

RESPONSES TO THE CONSULTATION PAPER ON THE REVIEW OF THE OECD ANTI-BRIBERY INSTRUMENTS

Comments from Theodore H. Moran (Professor of International Business and Finance, Georgetown University; Non-resident Fellow, Center for Global Development)

Thank you for the invitation to take part in the review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption, and to respond to the Consultation Paper of January 2008. The OECD Convention, with Phase I and Phase II Follow-Up Studies, has made an enormous contribution to deterring and preventing the use of corrupt payments as part of international business activities.

This contribution is being sent in the spirit of helping to extend and perfect the important achievements that you have already accomplished.

The CGD Report *Combating Corrupt Payments in Foreign Investment Concessions: Closing the Loopholes, Extending the Tools*, and meeting to present the Report on January 30, 2008, raise serious doubts about the adequacy of the OECD Convention, as now written and interpreted, to prevent multinational corporations from using financial “gifts” to the families and friends of developing country leaders to secure investment contracts on favorable terms.

Our investigations showed that, to obtain infrastructure concessions in Indonesia, US, European, and Japanese companies formed partnerships with family members and personal associates of the country’s leadership, lending the family members and personal associates the funds necessary to take an equity position in the partnership.¹ The terms of the loan provided that the partners would service the loans only out of future dividends and that they would incur no other obligations for debt service. The terms were such that the partners could anticipate a regular excess cash stream from the outset, on top of the portion of dividends withheld to repay the debt. The added costs from these arrangements were passed through in the form of higher electricity prices charged to Indonesian businesses and consumers.

The family members and personal associates put up no capital of their own, had no resources at risk, had no obligations to service the debt beyond surrendering a proportion of the dividend flow, and provided no appreciable services to the international companies, except access to the concessions on favorable terms without competitive bidding. By any common-sense test – such as the OECD Guidelines for Multinational Enterprises (see below) -- the equity position they received was an inappropriate benefit in return for preferential treatment of the investor.

The use of these “gift” partnerships has not been limited to a particular historical period in Indonesia. There is evidence that they continue today in Africa and elsewhere. The use of joint ventures and holding companies involving advisers, consultants, business intermediaries, sons, daughters, and wives permeates the US Senate Report on Riggs Bank and the oil industry in

¹Louis T. Wells and Rafiq Ahmed. 2007. *Making Foreign Investment Safe: Property Rights and National Sovereignty*. New York: Oxford University Press. Theodore H. Moran. 2006. *Harnessing Foreign Direct Investment for Development: Policies for Developed and Developing Countries*. Washington, DC: Center for Global Development.

Equatorial Guinea (2004), for example, and the UK High Court “Approved Judgment” involving the sale of petroleum from the Republic of Congo (2005).²

Why might the OECD Convention, as now written and interpreted, not be adequate to deal with “gift” partnerships such as these?

The OECD Working Group on Bribery in International Business Transactions has highlighted that “it would be a significant obstacle to the effective implementation of the Convention if a briber were able to avoid liability for the foreign bribery offense by transferring the benefit directly to a third party, rather than to the foreign public official who would then transfer it to the third party.”³

But in characterizing impermissible behavior, the 2006 Mid-Term Study of Phase 2 Reports says that the benefit has to be provided directly to the third party “with the consent of the foreign public official” (p. 18). The 2008 Consultation Paper (Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption) says an agreement has to be “reached between the briber and the foreign public official to transmit the bribe directly to a third party”(p. 8).

This gives rise to the concern that the OECD Convention, as now written and interpreted, does not cover payments to family members or business associates where there is no explicit direction, agreement, or consent expressed by the public official. There is also a need for OECD guidance about how to determine payments to third parties that are permitted, in comparison to those that are not, i.e. because of conflict of interest, or lack of proportional relationship between services rendered and rewards received, leaving it unclear what constitutes a gift as opposed to a legitimate payment for services rendered.

The Report offers some suggestions that might be useful to the OECD Working Group as it seeks to ensure the effectiveness of the Convention.

