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U.S. Appeals Court Decision Defining Foreign 'Instrumentality' under the Foreign Corrupt Practices Act Looks to International Law

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On May 16, 2014, the U.S. Court of Appeals for the Eleventh Circuit issued a highly anticipated decision in *United States v. Esquenazi*, No. 11-15331, 2014 WL 1978613 (11th Cir. May 16, 2014), clarifying the reach of the term "foreign official" under the Foreign Corrupt Practices Act ("FCPA") (*see WSLR, June 2014, page 35*). For the first time, an appeals court, rather than the Securities and Exchange Commission ("SEC") or the Department of Justice ("DOJ"), decided what qualified an employee of a state-owned enterprise to be a "foreign official."

The *Esquenazi* court determined that employees of Telecommunications D'Haiti, S.A.M. ("Teleco"), the Haitian state-owned telephone company, were "foreign officials" under the FCPA because the company qualified as an "instrumentality" of a foreign government. The court held that an "instrumentality" of a foreign government under the FCPA is an entity 1) controlled by the government of a foreign country that 2) performs a function the controlling government treats as its own. Notably — and notwithstanding judicial controversy over the use of international law to interpret domestic law — the *Esquenazi* court referred to international norms and standards to determine the intended scope of FCPA terms.

What does *Esquenazi* mean for entities conducting business abroad?

The Eleventh Circuit's decidedly fact-intensive definition of instrumentality, along with its searching inquiry into international law, should lead in-house counsel and compliance professionals to continue treading with caution and with greater understanding of international anti-corruption law when dealing with state-owned/controlled enterprises.

The *Esquenazi* Test: Control and Function

Under the FCPA, a "foreign official" is defined as "any officer or employee of a foreign government or any department, agency or *instrumentality* thereof" (emphasis added).

The issue raised by defendants in *Esquenazi* was whether Teleco was an "instrumentality" of the Haitian

government such that bribes paid to Teleco's employees would be covered by the FCPA.

As a practical matter, *Esquenazi* provides a road map for compliance professionals to follow, and will give lower courts help in interpreting the statute and defense lawyers ammunition in dealing with the DOJ and the SEC.

The court looked to dictionary definitions and other statutes (such as the Americans with Disabilities Act) for the language's meaning, applied various doctrines of statutory construction, and "glean[ed]" that an entity needed to be under the "control or dominion" of the government and that the instrumentality must be "doing the business of the government." (*Id.* at *5) Then the court referred to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ("OECD Convention") to define and explain those terms.

The two prongs of the *Esquenazi* test to determine "instrumentality" under the FCPA involve questions of control and business function.

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The two prongs of the *Esquenazi* test lead to several considerations, including:

- **Control:** More than ever, it is important that an entity subject to the FCPA has a clear understanding of its counterparties and corruption risk. Questions for vendors and acquisition targets now must include the percentage of state ownership and the foreign government's control over board members or officers.
- **Function:** Entities working with a state-owned enterprise must understand the country and the entity's role to determine if the state-owned enterprise is engaged in what could traditionally be described as a "governmental function" of that government. In some countries with long histories of state ownership, this will be quite broad.

'Instrumentality' and International Law

Esquenazi found that the FCPA envisioned that a government-controlled entity that provided a commercial service could be an instrumentality under the statute.

But when? And what can a practitioner look to for help?

To answer those questions, the Eleventh Circuit turned to the commentaries to the OECD Convention, relying on international anti-corruption norms as a tool of statutory construction to define "foreign official." The United States joined the OECD Convention in 1998, and agreed it would take measures (already generally encompassed in the FCPA) to make it a criminal offense to "offer, promise, or give a bribe to a foreign public official for the official to act or refrain from acting in relation to the performance of official duties in order to obtain or retain business or other improper advantage in the conduct of international business."

The OECD defined a "foreign public official" as "any person exercising a public function for a foreign country, including for a . . . public enterprise."

But what is a "public enterprise"? And does the OECD definition shed any light on the definition of "instrumentality" under the FCPA?

The Eleventh Circuit, relying on a doctrine that dates to John Marshall, the fourth chief justice of the U.S. Supreme Court, that U.S. law should be interpreted consistent with U.S. treaty obligations, interpreted the FCPA in light of the OECD Convention, and said yes.

The *Esquenazi* court, in applying the OECD Convention, noted that, since Congress had *not* changed the definition of "foreign official" in 1998 except to add employees of international organizations to the statute, the existing FCPA definition must include the OECD Convention language that applied the anti-corruption regime to a " 'foreign public official' of an 'enterprise . . . over which a government . . . exercise[s] a dominant influence' that performs a 'public function' because it does not operate[] on a normal commercial basis . . . substantially equivalent to that of . . .private enterprise[s]' in the relevant market 'without preferential subsidies or other privileges.' " (*Id.*) This ensured the FCPA is interpreted in the mainstream of international law.

