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FCPA Alert: Appellate Court Ruling Largely Affirms DOJ and SEC's Interpretation of a Foreign State "Instrumentality" Under the FCPA

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The U.S. Foreign Corrupt Practices Act's (FCPA) prohibition on corrupt payments to foreign officials is not limited to those officials serving only in a traditional government ministry or agency, but also extends to officers, directors and employees of an "instrumentality" of a foreign government.[1] The question of what constitutes an "instrumentality," which is not defined by the FCPA, had not been addressed by a federal Court of Appeals until now. Both the U.S. Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have taken the position that the term includes, under certain circumstances, state-owned or controlled entities serving various public and commercial functions, and have successfully brought enforcement actions involving corrupt payments to officers and employees of such entities, including state-owned or controlled telecommunications, electricity, oil, steel, and aluminum companies, and public hospitals.[2]

On May 16, 2014, the Eleventh Circuit Court of Appeals became the first federal appellate court to rule on the issue in its decision in *United States v. Joel Esquenazi*, No. 11-15331, 2014 WL 1978613 (11th Cir. May 16, 2014). In *Esquenazi*, the defendants were convicted by a jury of violating the FCPA by bribing officers of Telecommunications D'Haiti, S.A.M. (Teleco), a company owned by Haiti's central bank during the time of the relevant bribes. *Id*. at *1-2. On appeal, the defendants challenged their FCPA convictions by arguing that Teleco was not a foreign government "instrumentality" within the meaning of the FCPA, and therefore its employees were not foreign officials under the FCPA. *Id*. at *4. The court of appeals rejected their argument and affirmed their convictions.

Adopting a two-part case-specific test, the court held that a foreign government "instrumentality" under the FCPA is: (1) "an entity controlled by the government of a foreign country" that (2) "performs a function the controlling government treats as its own." *Id*. at *8. The court cited several non-exhaustive factors that judicial fact-finders should use to determine if each part of the test has been satisfied.

> ***Factors relevant to determining whether the "entity is controlled by the government of a foreign country":*** "the foreign government's formal designation of that entity; whether the government has a majority interest in the entity; the government's ability to hire and fire the entity's principals; the extent to which the entity's profits, if any, go directly into the governmental fisc, and, by the same token, the extent to which the

government funds the entity if it fails to break even; and the length of time these indicia have existed." *Id*.

Factors relevant to determining whether the entity "performs a function the controlling government treats as its own": "whether the entity has a monopoly over the function it exists to carry out; whether the government subsidizes the costs associated with the entity providing services; whether the entity provides services to the public at large in the foreign country; and whether the public and the government of that foreign country generally perceive the entity to be performing a governmental function." *Id*. at *9.

Applying this analysis, the court affirmed the jury's finding that Teleco was in fact an "instrumentality" of a foreign government under the FCPA. The court reasoned that, at the time of the relevant conduct, Teleco was 97 percent owned by Haiti's central bank, its Director General was chosen by the Haitian President and Prime Minister, its board was appointed by the Haitian President, it "had a state-sanctioned monopoly for its activities," it had "no fisc independent of the state," and, according to the government's testifying expert, was considered a "public administration" by Haitian government officials. *Id*. at *11.

Analysis

The court's two-part test for a foreign government "instrumentality," and the factors it considered in applying that test, should not result in any significant modification to the DOJ and SEC's current FCPA enforcement program and are likely to be viewed by those regulators as affirmation of their current interpretation of the FCPA. The factors articulated by the court are, in fact, very similar to those previously cited by the few district courts that have considered this issue[3] as well as by DOJ and SEC in their 2012 *Resource Guide to the U.S. Foreign Corrupt Practices Act*.[4] The court's two-part test makes clear that government ownership or investment is itself not enough to transform an entity into an "instrumentality" of that government.[5] At the same time, the court's test does not exclude the possibility that an entity could be an "instrumentality" of a foreign government even if the government's ownership interest represents only a minority interest in that entity.[6]

Perhaps more noteworthy, the court's test validates reliance on factors that turn on the *foreign government's "perception"* of the entity's role and purpose. *See Esquenazi*, 2014 WL 1978613, at *7 (courts should "follow the lead of the foreign government itself in terms of which functions it treats as its own"). The role played by various entities in the public administration of a foreign state may often be less discernable than other criteria such as state ownership and management control. Each case will therefore require specific analysis of various factors to determine whether an entity is a foreign government "instrumentality" under the FCPA.