First, the OECD Working Group might want to make it clear that the baseline for impermissible behavior can be found in the OECD Guidelines for Multinational Enterprises: “enterprises should not, directly or indirectly, offer, promise, give, or demand a bribe or other undue advantage to obtain or retain business or other improper advantage. Nor should enterprises be solicited or expected to render a bribe or other undue advantage. In particular, enterprises should not offer, nor give in to demands to pay public officials or the employees of business partners any portion of a contract payment. They should not use subcontracts purchase orders or consulting agreements as a means of channeling payments to public officials, to employees of business partners or their relatives or business associates.” These guidelines do not make the

2 Money Laundering and Involving Riggs Bank. Report prepared by the Minority Staff of the Permanent Subcommittee on Investigations, US Senate, July 15, 2004. Approved Judgement of the Honourable Mr. Justice Cooke between Kensington International and the Republic of Congo in the High Court of Justice, Queens Bench Division, Commercial Court, Royal Court of Justice, Strand, London. November 28, 2005.

3 The 2008 Consultation Paper (Review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption), para 5, p. 8.

impermissible payments dependent upon whether they occur at the direction of, or with the consent or agreement of the public official.

Second, the OECD Working Group might want to clarify under what conditions would payments to family members, friends, and business associates be treated as improper.

The Report points out that it is probably impossible – and inadvisable – to criminalize every economic arrangement that involves a family member or personal associate. Family members and friends of leaders may have legitimate business or consulting roles to play in the economic life of the host country.

The tests for impermissible behavior therefore would have to focus on whether there is a conflict of interest and whether a gift is being given. The tests might include -- but would not necessarily have to depend upon -- whether any favor or influence was sought or given in return. Where this appears to be the case, the burden of proof would fall on the investor to show value received or promised for any and all benefits provided.

A key test for conflict of interest in these circumstances is whether there is the possibility of self-dealing, in which public and private interests and/or public and private roles collide.

Turning to whether a gift is being bestowed, the tests could include whether there is a genuine service rendered for any payment made, whether there is a discernible proportionality between the value being given and the considerations offered in return, and whether the transaction is consistent with what would have happened through an open and competitive process. If the payment takes place via an equity partnership, does the recipient have to put any assets at risk?

Forbidden behavior would not have to be limited to whether there were a clear quid pro quo showing that the payment or “gift” affected the awarding of the investment concession, or the structure of the terms. The creation of circumstances in which there were a conflict of interest and the bestowal of gifts to conflicted parties could be a stand-alone prohibition.

To enable external assessments of the propriety of payments, enterprises should be required to disclose all payments to possibly conflicted parties, and be prepared to demonstrate that value offered was commensurate with services received as would happen in a true arms-length transaction.

Finally, the OECD Working Group will want to be concerned about creating a level playing field among international investors from diverse home countries, including non-OECD countries that are not known for tight enforcement of anticorruption regulations. Here the Working Group might take heart from a trend in investor-state arbitration – as summarized in the CGD Report -- in which tribunals have shown themselves unwilling to enforce investment contracts when those contracts have been acquired through use of corrupt payments. As reviewed in the CGD Report, recent arbitration cases show growing multilateral acceptance of the principle – which already is widespread in domestic law -- to reject the validity of any contract or permit obtained by corrupt means.

While the OECD cannot, of course, dictate what independent arbitral Tribunals do, the OECD Working Group can recognize and endorse the principle that where there is some reasonable basis for believing there could be corruption, whether raised directly by a party to the arbitration or by a third party (*amicus curiae* for example), the Tribunal should exercise its responsibility to investigate, and must be prepared to deny the investor rights of contract enforcement if the contract was obtained through corrupt methods. All investors, regardless of national origin, will be forced to think twice about using bribes to obtain concessions if they understand that their contracts will not subsequently be respected or enforced if at any point they find themselves engaged in investor-state arbitration. In short, corruption at the beginning of operations could lead them to lose all the capital they invest over the long life of their projects.

Thank you again for the invitation to submit these observations as part of the review of the OECD Instruments on Combating Bribery of Foreign Public Officials in International Business Transactions Ten Years after Adoption. I hope that these comments prove useful to your Working Group.