

The Line Between Lawful and Unlawful Payments

The Foreign Corrupt Practices Act of 1977 (FCPA) prohibits the making of “corrupt” offers, promises or payments to foreign officials in order to secure their official action or inaction, while at the same time requiring that issuers of securities registered in the United States maintain accurate books and records and adequate internal controls.

Although the FCPA provides for a variety of affirmative defenses and exceptions, it does not state whether a company that pays a corrupt foreign official in response to threats of economic harm should be treated as a victim of extortion or prosecuted for bribery. Remarkably, more than 30 years after the FCPA’s enactment, this question remains largely unanswered. As a result, companies operating in one of the many less than transparent markets around the world find themselves in a perilous position: make extorted payments and face potential prosecution in the United States, or refuse the demand and accept substantial economic injury abroad. This result is both unfair and contrary to the purposes of the statute.

The only evidence of Congressional intent regarding extorted payments suggests that Congress did not intend to make victims of foreign extortion targets of prosecution in the United States. To be sure, the Congressional record makes clear that the anti-bribery provisions were meant to “cover payments and gifts intended to influence the recipient, regardless of who first suggested the payment or gift.” As noted by the Senate, “[t]hat the payment may have been first proposed by the recipient rather than the U.S. company does not alter the corrupt purpose on the part of the person paying the bribe.” Thus, a defense based merely on the fact “that the payment was demanded on the part of a government official as a price for gaining entry into a market or to obtain a contract would not suffice, since at some point the U.S. company would make a conscious decision whether or not to pay a bribe.” Nonetheless, the record makes equally clear that “true extortion situations would not be covered by this provision, since a payment to an official to keep an oil rig from being dynamited should not be held to be made with the requisite corrupt purpose.”

The oil rig scenario was an extreme example meant to draw a clear distinction between instances where a company is faced with a genuine economic threat, and situations where a company voluntarily accedes to a corrupt solicitation to gain a business advantage. Because the former reflects the payer’s purpose in avoiding a massive economic loss, rather than an attempt to obtain a competitive edge, it should not be punishable under the FCPA. Although this makes it clear that threatened physical destruction of an asset is not a prerequisite to an extortion defense, drawing a precise line between the two types of payments, lawful and unlawful, can be difficult in practice.

Despite the difficulty, two district court decisions, *United States v. Kozeny* and *United States v. Kay*, have recognized the relevance of evidence of economic coercion as a defense to FCPA charges. In both decisions, the courts indicated that evidence of extortion may tend to negate the government’s showing that the prohibited payment was made with the requisite “corrupt intent.” Although neither court articulated a clear test for distinguishing unlawful payments from extorted payments, the decision in *Kozeny* indicates that the line should be drawn so as to limit prosecution to circumstances where the victim could have reason-

ably “turned his back and walked away.” In describing how this distinction might operate in practice, the court contrasted threats to a new business opportunity with threats to a company’s existing business, and asserted that only threats to existing business might wield sufficient coercive force to constitute “true extortion.” Apart from this broad categorization, however, the court offered no guidance on the parameters of an economic coercion defense.

As the decision in *Kozeny* indicates, promoting the goals of the FCPA is not inconsistent with treating the targets of extortion as victims. Merely recognizing the potential relevance of economic coercion as evidence at trial, however, provides insufficient protection to companies plagued by such threats. Rather, a clear test separating victim from villain is needed. One of the barriers to articulating such a test comes from the fact that courts have treated evidence of extortion not as an affirmative defense, but merely as facts that might rebut the government’s proof of corrupt intent.

The defense of extortion, however, is more properly understood as a lesser species of the well-established defense of duress. Under the framework common to duress and other necessity defenses, an economic coercion defense should excuse a payment in violation of the FCPA if: the payment was the result of an imminent threat by a foreign official; that threat created a well-founded fear of significant economic loss; and the payer had no reasonable lawful alternative but to comply in order to avoid the threatened loss.

This of course leaves unresolved which factors or what loss threshold might dictate when the threatened economic harm is “significant.” An overly rigid test is impracticable here given the degree to which the characteristics of the victim, its business, and the threat itself will affect the seriousness of a given demand. Nonetheless, some bright lines can be drawn. For example, the threatened harm must involve actual economic loss rather than a decision to forego

purely prospective business, as in the latter instance the victim could simply “walk away” unless it has already made some readily identifiable and substantial investment in the specific opportunity that is threatened. In contrast, if an official threatens to interrupt or shut down an existing business unless payment is made, then actual economic injury is threatened and the affirmative defense should apply.

FCPA cases are, however, rarely litigated and additional judicial consideration of these issues, let alone adoption of any clear formula, is unlikely to be forthcoming. Specific guidance from the Department of Justice and Securities and Exchange Commission

giving recognition to this defense might obviate the need for such litigation. In the absence of such a public statement, American companies operating abroad cannot be certain whether the Department of Justice and SEC are interested in prosecuting, or protecting, American victims of foreign extortion.

Even worse, there is some indication that the SEC may be more interested in the former. In January of this year, the SEC settled a civil enforcement action against the NATCO Group, which allegedly had “created and accepted false documents, while paying extorted immigration fines and obtaining immigration visas in the republic of Kazakhstan.” In the settlement, the SEC specifically noted that NATCO employees were threatened with fines, jail or deportation, and that they believed the threats to be genuine.