Corporate compliance and legal departments should thus continue to subject to FCPA review all transactions with entities that have any degree of foreign state involvement in their creation, ownership, control, funding, finances, operations, or economically sanctioned privileges. This would include scrutiny of investments and partnerships with such entities; arrangements with such entities through third-parties; and hospitality and sales incentives for officers and employees of such entities, even when such things would otherwise be routinely extended to business partners. Companies should also evaluate their compliance systems to ensure that they are capable of identifying entities that may qualify as "instrumentalities" of a foreign government based on all of the criteria identified by the court.

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1. The FCPA defines a "foreign official" as "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 . . . ." 15 U.S.C. §§78dd-1(f)(1)(A), 78dd-2(h)(2)(A), and 78dd-3(f)(2)(A).

2. *See United States v. Alcatel-Lucent France, S.A.*, No. 10-cr-20906 (S.D. Fla. Dec. 27, 2010) (foreign government "instrumentality" was a state-controlled telecommunications company); *SEC v. ABB, Ltd.*, No. 10-cv-1648 (D.D.C. Sept. 29, 2010) (electricity commission); *United States v. Total, S.A.*, No. 13-cr-239 (E.D. Va. May 29, 2013) (state oil company); *United States v. SSI International Far East, Ltd.*, No. 6-cr-398 (D. Ore. Oct. 10, 2006) (steel companies); *United States v. Alcoa World Alumina LLC*, No. 14-cr-7 (W.D. Pa. Jan. 9, 2014) (aluminum smelter); *United States v. Pfizer H.C.P. Corp.*, No. 12-cr-169 (D.D.C. Aug. 7, 2012) (hospitals).

3. *See, e.g., United States v. Aguilar*, 783 F. Supp. 2d 1108, 1115 (C.D. Cal. 2011) (setting forth non-exclusive list of factors, including whether the entity provides services to citizens, whether the government appoints its officers and directors, whether the entity is financed by the government, whether the entity is performing a governmental function); *United States v. Carson*, 2011 WL 5101701, at *3-4 (C.D. Cal. May 18, 2011) (same).

4. The *Resource Guide*, at 20, sets forth the following factors: (i) "the foreign state's extent of ownership of the entity;" (ii) "the foreign state's degree of control over the entity (including whether key officers and directors of the entity are, or are appointed by, government officials;" (iii) "the foreign state's characterization of the entity and its employees;" (iv) "the circumstances surrounding the entity's creation;" (v) "the purpose of the entity's activities;" (vi) "the entity's obligations and privileges under the foreign state's law;" (vii) "the exclusive or controlling power vested in the entity to administer its designated functions;" (viii) "the level of financial support by the foreign state (including subsidies, special tax treatment, government mandated fees, and loans);" (ix) "the entity's provision of services to the jurisdiction's residents;" (x) "whether the governmental end or purpose sought to be achieved is expressed in the policies of the foreign government;" and (xi) "the general perception that the entity is performing official or governmental functions."

5. Neither the DOJ nor the SEC has articulated such a limited test. Rather, according to those agencies, they have always "used an analysis of ownership, control, status, and function to determine whether a particular entity is an agency or instrumentality of a foreign government." *Resource Guide* at 20.

6. For example, the DOJ has brought an enforcement action against subsidiaries of Alcatel-Lucent France for paying bribes to employees of a Malaysian telecommunications company that was only 43 percent owned by Malaysia's Ministry of Finance, because the Ministry exercised control over "major expenditures" and "important operational decisions" and "the most senior company officers were political appointees." *Resource Guide* at 21.

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