

2B.III Agents, consultants and joint-venture partners in international business transactions

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Particularly when moving into a unfamiliar jurisdiction for the first time, international companies are likely to seek local contacts who can offer an understanding of the local business environment, familiarity with the legal system and—perhaps most important—access to key decision makers. One way of acquiring such expertise is to employ well-placed individuals as agents or representatives: Such people can expect to be richly rewarded if they help win valuable contracts for their clients. Another approach is to set up a joint venture with a local partner with the right connections and expertise.

Agents and joint venture partners perform an important commercial function, and in some countries and sectors—notably in parts of the Middle East and in certain transition economies—foreign companies may be obliged to work through them. Problems arise when the ethical or business practices of these partners fall short of international standards. For example, a joint venture partner may seek political influence by employing the son of a minister and awarding him a high salary in return for little or no work; or an agent paid by commission may use part of his fee to bribe a Government official.

In the past, foreign partners have often argued that they have no legal or moral responsibility if local partners or agents pay bribes without their direct knowledge or explicit approval. Indeed, they may employ local partners precisely because of their ability to serve as a “buffer,” protecting them from questionable local business practices. In the 2002 Control Risks survey regarding international business attitudes to corruption, 70 per cent of respondents thought that US companies circumvented anti-corruption laws by using middlemen “regularly or occasionally”; and 77 per cent thought that companies from other OECD countries followed similar practices.

This article argues that this kind of approach was always flawed from a risk management perspective, and the risks will increase as the enforcement of anti-corruption laws becomes more effective. Local knowledge is of course essential, and it is important to build up trust between business partners. However, this trust must be based on a common understanding of what kinds of business practice are and are not acceptable. International companies cannot adequately protect their own interests unless they understand and can monitor what local partners do on their behalf.

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Agents and consultants: defining the risks

When an international company acquires the services of a local partner, it is purchasing their expertise as well as their time and energy. However, the international partners cannot afford to remain wholly ignorant of conditions and developments in the host country. At the minimum, they need sufficient knowledge and safeguards to ensure that the local partner is carrying out the contracted services in an acceptable manner. From a practical management perspective, this sounds like common sense. Nevertheless, a different logic has all too often been applied to the management of agents and other intermediaries.

The intrinsic hazards of loose controls

In the experience of many international business people, the formal instructions given to agents differ from the implicit objectives of employing them (for examples of such contradictory messages see Moody-Stuart (1997) and the case studies in Transparency International (2005)). The formal instructions are to win business by ethical means: the implicit instructions are “to do whatever is necessary” according to local business practices. The international partner pays by commission rather than asking for detailed activity reports or itemized bills. If the intermediary is found to have paid a bribe, the company can deny responsibility, arguing that the middleman acted on his own initiative.

Deniability is supposed to afford the company a degree of legal protection. As will be seen below, this supposition is questionable. Moreover, plausible deniability implies a loss of control: the company cannot claim ignorance if it is found to have been closely involved in managing the intermediary’s activities. Loss of control in turn has a “boomerang effect,” exposing the company to new costs and risks in addition to the legal risks it is trying to avoid.

First, there are no cost controls. If the company is not actively involved in the bargaining process, it cannot judge what payments are justified, or even whether the agent’s services perform a useful function at all. In a recent court case in the United States, a company was pros-

ecuted for bribing a Government official via a consultant, even though the official did not in fact perform the service required. In such cases, companies have no means of redress because their own actions are illegal. Moreover, companies that use illegal means open themselves to the possibility of blackmail, particularly if there is a change of political regime. Contracts that are based on bribery or on personal favouritism are more exposed to political risks.

Legal risks

Recent legal developments have added to the intrinsic risks implied by the loose management controls.

Historically, the US has the strongest record of enforcing anti-bribery legislation through its US Foreign Corrupt Practices Act (FCPA), which was first passed into law in 1977 and has influenced similar more recent legislation in other countries. The FCPA explicitly contradicts the theory of plausible deniability. It says that knowledge of bribery is established “if a person is aware of a high probability of the existence” of circumstances that might involve bribery. A company that pays a large commission to an agent cannot say that it did not “know” that the commission was used to pay bribes if there is a high probability that such bribes would in fact be paid.

