MNCs to insist on the mandatory character of the code. Second, this may also explain why the European allies of the U.S. did not offer much support to its position in the U.N. forum.¹⁰⁴¹ Possibly, the European MNCs did not want to lose the "competitive edge" given to them by looser controls. Third, developing countries, on the other hand, may have felt that the U.S. situation was one that left that country with very little leeway. This was seen as an opportunity to obtain concessions in other areas. Thus, they insisted on the mandatory character of a general code of conduct, which included, inter alia, illegal payments.¹⁰⁴²

¹⁰³⁸ Jeffrey J. Hamilton, *supra*, footnote 824, at 128.

¹⁰³⁹ Seymour Rubin, "International Aspects of the Control of Illicit Payments" (1982), 9 *Syracuse J Int'l L. & Com.*, 315-323, at 321.

¹⁰⁴⁰ Ibid.

¹⁰⁴¹ Ibid.

¹⁰⁴² Ibid.

The opposing positions thus made it difficult to come to a resolution of the issue. Consequently, it is easy to understand why the legal nature of the code still undetermined, its final determination was, by consensus, deferred to the concluding phase of the negotiations and is still outstanding.¹⁰⁴³

As we have stated, the internal position of the U.S. has put its MNCs in a delicate situation. Possibly, they would prefer the absence of any control on their business behaviour abroad; since such controls do exist, (FCPA), they fear for their competitiveness in relation to MNCs whose home countries have not addressed the issue.

The situation, of course, depends on the vigorous enforcement of the FCPA; but such vigorous enforcement is itself subject to the will of the Administration in power. The current administration is not interested in enforcing the FCPA as was clearly stated by former Assistant General Council of the Securities and Exchange Commission.¹⁰⁴⁴ Thus when the proposal for a mandatory code was mooted, it did not gather a consensus; since then, it is an outstanding issue, but one does not seem, at the present time, to have a great impetus.¹⁰⁴⁵

The difficulty of creating a consensus on a mandatory code should not, in the writer's view, prevent U.S. from exerting pressure on other countries to reach a reasonable compromise and solution to the problem of illegal payments abroad. The U.S. should make some concessions on other issues; and developing countries also should soften their position to reach an achievable compromise. In any case,

¹⁰⁴³ See U.N. Document E/C.10/1984/S/5 of May 29, 1984. "Outstanding Issues in the Draft Code of Conduct on Transnational Corporations", reproduced in 23 *Int'l Leg. Mat.*, 602-640, at 629.

¹⁰⁴⁴ See John Sweeny, "The SEC Interpretive and Enforcement Program Under the FCPA", (1982), 9 *Syr. J. Int'l L. & Com.*, 273-281, at 281.

¹⁰⁴⁵ See U.N. Document E/C/1983/S/2 of January 4, 1983. "Information Paper on the Negotiations to Complete the Code of Conduct on Transnational Corporations", reproduced in 22 *Int'l Leg. Mat.* at 177.

the writer feels that the only theoretical solution possible be a mandatory international code prohibiting illicit payments by MNCs to foreign officials abroad.

6. Appraisal

It shall be recognized that national sanction of illegal payment alone does not and will not amount to the elimination of such abhorrent activities by MNCs, as long as other countries do not have the will to enforce their laws if they have any and to maintain and preserve a required ethical standard of business. Such a situation also puts MNCs in the position of being hostages to other foreign officials whose society does not condemn illegal payment or bribery, or whose political system shields the wrongful acts of officials from being detected and punished.

The steps taken to date by regional groups such as the OECD, the ICC and the OAS toward the elimination of illegal payment fall short of accomplishing their goal, because all these efforts depend upon the voluntary compliance of MNCs rather than on laws or treaties that have a mandatory proscription. Congruently, it shall be noted that wide condemnation by the international community points to a prevailing attitude against corrupt activities of MNCs in general and illegal payments in particular. This leads us to conclude that the solution is a mandatory international treaty to eliminate bribery and other illegal payments and to obviate the need for unilateral sanctions which might have counterproductive results amidst the diverse political systems in the world today. Such an effort would:

- (a) establish standards of ethical and equitable conduct of international business;
- (b) provide a greater degree of foreign cooperation in enforcement matters;
- (c) provide a wide divergence of opinions and expertise in formulating an international solution to illegal payments;
- (d) protect the competitive interest of any nation by causing other competi-

ble nations' corporations, to honour an international agreement, and;

- (e) create pressures or impose obligations on government to vigorously enforce relevant domestic law.¹⁰⁴⁶

When an international agreement is reached, the nations' corporations need not fear a competitive advantage from other corporations that would otherwise be free to bribe foreign officials. Furthermore, it would minimize if not eliminate enforcement difficulties. The draft agreement on illicit payment by the U.N. is in the writer view's inconclusive, and compromise should be made to accommodate the opposing views. The U.S. bears a great responsibility to utilize its economic and political leverage to exert pressure and make compromises to push other nations to ratify the agreement, especially those nations wielding western economic and industrial power.

¹⁰⁴⁶ Steven M. Morgan *supra*, footnote 611, at 385-386. Many countries however, do not enforce their statutes, or provide for only minimal penalties. See generally Yerachmiel Kugel and Neal D. Cohen, *Government Regulation of Business Ethics*, Book III, at 6.

GENERAL CONCLUSION

The crusade to control MNC bribery and illegal payment was triggered by the revelation of the Watergate scandal of the 1970s. Our purpose throughout this dissertation has been to examine the most effective way of controlling illegal payment and bribery by MNCs in all transnational transactions. As we have seen in Chapter 1.0, illegal payments involve resorting to operational methods that compromise morality in politics, and that are shamelessly rationalized as expedient to the survival of both parties. This method of conducting business, besides deviating from a legal norm, arouses anger and anxiety in our society.

The elite officials in countries where MNCs do business tend to back systems that are designed to secure their power and maintain their validity. By adopting an authoritarian approach, these officials elevate themselves above all criticism, thus facilitating the purchase of their favour. Such purchase of officials' favour can be perceived from the practices of certain MNCs that have been closely associated with illegal payments and that show evidence of strong ties with government officials. This black market of the buying and selling of influence prostitutes the authority and power conveyed on public officials and results in the abuse of public trust for personal advantage. Consequently, these activities have a damaging effect on the economic and political structure of the officials' country as well as on the MNCs.

It shall be recognized that bribery and illegal payments can be neither controlled nor eliminated without the cohesiveness of the officials' attitudes about bribery and illegal payments. The practice of denominating a particular payment as legal or not according to the role or responsibility of the receiving government official is weak and corrupt, and only serves to perpetuate such activities.

However, to reassert the value of justice in an open society, emphasis here has been on changing the behaviour of those who can influence decisions regarding illegal payments. The legal advisor in any business organization thus plays a significant role in controlling illegal payments. While this legal advisor is sometimes a member of the elite personnel of a corporation, he shall play the role of a loyal opposition in facing down proposed wrongdoings by other members of the organization, ideally forming a counter elite whose concern is the maintaining of justice and the carrying out of society's expectations. The legal advisor's prestigious position increases his responsibility to carefully and diligently observe the right and wrong methods of business practices, and therefore to efficiently and quickly intervene to prevent any perceived abuse that does not correspond to legal and moral standards in conducting business. Whether he is an outsider or an employee of the corporation, the legal professional shall dedicate himself to his corporation's best interests, as well as to his profession. He shall exercise a strong ethical imperative to prevent unethical conduct by his corporation.

These obligations may extend to the point of revealing illegal conduct within his corporation. This duty of disclosure is one way to control illegal and questionable conduct by MNCs, as was demonstrated by the decision in the case of *SEC v. National Student Marketing Corporation*,¹⁰⁴⁷ in which the U.S. court imposed on an MNC's legal advisor the duty to reveal any wrongdoing by his corporation when the conduct is repugnant and does not correspond to society's expectations. This case showed that the legal advisor had a duty to the shareholders and to the public, as well as to his client. This duty of disclosure controls the abuse of the client's privilege when used to conceal illegal conduct, as the U.S. Court of Appeals for the Ninth circuit held in the *Re Sealed*¹⁰⁴⁸ case and as the Fifth

¹⁰⁴⁷ *SEC v. National Student Marketing Corporation*, 457 F. Supp. 682 (D.D.C. 1972).

¹⁰⁴⁸ *Re Sealed Case*, 676 F. 2d 793(D.C. Circuit 1982).