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The SEC nonetheless pursued the enforcement action, based not on the payments themselves, but on NATCO’s mischaracterization of the payments as a “payroll advance” and “visa fines” in its books and records. Unlike bribery offenses, books and records violations do not depend on proof of any particular *mens rea*, and thus are not susceptible to a defense based on extortion. Nonetheless, insisting that victims of extortion record extorted payments in non-transparent markets with greater transparency is sufficiently impracticable to warrant questioning whether such an enforcement action should be taken as a matter of discretion. Foreign officials extorting payments from American companies are unlikely to issue invoices accurately reflecting the nature of the victim’s payment, or to look favorably on local accounting entries describing their criminal conduct. Although there are no equally explicit examples of criminal prosecutions of victims of extortion, at least one Department of Justice opinion release is susceptible to being read as supporting the view that such victims may be deserving of prosecution.

In addition, companies doing business outside the United States, unlike domestic extortion victims, often lack a realistic opportunity to gain relief by means of complaint to foreign or domestic law enforcement officials. As a result, companies that yield to extortionate demands render themselves almost entirely dependent on the often unpredictable exercise of prosecutorial discretion in the United States.

Unless and until U.S. regulators publish guidelines identifying at least a narrow section of victims of extortion who will be exempt from prosecution, American companies will continue to find themselves in the unenviable position of having to choose between the potentially disastrous consequences of not meeting an extortionate demand abroad and the prospect of criminal and civil prosecution at home. Although a refusal to pay will almost invariably represent the only lawful course of action, victims of threats approaching the level of the “oil rig” example who cannot reasonably “walk away” are going to need a strong stomach, and a good lawyer.

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The Price of Beauty in the Game of Trust

One mechanism by which people decide whether to trust strangers is the interplay between the stranger’s initial appearance and the observer’s intuitive biases. So, when entering a negotiation with opposing counsel who you have never met or meeting an opposing litigant for the first time at mediation, be aware that you may initially make a social judgment about the other person’s trustworthiness, which is based on your past biases. The result can be unnecessary misunderstandings resulting in delays or missed opportunities.

Secondly, and perhaps more significant than the fact that first impressions may temporarily mislead one as to trustworthiness of another, is that the natural reaction to discovering one is misled by one’s own bias is to attach a “penalty” to the innocently observed participant who is then deemed less likely to be worthy of your trust! To protect our clients, we must be aware of both of these counterproductive tendencies.

In *Judging a Book by its Cover: Beauty and Expectations in the Trust Game*, Rick W. Wilson (Rice University) and Catherine C. Eckel (University of Texas, Dallas) created a game to measure the extent to which individual strangers may trust each other. The Trust Game involves two persons – a first mover, who we will call Jane, and a second mover, who we will call Lev. Jane and Lev are told that they may keep whatever amount of money is in their possession at the end of the Trust Game. The laboratory experimenter then gives an initial endowment of a specific sum of money, say \$10 each, to Jane and Lev.

Jane is then told that she may invest anywhere from \$1 to \$10 of her money with Lev. Once Jane chooses how much she wishes to give to Lev, the laboratory experimenter will triple that amount and give the tripled sum to Lev. So Lev will have his initial endowment of \$10 and he will have received an additional \$30 from Jane and the lab experimenter’s supplement. Lev is then asked to consider giving anywhere from nothing up to all of his \$40 to Jane, the first mover. For Jane, the first mover, her transfer or investment in Lev is interpreted as a manifestation of trust; and for Lev, the second mover, his transfers are interpreted as a manifestation of trustworthiness.

The experimenters discovered that “attractive” participants received a “beauty premium” (i.e., they were disproportionately trusted during the first round of the game and given a higher proportion of the initial \$10 start up monies). Thereafter, in those situations in which the “attractive” person did not reciprocate to the satisfaction of the initial donor, the feelings of the original participant switched rapidly to a “beauty penalty,” in which the attractive person then received disproportionately less in the next round of the Trust Game. When the positions were switched and the “attractive” person was placed as an initiator of the Trust Game, the person who had previously offered a “beauty premium” compared to the other, now gave back disproportionately less to the “attractive person.”

Similar results have occurred playing the Trust Game when participants appear facially to be of similar ethnicity or otherwise kindred in culture or religion. An initial “premium” of trust is awarded, which when

not reciprocated leads to a “penalty” response toward the “deceiver.”

It’s easy to think to ourselves: “I’m a smart, educated person; I don’t have such knee-jerk biases.” The trouble with this idea is that our brains are hard-wired to distrust those not like us. Professor Mahzarin Banaji of Harvard University found that viewing photographs of those who are “different” automatically activates the brain’s fear center, and that we are slower to think of them as having “good” qualities when we are required to react reflexively rather than consciously. (Cromie. William J., *Harvard Gazette*, “Brain shows unconscious prejudices: Fear center is activated.” <http://www.news.harvard.edu/gazette/2003/07.17/15-prejudice.html> (visited March, 12, 2010).

The good news? Professor Banaji reports that if given time to be thoughtful about our actions toward those unlike us, and to interact before making decisions, we can overcome our biases.

Think of how easily we may betray our own client’s trust by making initial judgments based on such first impressions, and then over-reacting in a punishing fashion just because our initial judgment was hasty, based on fear, and not informed by any facts other than appearance.

The lesson here? Negotiate thoughtfully, not reflexively. Ask yourself: “Am I responding based

on bias, or punishing a “traitor” who was supposed to behave favorably toward me?” Take some time to know your opponent, especially if he or she is unlike you in some important way. If you make the effort to be mindful, you will overcome the biases that get in the way of successful negotiating.



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