This was not the first time a circuit court of appeals had applied the OECD Convention to the FCPA. The U.S. Court of Appeals for the Fifth Circuit had used the OECD Convention and the 1998 FCPA amendments in 2004 (notwithstanding the then-blooming controversy concerning the use of international law in the Supreme Court) to confirm its understanding of the "business nexus" element of the FCPA. The Fifth Circuit used the OECD Convention to "bolster" its conclusion that the business element of the FCPA should be interpreted broadly after it had already interpreted the legislative history of the FCPA in 1977 and the 1988 amendments and to ensure that the later amendments did not conflict with its conclusions based on the 1977 enactment. (*United States v. Kay*, 359 F.3d 738, 750, 755 (5th Cir. 2004))

By contrast, in *Esquenazi*, the Eleventh Circuit looked to the substance of the OECD Convention's commentaries in order to interpret the FCPA's existing language defining "foreign official" to ensure that the FCPA was interpreted in a manner that was consistent with the OECD Convention.

Esquenazi's analysis is also consistent with current legal global trends, in which international anti-corruption norms are converging. The U.K., Canada, Indonesia, Russia, China, and Brazil, among other countries, have strengthened their domestic statutes and increased their

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investigative activity against their own citizens or in parallel with other nations. For example, in May 2014, Canada sentenced an individual to the first prison term under its new anti-corruption regime for a conspiracy to provide services to Air India, and charged two Americans and a Briton for the same conspiracy in June 2014. Many nations, including China, the U.K., Poland, Jordan, and Lebanon are investigating claims against GlaxoSmithKline. JP Morgan is under investigation in the Eastern District of New York and Hong Kong. And the United States worked with foreign states in the recent prosecution of the former president of Guatemala and credited many countries in the recent Alcoa settlement with the SEC and the DOJ.

Yet, despite the evident salience of international law to FCPA interpretation, the Eleventh Circuit's analysis is particularly interesting, considering it comes after at least a decade of violent disagreements within the Supreme Court concerning the use of international standards and norms in American law. As a result, an appeal of this decision could be open to attack (should the Supreme Court ultimately grant *certiorari* after any motions for reconsideration and *en banc* review in the Eleventh Circuit are resolved) on the grounds that the Eleventh Circuit may have relied too much on the OECD's definition of "instrumentality" and not solely on U.S. precedent. Nonetheless, given the evident tendencies of courts to look to international anti-corruption norms in FCPA interpretation, organizations would do well to keep apprised of developments in this body of law.

Questions and Considerations

The court's decision leaves two major questions open: What is *control* and what is *a function the controlling government treats as its own?*

Each of these issues is fact-based and may require expert testimony, because the government function prong requires the federal court to understand the foreign government and its policies and economic system.

Certain relevant factors for *control* were cited by the court, from both the OECD Convention and U.S. case law concerning Amtrak and the Reconstruction Finance Corporation, including:

- the foreign government's formal designation of the entity;
- the government's majority interest;
- the government's ability to hire and fire the principals;
- the extent to which profits go to the government; and
- the extent to which the government funds losses.

Relevant factors for *functions the controlling government treats as its own* may be more difficult and could require foreign law experts. This inquiry is quite literally foreign to U.S. courts, since the main examples included the OECD Convention and cases involving the unique circumstances of Amtrak and the Reconstruction Finance Corporation. The factors for this second prong include:

- Does the government have a monopoly over the service?
- Does the government subsidize the entities' costs?
- Does the entity provide services to the public at large?
- Do the public and the government consider the entity to be performing a government function?
- And, based on the OECD Convention, the entity must *not* operate on a "normal commercial basis in the relevant market."

The court's definition of "instrumentality" suggests the following steps for in-house counsel and compliance officers:

1) Know your customers. Require as part of a routine check on new business (and existing customers) that local colleagues review indicia of control and ownership and provide sufficient background on the entity's role in the country.

2) Flag entities that are state-owned or state-controlled and train staff concerning FCPA compliance, including limitations on entertainment, gifts, and services provided to those entities or their employees to gain business.

3) Be particularly aware of operations in countries in which the state (or the military) plays a large role in the economy through state-owned enterprises that may have monopoly powers but are not obviously state-owned.

4) Question the results of the local inquiry — for example, some government-controlled companies will straddle the line, with some commercial elements, and some more "governmental" functions. For example, consider a state real estate development company. Is it an "instrumentality?" The answer will depend, in part, on public perception and questions such as: Does it have exclusive control over an area? Does the government appoint its leadership? Could preferential financing from a state-owned bank be a subsidy? If so, be extra careful.

5) Be particularly careful if dealing with a recently privatized or privatizing entity; depending on where in its transformation the company is, state control may remain significant.

Ultimately, *Esquenazi* adds to the growing body of judicially interpreted FCPA law, which in turn should lead in-house counsel and compliance professionals to conduct due diligence with regard to potential connections with state-owned or state-controlled organizations.

The text of the Eleventh Circuit's opinion in United States v. Esquenazi is available at http://www.bloomberglaw.com/public/document/USA_v_Joel_Esquenazi_et_al_Docket_No_1115331_11th_Cir_Nov_14_2011/3.

The text of the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions is available at http://www.oecd.org/corruption/oecdantibriberyconvention.htm.

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