Circuit held in the *Re International Systems and Controls Corporation* case¹⁰⁴⁹ both of which involved illegal payments by MNCs to public officials. This duty of disclosure extends to all of the various methods of MNC illegal payments, whether it be a political contribution or excessive fees to agents abroad. The purpose and impetus of the payment are the determining factors in deciding its legality, as we have seen in Chapter 2.0. Though evaluations of the propriety of a particular payment will be influenced by various factors and by context, great weight shall be given to economic and public order, so as to avoid justification of the payment by shifting to a teleological rather than a logical derivation of impetus and motivation.

In addition to having a legal advisor to help control illegal payments by MNCs to officials abroad, MNCs have internal remedies for these illegal practices, which, though self serving, are a positive step toward controlling such illegal activities. These measures are beneficial and seriously appreciated when they are implemented efficiently. By having a code of conduct, an MNC signals its condemnation of illegal payments and states its corporate philosophy, its ethical standards and its commitment to the society where it operates. Such a code also provides broad guidelines for its employees in conducting business.

Furthermore, the installation of outside independent directors has the advantage of monitoring management activities and reviving the board of directors' role as the ultimate authority in managing the corporation. Such outside directors have an increased accountability to dispel the veil of prestige that formerly surrounded the traditional role of the board. Moreover, the creation of audit committees to oversee MNC activities would aid boards of directors to ensure effective and

¹⁰⁴⁹ *Re International Systems and Controls Corporations*, 693 F. 2d 1235 (5th Circuit 1982).

appropriate internal accounting control and will inevitably lead to the discovery of illegal acts or at least raise suspicion of covert illegality by the corporation. Also, internal self investigation may be used to raise the consciences of corporate employees and to discourage the conduct of business with bribery, because such activities may antagonize shareholders to the point of bringing a derivative suit to recover the cost of a bribe. The benefit of these controls would be the prevention of government interference in corporate activities, so long as it is evident that MNCs are making an honest effort to maintain and uphold legal and ethical standards.

One may wonder to what extent these house cleaning and self reform efforts are seriously intended and to what extent they are a way of parrying official efforts at reform. If they do not firmly commit themselves to reform and to following through on adopted remedies, MNCs will be faced with tight official regulation of their behaviour by laws that will deter prudent traders and business persons from engaging in bribery. In other words, a spurious show of reform would invite severe government action, either in the country where the MNC is incorporated or in the country where it is doing business, as we have seen in Chapter 5.0.

Admittedly, almost every country in the world has laws that combat illegal payment or bribery, but the success and efficiency of these legal sanctions depend on the effective enforcement of these laws. Yet when the bribe takers in host countries are the officials themselves or a related third party, they tend to exercise so called prosecutorial discretion enforcing the law in selected cases which makes deterrence of law breaking dim and remote, especially for those already backed by the authorities. Assessing the benefit of such laws becomes difficult. One writer has said: "Most unenforced criminal laws survive in order to satisfy moral objec-

tions to established modes of conduct. They are unenforced because we want to continue our conduct, and unrepealed because we want to preserve our morals."¹⁰⁵⁰

In the writer's opinion, the reason for such selective enforcement of the law is that there is no non democratic political system that would make it possible for ordinary citizens to serve as watchdogs for those acting on behalf of the government. The perpetuity of the de facto state of dictatorship in most of the developing countries is thus supported to the advantage of outsiders and of international politics, which manage to keep these countries under their sphere of influence. So, when a country senses resentment against corruption in its business entities or business persons, it may, for policy reasons, take action to prevent its MNCs from making bribes or any sort of illegal payments to gain access to foreign countries for business purposes. This was the case when the U.S. enacted the FCPA. The goal of making bribery in international business a crime was to reduce public discontent and to dispel the over simplified image of MNCs as corrupters of officials in underdeveloped countries.

Thus, the U.S. became the first country in the world to pass a criminal statute that regulates its corporations in conducting business abroad. However, the FCPA has several weaknesses that may hinder its effectiveness, one being the national security exception and the difficulties associated with its application, such as the possible extraterritorial reach of the Act and the embarrassment that would surface when the disclosed information reveals that the beneficiary is a high ranking foreign official or a leader of a country having close ties with the United States. Extraterritorial consequences may arise when U.S. MNCs have foreign subsidiaries who depend on bribes for doing business abroad, or who have knowledge of

¹⁰⁵⁰ T. Arnold, *The Symbols of Government*, (1935), at 160.

agents in other countries who pay such bribes.