Between 1977 and 2005, the US Department of Justice initiated some 36 criminal prosecutions and five civil actions under the FCPA, while the Securities Exchange Commission prosecuted 21 foreign bribery cases (Newcomb 2005). An analysis of FCPA prosecutions shows that a large number have involved agents, consultants or other intermediaries. Recent examples include:

- An agricultural products company reportedly paid US\$50,000 to a South-east Asian Government official to overturn an environmental regulation. The money was paid via a locally based consultancy. In early 2005, the company reached a settlement with the SEC whereby it agreed to pay a US\$500,000 civil penalty without admitting or denying the SEC’s charges.

“The commercial implications for companies convicted of bribery go beyond the financial penalties imposed by large fines.”

- In March 2005, a telecommunications company paid a total of US\$28.5 million in fines and other penalties after pleading guilty to FCPA charges concerning payments to an agent in a West African country, who claimed to have close ties to the President. The company acknowledged that it had failed to conduct any meaningful due diligence on the agent, and paid hundreds of thousands of dollars for services that were never properly documented. The funds appear to have contributed to the President’s re-election campaign.

The principles behind the FCPA influenced the drafting of the 1997 OECD Convention against Bribery of Foreign Officials in International Business Transactions. Under the terms of the convention, all 30 OECD member states and six others have introduced laws criminalizing foreign bribery. Article 1 of the convention states that companies may not pay bribes to officials “either directly or through intermediaries.” Similar wording has been introduced into the United Nations Convention against Corruption, which was signed in 2003 and came into force in late 2005. Articles 15 and 21 of this convention call on Member Governments to prohibit bribes paid “directly or indirectly” to Government officials or to private companies.

Compared with the US, there have so far been few prosecutions for foreign bribery in other OECD countries. However, cases have now been reported in Sweden, Norway, the Republic of Korea and Canada. Press reports suggest that further investigations are under way in several OECD jurisdictions and that—as in the US—many of these involve bribes paid via intermediaries.

Meanwhile, one of the most significant international prosecutions has taken place not in an OECD country but in the small southern African kingdom of Lesotho. The case involves the Lesotho Highlands Water Project (LHWP), a massive hydro-electric scheme that is designed to provide water and electricity to South Africa. The project is sponsored by—

among others—the World Bank, the European Investment Bank and a number of commercial banks.

In 2002, the Lesotho High Court convicted Masupha Sole, the former Chief Executive of the LHWP, of receiving some US\$1.6m in bribes from 12 international companies. The payments had been transmitted via Swiss bank accounts. The Lesotho Government then initiated proceedings against the companies that had paid the bribes. The first was a Canadian company, which in September was sentenced to a fine of US\$2.2m. The Lesotho Appeal Court subsequently upheld the first of two charges against the company, but dismissed the second and therefore reduced the fine. In 2003 and 2004, a German and a French company were convicted of paying bribes in connection with the LHWP.

The legal arguments in the Canadian company’s case focused on its Representative Agreement with a local agent (for a summary of the issues see Darroch 2004). Sole refused to testify, and the agent himself was now dead. However, many of the key facts were undisputed. The company had paid regular commissions to the agent who in turn had passed them to Sole: The question was whether the company knew that this was happening. The court’s judgement was based on inference: There was no clear explanation as to why the agent’s services were needed; there was no evidence that he had in fact performed them; the fees seemed unjustifiably high; he was not living in Lesotho at the time; and there was no obvious reason why the Representative Agreement should be kept secret unless it was intended as a vehicle for bribery.

The risk of debarments

The commercial implications for companies convicted of bribery go beyond the financial penalties imposed by large fines. In July 2004, the World Bank debarred the Canadian company convicted in the Lesotho case from bidding for Bank-sponsored projects for a period of three years. The Bank publishes a list of debarred companies and individuals on its website. US Government agencies likewise blacklist companies convicted of corruption, and Government agencies in other countries increasingly are following suit.

