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CLIENT MEMORANDUM

# Landmark Decision Issued on the Scope of the Terms “Foreign Official” and “Instrumentality” Under the Foreign Corrupt Practices Act

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On May 16, 2014, the Eleventh Circuit Court of Appeals in Atlanta, Georgia issued a landmark decision in *United States v. Esquenazi*, No. 11-15331, defining the scope of the terms “foreign official” and “instrumentality” under the Foreign Corrupt Practices Act (“FCPA”). Under the decision, state-controlled companies may qualify as “instrumentalities” under the FCPA, and employees of such entities may consequently qualify as “foreign officials,” based on a two-part, fact-specific test. The case will have a significant impact on enforcement actions brought by the Department of Justice (“DOJ”) and Securities and Exchange Commission (“SEC”) and is an important decision for company compliance programs.

**Background**

The FCPA prohibits corrupt payments or transfers to “foreign officials.” 15 U.S.C. §§ 78dd-1, 78dd-2, 78dd-3. Under the FCPA, the term “foreign official” includes, *inter alia*, “any officer or employee of a foreign government or any department, agency, or <u>instrumentality</u> thereof . . . .” 15 U.S.C. §§ 78dd-1(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A) (emphasis added). The FCPA, however, does not define the term “instrumentality,” nor is a clear definition found in the legislative history. The absence of a clear definition has created substantial ambiguity as to the types of entities whose employees may qualify as foreign officials. In particular, although the DOJ and SEC have taken the position that the term “instrumentality” includes state-controlled entities, and thus that the term “foreign official” includes ordinary employees of state-controlled entities, the statute does not clearly resolve the issue.

On November 14, 2012, the DOJ and SEC published a 120-page *Resource Guide to the U.S. Foreign Corrupt Practices Act*, which reasserted the DOJ and SEC's long-held view that the term "instrumentality" is "broad and can include state-owned or state-controlled entities." The Resource Guide does not identify specific ownership levels at which an entity actually becomes an instrumentality. Instead, the Resource Guide proposes "a fact-specific analysis of an entity's ownership, control, status, and function." Relevant factors set forth by the DOJ and SEC include: (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 provided 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. The Resource Guide encourages companies to consider these factors in evaluating the risk of FCPA violations and in designing compliance programs.

In several cases, district courts have largely agreed with the DOJ and SEC in taking a fact-specific approach to the issue.[1] Like the DOJ and SEC, these district courts have followed non-exclusive fact-based tests for determining whether an entity qualifies as an "instrumentality" under the FCPA.

**The Eleventh Circuit's Decision**

In *United States v. Esquenazi*, U.S. enforcement authorities charged two Miami telecommunications executives with bribing employees of Telecommunications D'Haiti, S.A.M. ("Teleco"), Haiti's state-owned telecommunications company. The defendants argued that they did not violate the FCPA because, they claimed, the entity in question, Teleco, was not an "instrumentality." After a trial, the district court instructed the jury:

> An instrumentality of a foreign government is a means or agency through which a function of the foreign government is accomplished. State-owned or state-controlled companies that provide services to the public may meet this definition.

The district court instructed the jury to consider various factors, including the extent of government ownership, the involvement of government officials as key officers and directors, and whether Teleco was widely perceived to be

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1 *See United States v. Aguilar*, 783 F. Supp. 2d 1108, 1112-21 (C.D. Cal. 2011); *United States v. Carson*, No. SACR 09-00077-JVS, 2011 WL 5101701 (C.D. Cal. May 18, 2011); *Aluminum Bahrain B.S.C. v. Alcoa Inc.*, Civil Action No. 8-299, 2012 WL 2094029, at *3 (W.D. Pa. Jun. 11, 2012); *United States v. O'Shea*, Case No. 4:09-cr-00629 (S.D. Tex. Jan. 13, 2012) (Management Order).

performing official or governmental functions. Based on the district court's instructions, the jury convicted the two defendants of violating the FCPA, as well as of other related charges.

On appeal, the Eleventh Circuit rejected the defendants' "instrumentality" argument and upheld the convictions. Based on a lengthy analysis of the statute, the Eleventh Circuit defined "instrumentality" as "an entity [1] controlled by the government of a foreign country that [2] performs a function the controlling government treats as its own." According to the Eleventh Circuit, "what constitutes control and what constitutes a function the government treats as its own are fact-bound questions." In reaching its decision, the Eleventh Circuit focused, among other things, on the Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ("OECD Convention"). The Eleventh Circuit looked to the OECD Convention because the FCPA is the OECD Convention's implementing legislation, and Congress modified the FCPA to conform to the OECD Convention's requirements.

The Eleventh Circuit provided the following list of non-exclusive factors for considering whether its two-part test is met:

1. **Whether a Foreign Government Controls the Entity in Question:** According to the Eleventh Circuit, "courts and juries should look to 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 government 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."

2. **Whether the Entity Performs a Function the Foreign Government Treats as Its Own:** According to the Eleventh Circuit, "[c]ourts and juries should examine 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."

In *Esquenazi*, the Eleventh Circuit found that Teleco qualified as an "instrumentality" based on the facts in the record. The Eleventh Circuit noted that Teleco had a monopoly over telecommunications services; that Teleco had various tax advantages; that Haiti's national bank owned 97 percent of Teleco in the years in question; that Teleco's Director General was chosen by the Haitian President with the consent of the Haitian Prime Minister and other ministers; that the Haitian President appointed all Teleco board members; and that the government's expert had testified that Teleco belonged "totally to the state" and was considered a "public entity."

### Discussion

The Eleventh Circuit's decision largely vindicates U.S. enforcement authorities, who have long asserted that the term "instrumentality" can include state-controlled entities and that the term "foreign official" can likewise include employees of state-controlled entities. In light of the decision, companies should generally continue to take a broad view of these terms in their internal compliance programs. Given that the definitions rely on "fact-bound questions," and given the relative amorphousness of the test created by the Eleventh Circuit, functionality concerns should generally weigh in favor of taking a conservative approach—at least until additional precedent or enforcement actions provide more guidance. Accordingly, payments or transfers provided to employees of state-controlled companies (including gifts, meals, travel, or entertainment) should continue to receive close scrutiny from company compliance personnel.

That said, the decision contains significant limitations on the scope of the terms. In particular, the Eleventh Circuit's second requirement—that an entity perform a function that the government treats as its own—could very well exclude small non-monopolist companies in many instances. For example, in China, many small companies are owned partially or wholly by government entities; but they act just like private companies, they are not providing services to the public at large, and the public and government do not necessarily view these companies as performing government functions. In light of the Eleventh Circuit's opinion, mere state ownership alone would not make them instrumentalities under the FCPA. Overall, the decision limits the scope of the terms "instrumentality" and "foreign official" and could prove to be very important in limiting the scope of many enforcement actions under the FCPA.

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If you have any questions or need assistance on FCPA compliance, please contact Martin Weinstein (202-303-1122, mweinstein@willkie.com), Robert Meyer (202-303-1123, rmeyer@willkie.com), Jeffrey Clark (202-303-1139, jdclark@willkie.com), or the Willkie attorney with whom you regularly work.

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