These extraterritorial consequences have raised some doubts about the effectiveness of a unilateral legal sanction of illegal payments, which leads us to the conclusion that effective legal control of MNCs' illegal payments in transnational business dealings depends on the full cooperation of the international community. These cooperative efforts among nations would activate and effectuate the implementation of national law. Also, any international effort--such as a multilateral treaty--directed at prohibiting and consequently eliminating illegal payment, would alleviate the adverse effect of a unilateral sanction and the potential extraterritorial consequences of its enforcement. Moreover, multilateral action would eliminate the potential negative effect on foreign relations, because any foreign official accused of demanding or accepting illegal payment would have the chance to defend himself before a national court. If the official is convicted, the MNC would not have to fear retaliation for having exposed him. Finally, international cooperative efforts would ensure judicial assistance in gathering evidence and effective enforcement of the court's sentences if the convicted MNC or official is beyond the border of the country where the crime took place.

APPENDIX I

SAUDI ARABIA

Regulations Against Bribery

Promulgated by Royal Decree No. 15/m

on 7.3.1382.A.H. (August 9, 1962)

Art. 1 Every public employee who asks for, accepts or requests a promise for himself or another or a gift in order to perform an act within his duties, or pretends that the act falls within the scope of his duties even though it is a lawful act is considered corrupt and shall be punished with imprisonment from one to five years and a fine from 5000 to 100,000 Riyals, or either of these penalties. Whether the official intended to carry out what was promised has no bearing on the constitution of the crime.

Art. 2 Every public official who solicits for himself or another a promise or a gift as a reward for abstaining from performing an act within his duties, or pretends that such an act falls within the scope of his duties, although not performing it is legal, is considered corrupt and shall be punished by the penalties prescribed in Article 1 of this law. Whether the official intended not to carry out what was promised has no bearing on the crime.

Art. 3 Every public official who solicits or accepts for himself or another a promise or a gift as a reward for obstructing the performance of his duties or as a reward for what he has accomplished, even if there was no previous agreement, is considered corrupt and shall be punished by the penalties prescribed in Article 1 of this law.

Art. 4 Any public official who violates the duties of his position in order to commit or abstain from committing an act as a result of a request, recommendation, or mediation, is considered corrupt and shall be punished by imprisonment

for one year and a fine not to exceed 1000 Riyals or either of these penalties.

Art. 5 Any public official who solicits or accepts for himself or another a promise or gift in order to use his genuine or alleged influence to get or try to get from any public authority, works, ordinances, decisions, commitments, concessions, procurement contracts, or a job, service or any kind of privilege, is guilty of bribery and shall be punished by the penalty prescribed in Article 1 of this law.

Art. 6 The briber, the intermediary and any participant in any of the above mentioned crimes shall be punished by the penalty prescribed in the incriminating article. Whoever concurs, instigates, or helps to carry out a crime knowing that the crime has been committed by virtue of his concurrence, instigation and assistance, shall be considered an accomplice.

Art. 7 He who uses force or violence or threats against any public official to get something illegal from him, or to force him to avoid implementation of lawful action within his duties, shall be punished by the penalties prescribed in Article 1 of this law.

Art. 8 He who offers a bribe but it was not accepted, or uses force, violence or threats without attaining his objective, shall be punished by imprisonment from six months to thirty months and a fine from 2,500 to 50,000 Riyals or either of these penalties.

Art. 9 In the application of this law, the following are considered public officials:

- a. an employee of the government, its agencies, or public institutions, whether he has been appointed to a permanent or temporary job.
- b. the arbiter or expert appointed by the government or any other institution endowed with judicial authority;

- c. the doctor or midwife, in regard to the reports he or she submits, even if he or she is not a public official;
- d. every individual commissioned by the government or by any other administrative authority;
- e. employees of corporations or companies that undertake any project for the public sector.

Art. 10 Every individual appointed by the briber or the bribed person to receive a gift or a benefit, who accepts it knowing the reason behind it, shall be punished by imprisonment from 1 to 6 months and a fine of 5,000 Riyals or either of these penalties, provided that this person was not an intermediary in the bribery.