“The practice of conducting due diligence enquiries before employing agents is becoming more common.”

Tighter export credit agency rules

Meanwhile, the various national export credit agencies (ECAs) are tightening their own rules on corruption under the coordination of the OECD Working Party on Export Credits and Credit Guarantees. Companies applying for export credits now have to make formal statements saying that no bribes have been paid in connection with the transactions for which they are seeking support. The statements apply both to the applicants and to others—such as agents and representatives—acting on their behalf. Most ECAs now require companies to declare details of agents' commissions (OECD Working Party 2005) and may seek to double-check the details through their own due diligence enquiries. Companies may be denied credit if agents' commissions appear to be too large or raise suspicions for some other reason.

Agents and consultants: Emerging best practice

Increased legal risks underscore the need for well-designed management systems to govern the employment of agents and consultants. The key principles are that there must be a clear business justification for recruiting them, and that their activities need to be monitored for as long as they are working for the company, not just at the beginning.

The practice of conducting due diligence enquiries before employing agents is becoming more common, although it is still by no means universal. *Facing up to Corruption*, the 2002 Control Risks report, showed that 80 per cent of UK firms surveyed, and 74 per cent of US firms had formal procedures for vetting agents or representatives before employing them. However, only 50 per cent of German companies did so.

As with other anti-corruption procedures, it is important to ensure that there is a division of responsibilities: The sales and marketing department responsible for identifying potential recruits should not at the same time be responsible for vetting or confirming the appointment.

Due diligence enquiries

A well-designed application form may be the first step in acquiring the necessary information. One example of good practice comes from a US engineering company whose standard application form for agents and consultants includes information on the management and beneficial owners of the applicant's company; bank and credit references; references from other clients; questions on the applicant's previous relationship with the company or its competitors; and questions about the applicant's relationships with serving or former public officials. Applicants are asked to sign a statement agreeing that the information in the form may be checked by a third party.

The double-checking process should take nothing for granted. For example, the would-be agent will cite a business address, but what does this actually consist of? Is it an office building or a private residence? Does he or she employ a staff commensurate with the size of his presumed operations? A visit to his or her office will give a much clearer view of the agent's personality and potential than can be gained from a telephone conversation or an interview in a hotel guest room.

Red flags

Red flags are warning signs that—at a minimum—require further investigation. Some of the warning signs outlined below are likely to be deal-killers. In other cases, it may be possible to address concerns through further investigation, or by imposing appropriate safeguards.

- *Agents with close family relationships to key official figures.* At a minimum, it is important that the agent should disclose all relevant information. If the official concerned is in any way responsible for the project under review, the agent should not be employed.
- *Agents who want to be paid in cash, via third party, or to a numbered bank account.* Cash payments raise obvious suspicions

that the agent wishes to impede any future attempt to establish an audit trail. In many of the cases that have come to trial, payments have been made via Swiss or other foreign bank accounts. In addition to concerns about transparency, this practice may well infringe the host country's foreign exchange regulations.

- *Would-be intermediaries who—by apparent coincidence—volunteer their services at a time when companies run into unexpected difficulties in their negotiations.* The apparent coincidence raises suspicions that they are responding to a tip-off from an official hoping for a bribe. See the unsolicited approach case story in the “cautionary tales” below.
- *An agent recommended by one of the officials with whom the company is negotiating.* Again, there would be suspicions that the official is nominating a trusted intermediary who may serve as a conduit for bribes.
- *Agents who wish to remain anonymous.* The representative agreement in the Lesotho Highlands Water Project case cited above was not publicized, and this was one of the factors leading the judge to infer that the agreement was a vehicle for bribery. A request for anonymity prompts the question of what the agent has to hide. One possibility is that he may be acting for more than one party (see the “serving two masters” case story below).
- *Agents who wish to be paid large amounts of money in advance.* As noted above, companies cannot easily enforce agreements that are in any case illegal; agents suffer from the

same problem. Their own business risks include the possibility that their employers will renege on the agreement once the contract has been signed. Advance payments reduce the risk both to the agent and to the ultimate beneficiary of any bribes paid, but increase the financial and—potentially—legal risks of the employer.

