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Courts Reject Bright-Line Approach to Defining "Foreign Official" in Favor of Fact-Based Approach, Creating Greater Uncertainty for Business

Highlights

- The Department of Justice (DOJ) and Securities Exchange Commission (SEC) broadly interpret the terms "foreign official" and "instrumentality" under the Foreign Corrupt Practices Act (FCPA).
- Several federal judges have recently ruled that whether a state-owned or state-controlled entity qualifies as an "instrumentality" of a foreign government under the FCPA is a case-by-case fact-intensive inquiry based on a set of non-exhaustive factors.
- While providing some guidance, this emerging consensus in favor of a fact-based approach is less clear and predictable than the bright-line approaches often urged by defense counsel, resulting in considerable uncertainty for business.

On February 16, 2012, Judge Selna of the Central District of California issued an order in *United States v. Carson* regarding jury instructions pertaining to the terms "foreign official" and "instrumentality" of the government under the FCPA.[1] Judge Selna's order rejected defendant's proposal for a bright-line approach[2] in favor of a "fact-based finding in light of the totality of the circumstances."[3] This ruling is a recent example of a federal judge finding that whether a state-owned or state-controlled entity qualifies as an instrumentality of a foreign government under the FCPA and, accordingly, whether employees of the entity qualify as "foreign officials" under the statute, is a fact-based question for the jury.

Judge Selna's ruling closely parallels his earlier treatment of the issue in the same case. In April 2009, prosecutors indicted six former executives of Controlled Components Inc. ("CCI"), a manufacturing company with state-owned customers in China, Korea, Malaysia and United Arab Emirates. The indictment alleges that "US$4.9 million in bribes or corrupt payments were made to officers and employees of CCI's foreign, state-owned customers between 2003 and 2007."[4] Defendants moved to dismiss the indictment arguing, among

1 Order re Select Jury Instructions, *United States v. Carson*, No. 09-cr-00077-JVS (C.D. Cal. Feb. 16, 2012).

2 *Id.* at 4.

3 Order Denying Defendants' Mot. to Dismiss Counts 1 though *[sic]* 10 of the Indictment, at 3, *United States v. Carson*, No. 09-cr-00077-JVS (C.D. Cal. May 18, 2011).

4 *Id.* at 2.

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other things, that because "state-owned companies are not departments, agencies, or instrumentalities of a foreign government," employees of state-owned companies can never be foreign officials.[5]

In May 2011, Judge Selna denied the motion to dismiss. In so doing, he emphasized that one could not simply assume employees of state-owned companies were "foreign officials" under the FCPA, but that several factors must be considered on a case-by-case basis, including:

1. The foreign state's characterization of the entity and its employees
2. The foreign state's degree of control over the entity
3. The purpose of the entity's activities
4. The entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions
5. The circumstances surrounding the entity's creation
6. The foreign state's extent of ownership of the entity, including the level of financial support by the state (e.g., subsidies, special tax treatment and loans)[6]

In his recent order, Judge Selna identified two additional factors to be considered: "whether the governmental end or purpose sought to be achieved is expressed in the policies of the foreign government" and "the status of employees under the foreign government's law, including whether the employees are considered public employees or civil servants."[7] Judge Selna stated that the factors he identified are "not exclusive" and determined that "there is no basis to instruct that the jury must find that each factor is present."[8] The trial in the *Carson* matter is scheduled to begin on June 5, 2012.

The same issue has recently been considered by other federal judges, all of whom have reached similar conclusions:

- In *United States v. Aguilar*, (commonly known as the "Lindsey Manufacturing Case"), defendants argued that "because under no circumstances can a state-owned corporation be a department, agency, or instrumentality of a foreign government," officers or employees of a state-owned corporation cannot be foreign officials.[9] Judge Matz of the Central District of California rejected the defendants' argument, set forth a list of non-exhaustive factors similar to Judge Selna's, and held that Mexico's state-owned utility company, Comisión Federal de Electricidad, may be an "instrumentality" under the FCPA and its employees may therefore be "foreign officials."[10] Although the jury convicted the defendants, the conviction was subsequently vacated on prosecutorial misconduct grounds.
- In *United States v. Esquenazi*, (commonly known as the "Haiti Teleco Case"), the court for the Southern District of Florida denied defendants' motion to dismiss, which argued that "entities controlled or partially controlled by departments, agencies, or instrumentalities" do not fall under the FCPA's definition of those terms, and that "the phrase department, agency, or instrumentality is unconstitutionally vague if it is premised solely on government control of ownership."[11] The court rejected defendants' arguments and ruled that the "plain language" of the FCPA and the "plain meaning" of "foreign official" are such that, "as the facts are alleged in the indictment, Haiti Teleco could be an instrumentality of the Haitian government" and the directors of the company could therefore be foreign officials.[12] In August 2011, Mr. Esquenazi was sentenced to 15 years in prison.
- In *United States v. O'Shea*, the defendant filed a motion to dismiss arguing that the employees of the state-owned company did not fall under the definition of "foreign official." On January 3, 2012, Judge Hughes of the Southern District of Texas denied defendant's motion to dismiss in a single sentence, without explanation.[13] The FCPA charges were later dismissed on other grounds.

5 *Id.* at 1. The FCPA prohibits corrupt payments to foreign officials. Foreign official is defined as "any officer or employee of a foreign government or any department, agency or instrumentality thereof." 15 U.S.C. § 78dd-2(h)(2)(A). The FCPA does not define instrumentality. Both the DOJ and the SEC have long held the view that state-owned entities (SOEs) are "instrumentalities" of the government and, accordingly, that all employees of SOEs qualify as foreign officials under the FCPA.

6 Order Denying Defendants' Mot. to Dismiss Counts 1 though *[sic]* 10 of the Indictment, at 5, *United States v. Carson*, No. 09-cr-00077-JVS (C.D. Cal. May 18, 2011).

7 Order re Select Jury Instructions, at 5-6, *United States v. Carson*, No. 09-cr-00077-JVS (C.D. Cal. Feb. 16, 2012).

8 *Id.* at 6.

9 Criminal Minutes—General, at 2, *United States v. Aguilar*, No. 10-cr-01031-AHM (C.D. Cal. Apr. 20, 2011).

10 *See id.* at 2-16.

11 Order Denying Defendant Joel Esquenazi's (Corrected and Amended) Mot. to Dismiss Indictment for Failure to State a Criminal Offense and for Vagueness, at 2, *United States v. Esquenazi*, No. 09-cr-21010-JEM (S.D. Fla. Nov. 19, 2010) (internal quotation marks and citations omitted).

12 *Id.* at 2-3.

13 *See* Management Order, at 1, *United States v. O'Shea*, No. 09-cr-00629 (S.D. Tex. Jan. 3, 2012).

In short, courts faced with challenges to charges based on the terms "foreign official" or "instrumentality" as used in the FCPA have rejected bright-line approaches in favor of case-by-case inquiries based on the totality of the circumstances. These recent cases point to a growing consensus and provide some guidance, but the fact-intensive case-by-case approach utilized by courts fails to provide certainty to companies that interact with business entities affiliated with a foreign government.

Amidst increasing calls from the business community for legislative reform of the FCPA, a subcommittee of the House of Representatives Committee on the Judiciary held a hearing in June of last year to consider, among other possible amendments, proposals to define with greater particularity key terms in the FCPA, such as "foreign official." In addition, the DOJ has announced that it intends to release "detailed new guidance on the Act's criminal and civil enforcement provisions" sometime this year.[14] However, it is not clear whether the new guidance will address the agency's interpretation of "foreign official" or "instrumentality" or recent court decisions on the issue. Even if the DOJ's guidance does address these key terms, its guidance is unlikely to have much impact in light of the case-by-case fact-specific approach increasingly endorsed by courts.

Particularly since some courts have considered a "non-exhaustive" list of factors in resolving several recent challenges, continued litigation over the terms "foreign official" and "instrumentality" is likely. Given the case-by-case approach that has been increasingly endorsed, corporations should continue to be particularly mindful of FCPA risks when transacting business with state-owned entities, especially in high-risk areas. The safest approach remains to interpret the term "instrumentality" broadly and operate as if all employees of state-owned entities are "foreign officials" for FCPA purposes.

14 Lanny A. Breuer, Assistant Attorney General, Criminal Division, US Department of Justice, Remarks at the 26th National Conference on the Foreign Corrupt Practices Act (Nov. 8, 2011) available at http://www.justice.gov/criminal/pr/speeches/2011/crm-speech-111108.html.