Art. 11 In the application of the provisions of this law, any benefit or privilege received by the bribed individual, no matter what type or whether it is material or not, is considered a promise or a gift.

Art. 12 Anyone convicted of the crimes defined by this law, shall be removed from office and shall be denied having any public office, or admittance to any adjudication, public import licenses, public work contracts, government contracts or any other public authority, whether through practice or direct contracting. The Council of Ministers is entitled to consider an additional penalty after a period of 5 years since the original penalty.

Art. 13 Under all circumstances, the cash, privilege or benefit shall be confiscated.

Art. 14 The briber or the intermediary shall be acquitted of the penalty if he has informed or confessed to the authorities even if he confesses after disclosure of the act. The money, privilege or benefit shall not be confiscated if the briber has informed the authorities prior to the discovery of the crime.

Art. 15 Any person who is not a briber, intermediary or participant and informs the authorities of the crimes described in this law and whose information led to the confirmation of the crime, shall receive a reward of not less than 5,000 Riyals but not more than half of the money confiscated. If the bribe was not sufficient for the minimum reward, the Treasury shall pay the difference, or the whole amount if the bribe was not confiscated. The appropriate court shall estimate the reward according to Article 17.

Art. 16 When the integrity of the official has been ascertained through an incident in which he resisted bribery by those with vested interests, the Council of Ministers must encourage him with a financial reward and especially promote him to a higher rank if he has the qualifications, and when such an incident has been repeated.

Art. 17 The investigation of the crimes enumerated in this law should be entrusted to an official from the Bureau of Grievances and one from the Police Department. The Chairman of the Council of Ministers shall direct anyone of his choice to conduct such an investigation. When it is over, the file on these crimes shall be forwarded to a committee composed as follows:

- a. The Chief of the Bureau of Grievances or his deputy as Chairman;
- b. a legal councillor of the Bureau of Grievances;
- c. a legal councillor appointed by the Chairman of the Council of Ministers, as a permanent member of the committee.

No one who participated in any of these investigations, or gave any opinion is entitled to take part in the deliberation of this committee whose rulings are considered definitive when counter signed by the Chairman of the Council of Ministers.

APPENDIX II

PUBLIC LAW 95-213 [S.305]; Dec. 19, 1977

THE U.S. FOREIGN CORRUPT PRACTICES ACT OF 1977

An Act to amend the Securities Exchange Act of 1934 to make it unlawful for an issuer of securities registered pursuant to section 12 of such Act or an issuer required to file reports pursuant to section 15(d) of such Act to make certain payments to foreign officials and other foreign persons, to require such issuers to maintain accurate records, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE I--FOREIGN CORRUPT PRACTICES

SHORT TITLE

15 USC 78a note.

SEC. 101. This title may be cited as the "Foreign Corrupt Practices Act of 1977."

ACCOUNTING STANDARDS

SEC. 102. Section 13(b) of the Securities Exchange Act of 1934 (15 U.S.C. 78q(b)) is amended by inserting "(1)" after "(b)" and by adding at the end thereof the following:

"(2) Every issuer which has a class of securities registered pursuant to section 12 of this title and every issuer which is required to file reports pursuant to section 15(d) of this title shall--

records-keeping

"(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

Internal accounting controls

"(B) devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that--

"(i) transactions are executed in accordance with management's general or specific authorization;

"(ii) transactions are recorded as necessary (I) to permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements, and (II) to maintain accountability for assets;

"(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.

Exemption directive, issuance and expiration.

"(3) (A) With respect to matters concerning the national security of the United States, no duty or liability under paragraph (2) of this subsection shall be imposed upon any person acting in cooperation with the head of any Federal department or agency responsible for such matters if such act in cooperation with such head of a department or agency was done upon the specific, written directive of the head of such department or agency pursuant to Presidential authority to issue such directives. Each directive issued under this paragraph shall set forth the specific facts and circumstances with respect to which the provisions of this paragraph are to be invoked. Each

such directive shall, unless renewed in writing, expire one year after the date of issuance.

File maintenance. Annual summary, transmittal to congressional committees.