Documenting decision-making

The decision-making process should be clearly documented. This is good business practice in any case, and companies may be required to demonstrate the basis for their decisions both when applying for external funds and guaranteed funds and—in the worst case—in the event of an enquiry into corruption allegations. The FIDIC Model Representative Agreement (see below) outlines the most important features of the documentation process.

Agreements

The key points in the agreement should include a statement that the agent understands and will comply with the company's anti-corruption rules and procedures. Similar confirmatory statements should be signed afresh each year. The scope of services provided should be clearly defined. The agreement may be terminated if the agent is found to have infringed the rules. The company appointing the agent has a right to inspect the agent's financial and commercial records relating to its project.

Remuneration

According to Article 3a of the International Chamber of Commerce (ICC) Rules of Conduct: Extortion and Bribery in International Business Transactions enterprises should ensure that “any payment made to any agent represents no more than an appropriate remuneration for legitimate services rendered by such an agent” (Davies 1999). The purpose of this recommendation is of course to ensure that “surplus” funds are not passed on as bribes.

“Local knowledge often includes connections. The question is whether the partners make use of those links transparently and honestly.”

In many industries, it is the usual practice to calculate agents' commissions as a percentage of the contract: the range is typically between five and ten per cent, although higher percentages are not uncommon. However, it is difficult to argue that ten per cent of—say—a billion-dollar contract constitutes an appropriate remuneration for even the best-paid consultant. It is therefore better practice to define the commission as an absolute amount rather than a percentage. The scale of the fee will of course depend on the qualifications of the consultant and the time likely to be spent. An additional consideration is that many agents charge only “success fees”; they will expect the income from their successes to cover a portion of the time spent on unsuccessful projects.

Cautionary tales

The following examples illustrate the potential hazards of working with agents without proper checks and balances (names and other identifying details have been left out in order to preserve confidentiality):

- *An unsolicited approach*

An international company was seeking a license to set up a new operation in the former Soviet Union. The project had official approval at the highest level of Government, and everything seemed to be in place except that the company still needed a document signed by a deputy minister. The company was assured that the document would arrive in due course but, after repeated delays, it became apparent that there was some kind of problem. At this point the company received an unsolicited visit at its Western European regional headquarters from a “consultant” who had heard about the problem and offered his services to resolve it. However, he expected to be paid in advance at a bank account in Switzerland.

The company had never publicly disclosed the nature of its problems. The sudden arrival of

the agent therefore immediately raised questions: How did he know his services might be required? On whose behalf was he acting? Further warning signs included the fact that he required a large fee in advance, and that it was to be paid into a foreign bank account. Confidential investigations showed that the consultant was closely associated with the deputy minister, who himself depended on the political patronage of the Head of Government. In effect, his main role was to collect a bribe. The company decided not to pursue the project.

- *Serving two masters*

An international investor had been invited to join a consortium bidding for a major engineering project in Africa. Its due diligence procedures included an enquiry into the background and reputation of the agent working on behalf of the consortium. The enquiry confirmed that the agent had excellent commercial and personal credentials. However, it emerged that he was simultaneously working for a rival consortium bidding for the same project while also providing information to the Government. He stood to gain handsomely whichever consortium won. In the light of these manifold conflicts of interest, the investor decided not to go ahead.

Working with joint venture partners

Many of the integrity issues concerning agents and consultants apply equally to joint venture partners. International investors choose local partners for their local knowledge, technical expertise and (usually less importantly) their financial contributions. “Local knowledge” often includes connections with powerful figures in the Government or the ministries who award licenses and contracts. The question is whether the partners make use of those links transparently and honestly.

“Collective initiatives—preferably involving both business and other civil society actors—can be a highly effective weapon against corruption.”

Close connections with the ruling elite may appear to be an advantage, at least initially, but can backfire. If there is a dispute between the foreign and local partners, the latter may use their links with the regime to strengthen their positions, and even to force through some kind of expropriation. Similarly, links with the ruling elite may turn into a liability if there is a change of Government at the local or national levels. Powerful commercial vested interests may try to oppose the joint venture, for example, by drawing on their own political connections, if they think that their position is threatened.

In the more extreme—but by no means unusual—cases, potential integrity hazards include the possibility that local partners have connections with criminal or semi-criminal interests.

Due diligence

As with commercial agents, the topics to be checked include: sources of capital; beneficial owners and political connections; the status of the company, including the length of time it has been working; and whether it is included on the World Bank or other blacklists.

Agreements

The type of agreements that you can negotiate depends, of course, on how large a stake the international partner has, and therefore the nature of the power balance between them. Ideally, the foreign partner would seek to gain or retain management control. Training in procedures to avoid corruption is all the more important if local staff are to be transferred from an existing operation: They may be accustomed to a style of business that would be unacceptable in an international context.

Cautionary tales

The following are examples of potential hazards that demonstrate the need for thorough due diligence enquiries:

- *Local contacts, opaque sub-contract awards*
An international engineering company set up

a project in South-east Asia in a joint venture with a local company. The local partner’s main contribution was its assistance in winning the initial contract through its knowledge of the key players in its home market. No bribes were paid, but the local partner insisted on administering the award of sub-contracts. Awards were made on the basis of personal connections rather than merit, without a properly administered tendering procedure. Many of the immediate sub-contractors issued further sub-contracts to other companies, and much of the work had to be done twice. There was no corruption scandal, but high prices, poor quality and late delivery brought the entire project to the verge of bankruptcy.

- *Privatization purchase goes sour*

An international manufacturing company set up a joint venture with a recently privatized local company in an ex-socialist transition economy. The plan was to introduce updated technology to a formerly Government-owned factory, thus increasing both productivity and profitability. Many of the original staff of the factory continued to work for the joint venture.

The foreign partner conducted a due diligence review of the factory’s finances and potential markets. However, it made no attempt to understand the network of relationships linking the factory with local suppliers and customers. Some two years after launching the joint venture, it discovered that senior employees had been taking kickbacks from local suppliers. The foreign partner had majority ownership, and therefore overall control, but the network of corruption inside the factory was so deeply entrenched that it had

to shut down the factory for a month while it overhauled the entire management structure. The international executive in charge of this operation received a series of death threats. Many of these problems could have been avoided if the purchaser had done a more detailed due diligence review at the outset, and given staff more thorough training in the new style of business.

Collective initiatives

The article by the International Business Leaders Forum (see below) correctly argues that collective initiatives — preferably involving both business and other civil society actors—can be a highly effective weapon against corruption (see article by Alexandra Wrage above).

The International Federation of Consulting Engineers (FIDIC) represents a different kind of collective initiative: It is a professional association that has played a very important role in raising integrity standards within its field of expertise. FIDIC's role in developing its Model Representative Agreement is discussed in the case story that follows.

Case story: The FIDIC model representative agreement

Eigil Steen Pedersen | *Past President of FIDIC and Chairman of Its Representative Agreement Task Force*

Introduction

In the past decade, the International Federation of Consulting Engineers (FIDIC) has worked intensively in the fight against corruption together with other relevant bodies, such as Transparency International, the United Nations Global Compact, the World Business Council for Sustainable Development (WBCSD), the United Nations Commission on International Trade Law (UNCITRAL), the World Trade Organization (WTO), and the major multilateral development agencies. Corruption in its many forms will not be eradicated overnight, and certainly not through a single act by any one of these organizations. It is therefore necessary to continue and intensify collaboration between these organizations, the private sector and civil society.