"(B) Each head of a Federal department or agency of the United States who issues a directive pursuant to this paragraph shall maintain a complete file of all such directives and shall, on October 1 of each year, transmit a summary of matters covered by such directives in force at any time during the previous year to the Permanent Select Committee on Intelligence of the House of Representatives and the Select Committee on Intelligence of the Senate."

FOREIGN CORRUPT PRACTICES BY ISSUERS

SEC. 103. (a) The Securities Exchange Act of 1934 is amended by inserting after section 30 the following new section:

"FOREIGN CORRUPT PRACTICES BY ISSUERS

15 USC 78dd-1

15 USC 78i.

SEC. 30. (a) It shall be unlawful for any issuer which has a class of securities registered pursuant to section 12 of this title or which is required to file reports under section 15(d) of this title, or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the giving of anything of value to--

"(1) any foreign official for purposes of

"(A) influencing any act or decision of such foreign official in his official capacity, including a decision to fail to perform his official

functions; or

"(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person;

"(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of

"(A) influencing any act or decision of such party, official or candidate in its or his official capacity, including a decision to fail to perform its or his official functions; or

"(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality.

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or

"(3) any person, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of

"(A) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, including a decision to fail to perform his or its official functions;

or

"(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

Foreign official.

"(b) As used in this section, the term 'foreign official' means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical."

Penalties

(b)(1) Section 32(a) of the Securities Exchange Act of 1934 (15 U.S.C. 78ff(a)) is amended by inserting "(other than section 30A)" immediately after "title" the first place it appears.

(2) Section 32 of the Securities Exchange Act of 1934 (15 U.S.C. 78ff) is amended by adding at the end thereof the following new subsection:

"(c)(1) Any issuer which violates section 30A(a) of this title shall, upon conviction, be fined not more than \$1,000,000.

"(2) Any officer or director of an issuer, or any stockholder acting on behalf of such issuer, who willfully violates section 30A(a) of this title shall, upon conviction, be fined not more than \$10,000, or imprisoned not more than five

years, or both.

"(3) Whenever an issuer is found to have violated section 30A(a) of this title, any employee or agent of such issuer who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States (other than an officer, director, or stockholder of such issuer), and who willfully carried out the act or practice constituting such violation shall, upon conviction, be fined not more than \$10,000, or imprisoned not more than five years, or both.

"(4) Whenever a fine is imposed under paragraph (2) or (3) of this subsection upon any officer, director, stockholder, employee, or agent of an issuer, such fine shall not be paid, directly or indirectly, by such issuer."

FOREIGN CORRUPT PRACTICES BY DOMESTIC CONCERNS

15 USC 78dd-2

SEC. 104.(a) It shall be unlawful for any domestic concern, other than an issuer which is subject to section 30A of the Securities Exchange Act of 1934, or any officer, director, employee, or agent of such domestic concern or any stockholder thereof acting on behalf of such domestic concern, to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to

(1) any foreign official for purposes of

(A) influencing any act or decision of such foreign official in his official capacity, including a decision to fail to perform his official functions; or

(B) inducing such foreign official to use his influence with a foreign

government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person;

(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of

(A) influencing any act or decision of such party, official, or candidate in its or his official capacity, including a decision to fail to perform its or his official functions; or

(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person; or

(3) any person, while knowing or having reason to know that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes

(A) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, including a decision to fail to perform his or its official functions; or

(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such domestic concern in

obtaining or retaining business for or with, or directing business to, any person.

Penalties

(b)(1)(A) Except as provided in subparagraph (B), any domestic concern which violates subsection (a) shall, upon conviction, be fined not more than \$1,000,000.

(B) Any individual who is a domestic concern and who willfully violates subsection(a) shall, upon conviction, be fined not more than \$10,000, or imprisoned not more than five years, or both.

(2) Any officer or director of a domestic concern, or stockholder acting on behalf of such domestic concern, who willfully violates subsection (a) shall, upon conviction, be fined not more than \$10,000, or imprisoned not more than five years, or both.

(3) Whenever a domestic concern is found to have violated subsection (a) of this section, any employee or agent of such domestic concern who is a United States citizen, national, or resident or is otherwise subject to the jurisdiction of the United States(other than an officer, director, or stockholder acting on behalf of such domestic concern), and who willfully carried out the act or practice constituting such violation shall, upon conviction, be fined not more than \$10,000, or imprisoned not more than five years, or both.