The need for transparency in all business transactions has been a key principle in FIDIC's work. By ensuring transparency, we may provide guidance to all participants in the development process, thus preventing them from entering into illegal activities. In cases of doubt, transparency may guide audits and give directions for modified approaches. And, of course, in cases of illegal transactions, transparency will assist in bringing the culprits to justice.

The Model Representative Agreement

The Model Representative Agreement was drafted in 2003-2004 in accordance with FIDIC's Business Integrity Man-

agement Guidelines, and joins a series of similar guidelines, including FIDIC's Client-Consultant Model Services Agreement (White Book), its Joint Venture Agreement and its Sub-Consultancy Agreement. After a review by several interested parties, including multilateral development agencies, the document was presented and approved at FIDIC's annual conference in 2004. Since then it has been available from FIDIC's online bookshop (www.fidic.org/bookshop).

The document contains the following main elements: Agreement, Particular Conditions, General Conditions and Notes for Guidance, including recommended anti-corruption principles and provisions. It also includes appendices specifying the scope of services provided and remuneration, as well as models for a Consultant's Code of Conduct and Business Integrity Policy Statement.

The document may be used as the final agreement between consultant and representative. Alternatively, the General Conditions may be used separately as an appendix to a specially tailored agreement, the other parts of which may be executed on the basis of the other chapters of the Model Agreement. As an example, most major international consulting firms will wish to insert their own code of conduct and business integrity policy statement.

Details with the particular aim of preventing corruption

One of the most important objectives of the document is to ensure transparency in all business dealings from the very first steps towards acquiring a specific project or entering into business relations in a particular country until completion of the project—or the general collaboration between the two parties. In general, this is required in order to make clear to the parties involved how responsibilities, risks and rewards are shared, as well as defining the territory of action and stipulating rules for execution of the collaboration.

FIDIC has paid particular attention to a number of areas where experience has shown that corruption could take place. The important ones include the following:

1. Limits of representation

The representative shall not, unless so authorized, be considered the consultant's agent.

He shall possess the necessary licenses and permits to perform the services specified in the country of the project.

2. Conflict of interest

The representative must warrant that neither he nor any senior employee of his firm are Government employees or closely related to Government employees.

He must further warrant that he is not and will not be involved in any contract or business arrangement that would create a potential conflict of interest.

3. Liability

Each party is fully liable for any claim, liability or damage resulting from acts or omissions on his part.

4. Corruption

The parties must agree to comply with applicable laws as well as the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions.

The parties must agree to adhere to a documented Code of Conduct, Business Integrity Policy Statement and associated compliance programme.

The Representative shall accept that his books and records be audited by an accredited accounting firm, if activities or events give rise to the suspicion of corrupt or illicit activities in connection with the services performed.

Termination of the agreement will be effected forthwith, if he is in default of his obligations under the clauses on corruption.

5. Scope of services/remuneration

Both parties, as well as the client and other parties to the main contract, must know the detailed scope of the services provided by the representative, in general as well as on a specific project. If possible, an estimate of the input in terms of time spent and expenses shall be established.

Likewise, the remuneration shall be specified, enabling a check that remuneration is commensurate with the value of services rendered. It is important here to remember that most representatives will be remunerated on a “no cure-no pay” basis. Thus, the remuneration on a project won must allow for providing pre-contract services on, say, between two to five missed opportunities. A total remuneration of three to five per cent of the consultant’s net fees will be normal.

Concluding remarks

The Business Integrity Management System, which is described in another case story below by FIDIC President Dr. Jorge Diaz-Padilla, and the series of model agreements should all be seen as important elements of FIDIC’s contribution to this work, assisting its members in establishing the necessary business transaction tools. These documents are surely also applicable in other sectors, e.g. contractors and suppliers, representing the potential “supply side” in corruption as well as in Government entities, or other client organizations, representing the potential “demand side”.

Such tools, including the necessary self-audit of the individual organization, should be applied, but it will

also be necessary to institute relevant monitoring entities. The international organizations mentioned above could play an important role in this work.

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