(4) Whenever a fine is imposed underparagraph (2) or (3) of this subsection upon any officer, director, stockholder, employee, or agent of a domestic concern, such fine shall not be paid, directly or indirectly, by such domestic concern.

Civil Action

(c) Whenever it appears to the Attorney General that any domestic concern,

or officer, director, employee, agent, or stockholder thereof, is engaged, or is about to engage, in any act or practice constituting a violation of subsection (a) of this section, the Attorney General may, in his discretion, bring a civil action in an appropriate district court of the United States to enjoin such act or practice, and upon a proper showing a permanent or temporary injunction or a temporary restraining order shall be granted without bond.

(d) As used in this section:

Definitions

- (1) The term "domestic concern" means (A) any individual who is a citizen, national, or resident of the United States; or (B) any corporation, partnership, association, joint stock company, business trust, unincorporated organization, or sole proprietorship 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 or a territory, possession, or commonwealth of the United States.
- (2) The term "foreign official" means any officer or employee of a foreign government or any department, agency, or instrumentality thereof, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality. Such term does not include any employee of a foreign government or any department, agency, or instrumentality thereof whose duties are essentially ministerial or clerical.
- (3) The term "interstate commerce" means trade, commerce, transportation, or communication among the several States, or between any foreign country and any State or between any State and any place or ship outside thereof. Such term includes the interstate use of (A) a telephone or other interstate means of communication, or (B) any other interstate instrumentality.

TITLE II--DISCLOSURE

Domestic and Foreign Investment Improved Disclosure Act of 1977.

SEC. 201. This title may be cited as the "Domestic and Foreign Investment Improved Disclosure Act of 1977".

15 USC 78a note.

SEC. 202. Section 13(d)(1) of the Securities Exchange Act of 1934 (15 U.S.C. 78m) is amended to read as follows:

Equity security acquisition, statement, filing.

"(d)(1) Any person who, after acquiring directly or indirectly the beneficial ownership of any equity security of a class which is registered pursuant to section 12 of this title, or any equity security of an insurance company

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which would have been required to be so registered except for the exception contained in section 12(g)(2)(G) of this title,

15 USC 78l.

or any equity security issued by a closed end investment company registered under the Investment Company Act of 1940, is

(15 USC 80a-51).

directly or indirectly the beneficial owner of more than 5 per centum of such class shall, within ten days after such acquisition, send to the issuer of the security at its principal executive office, by registered or certified mail, send to each exchange where the security is traded, and file with the Commission, a statement containing such of the following information, and such additional information, as the Commission may by rules and regulations, prescribe as necessary or appropriate in the public interest or for the protection of investors

"(A) the background, and identity, residence, and citizenship of, and the nature of such beneficial ownership by, such person and all other persons by whom or on whose behalf the purchases have been or are to be effected;

"(B) the source and amount of the funds or other consideration used or to be used in making the purchases, and if any part of the purchase price is represented or is to be represented by funds or other consideration borrowed or otherwise obtained for the purpose of acquiring, holding or trading such security, a description of the transaction and the names of the parties there to, except that where a source of funds is a loan made in the ordinary course of business by a bank, as defined in section 3(a)(6) of this title, if the person filing such statement so requests, the name of the bank shall not be made available to the public;

"(C) if the purpose of the purchases or prospective purchases is to acquire control of the business of the issuer of the securities, any plans or proposals which such persons may have to liquidate such issuer, to sell its assets or to merge it with any other persons, or to make any other major change in its business or corporate structure;

"(D) the number of shares of such security which are beneficially owned, and the number of shares concerning which there is a right to acquire, directly or indirectly, by (i) such person, and (ii) by each associate of such person, giving the background, identity, residence, and citizenship of each such associate; and

"(E) information as to any contracts, arrangements, or understandings with any person with respect to any securities of the issuer, including but not limited to transfer of any of the securities, joint ventures, loan or

option arrangements, puts or calls, guaranties of loans, guaranties against loss or guaranties of profits, division of losses or profits, or the giving or withholding of proxies, naming the persons with whom such contracts, arrangements, or understandings have been entered into, and giving the details thereof."

Equity security ownership, statement, filing.

SEC. 203. Section 13 of the Securities Exchange Act of 1934, as amended (15 U.S.C. 78m), is amended by adding at the end thereof the following new subsection:

"(g)(1) Any person who is directly or indirectly the beneficial owner of more than 5 per centum of any security of a class described in subsection (d)(1) of this section shall send to the issuer of the security and shall file with the Commission a statement setting forth, in such form and at such time as the Commission may, by rule, prescribe--

"(A) such person's identity, residence, and citizenship; and

"(B) the number and description of the shares in which such person has an interest and the nature of such interest.

Amendments

"(2) If any material change occurs in the facts set forth in the statement sent to the issuer and filed with the Commission, an amendment shall be transmitted to the issuer and shall be filed with the Commission, in accordance with such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Person

"(3) When two or more persons act as a partnership, limited partnership, syndicate, or other ground for the purpose of acquiring, holding, or disposing of

securities of an issuer, such syndicate or group shall be deemed a 'person' for the purposes of this subsection.

"(4) In determining, for purposes of this subsection, any percentage of a class of any security, such class shall be deemed to consist of the amount of the outstanding securities of such class, exclusive of any securities of such class held by or for the account of the issuer or a subsidiary of the issuer.

Information, availability

"(5) In exercising its authority under this subsection, the Commission shall take such steps as it deems necessary or appropriate in the public interest or for the protection of investors (A) to achieve centralized reporting of information regarding ownership, (B) to avoid unnecessarily duplicative reporting by and minimize the compliance burden on persons required to report, and (C) to tabulate and promptly make available the information contained in any report filed pursuant to this subsection in a manner which will, in the view of the Commission, maximize the usefulness of the information to other Federal and State agencies and the public.

Exemption.

"(6) The Commission may, by rule or order, exempt, in whole or in part, any person or class of persons from any or all of the reporting requirements of this subsection as it deems necessary or appropriate in the public interest or for the protection of investors.

Report to Congress.

"(h) The Commission shall report to the Congress within thirty months of the date of enactment of this subsection with respect to (1) the effectiveness of the ownership reporting requirements contained in this title, and (2) the desirability and the feasibility of reducing or otherwise modifying the 5 per-

centum threshold used in subsections (d)(1) and (g)(1) of this section, giving appropriate consideration to--

Ante, p. 1498.

"(A) the incidence of avoidance of reporting by beneficial owners using multiple holders of record;

"(B) the cost of compliance to persons required to report;

"(C) the cost to issuers and others of processing and disseminating the reported information;

"(D) the effect of such action on the securities markets, including the system for the clearance and settlement of securities transactions;

"(E) the benefits to investors and to the public;

"(F) any bona fide interests of individuals in the privacy of their financial affairs;

"(G) the extent to which such reported information gives or would give any person an undue advantage in connection with activities subject to sections 13(d) and 14(d) of this title; 15 USC 78 n.

"(H) the need for such information in connection with the administration and enforcement of this title; and

"(I) such other matters as the Commission may deem relevant, including the information obtained pursuant to section 13(f) of this title."

SEC. 204. Section 15(d) of the Securities Exchange Act of 1934 is amended by inserting immediately before the last sentence the following new sentence:

"The Commission may, for the purpose of this subsection, define by rules and regulations the term 'held of record' as it deems necessary or appropriate in the public interest or for the protection of investors in order to prevent

circumvention of the provisions of this subsection." "Held of record",
definition. 15 USC 78o.

Approved December 19, 1977.

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LEGISLATIVE HISTORY:

HOUSE REPORTS:

No. 95-640 accompanying H.R. 3815 (Comm. on Interstate and Foreign Commerce) and No. 95-831 (Comm. of Conference).

SENATE REPORT

No. 95-114 (Comm. on Banking, Housing and Urban Affairs).

CONGRESSIONAL RECORD, Vol. 123 (1977):

May 5, considered and passed Senate.

Nov. 1, considered and passed House, amended, in lieu of H.R. 3815.

Dec. 6, Senate agreed to conference report.

Dec. 7, House agreed to conference report.

WEEKLY COMPILATION OF PRESIDENTIAL DOCUMENTS,

Vol. 13, No. 52: Dec. 20, Presidential statement.

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