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FCPA

Court Issues Rare Guidance on When State-Owned Enterprises are "Instrumentalities" of Foreign Governments

BY JAMES DOWDEN AND PATRICK WELSH

In *United States v. Esquenazi*,[1] the United States Court of Appeals for the Eleventh Circuit recently set forth a test for evaluating when the executives and employees of a company owned or otherwise controlled by a government constitute "foreign officials" under the Foreign Corrupt Practices Act ("FCPA"), 15 U.S.C. §§ 78dd-1, et seq. Although this opinion is controlling authority only in the states within the Eleventh Circuit, judicial guidance interpreting the FCPA is exceedingly rare. Therefore *Esquenazi* is likely to be an influential opinion, guiding both judicial rulings and prosecutorial charging decisions throughout the country.

Esquenazi reinforces the need for any investor or business operating outside of the United States to carefully consider potential anti-corruption risks. Under the broad language of *Esquenazi*, a number of entities owned, controlled or otherwise affiliated with foreign governments may very well be subject to the FCPA's mandates.

The defendants in *Esquenazi*, Carlos Rodriguez and Joel Esquenazi, were co-owners of Terra Telecommunications Corp. ("Terra"), a business that purchased phone time from foreign telecom providers and resold this time to customers in the United States. Telecommunications D'Haiti, S.A.M ("Teleco") acted as one of Terra's main suppliers. By October 2001, Terra owed Teleco over $400,000. According to the court's opinion, the defendants arranged to make "side payments" to Teleco executives to reduce both this pending balance and future costs. The defendants allegedly disguised their bribes by making these side payments to two sham companies.

The government alleged that Teleco was an instrumentality of the Haitian government, and thus its executives were "foreign officials" as defined in the FCPA. The defendants were ultimately convicted of conspiracy to violate the FCPA and to commit wire fraud, conspiracy to commit money laundering, twelve counts of money laundering, and seven substantive FCPA violations. Carlos Rodriguez received a seven-year sentence, and Joel Esquenazi received fifteen years, the longest prison term ever handed down in an FCPA prosecution. In upholding these convictions, the Eleventh Circuit squarely addressed whether Teleco was an "instrumentality" of the Haitian government. On appeal, the defendants argued that, among other er-

[1] No. 11-15331, 2014 BL 136610 (11th Cir. May 16, 2014).

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rors, the trial court improperly instructed the jury on the meaning of the term ''instrumentality.'' The defendants argued that Teleco was not an ''instrumentality'' of the Haitian government, and accordingly that they could not be convicted of bribing a ''foreign official.''

''Foreign Officials'' and Government ''Instrumentalities''

Broadly speaking, the FCPA's anti-bribery provisions prohibit authorizing, offering, promising, or paying money or anything else of value to a ''foreign official'' in order to influence that official's actions, or to otherwise secure an improper business advantage. ''Foreign officials'' are defined in the FCPA to include any ''officer or employee of a foreign government or any department, agency, or instrumentality thereof.'' Traditional government bureaucrats, such as a trade minister, clearly fall within this definition. The statute itself, however, provides little guidance as to what constitutes an ''instrumentality'' of a foreign government. The officers and employees of any ''instrumentality'' are ''foreign officials'' under the FCPA, to the same extent as, for example, a Prime Minister. Therefore the definition of instrumentality is a key component of determining whether the FCPA applies to state-owned or state-controlled entities.

In interpreting the term ''instrumentality,'' the DOJ and SEC have traditionally taken an expansive view, arguing that a wide variety of state-owned and state-controlled entities fall within its parameters. In many countries, large swaths of the economy are dominated by state-owned entities. For example, the DOJ and SEC have at times argued that health care providers practicing at publicly owned hospitals are ''foreign officials'' because they work for an ''instrumentality'' of the foreign government. Employees of state-owned airlines, steel mills, and oil companies have similarly been deemed to be ''foreign officials'' by these enforcement agencies.

The *Esquenazi* defendants took this broad interpretation head-on. In appealing their convictions, the defendants argued that the term ''instrumentality'' should be read to include only entities that perform traditional, core government functions similar to those performed by state bureaucracies, agencies, committees or commissions. Teleco, they argued, was not an agency or department of the Haitian government, and it did not perform a function traditionally associated with government service.

Esquenazi Factors

The Eleventh Circuit rejected the defendants' core government function test. Instead, the court set forth its own test focused on whether (1) the entity is controlled by a foreign government, and (2) it ''performs a function the controlling government treats as its own.''

On the first point, the court articulated that control is evaluated by considering (1) whether the entity has been formally designated as government-controlled; (2) whether the government has a majority ownership stake in the entity; (3) the government's ability to select management; and (4) whether the government retains profits and covers shortfalls. The court further noted that the length of time these indicia have existed is also relevant to determining whether an entity is government-controlled.

But, mere control is not enough. Rather, the court emphasized, the prosecution carries the burden of showing that the entity is carrying out ''a function the government treats as its own.'' Thus, purely commercial enterprises owned by foreign governments could well be found to be instrumentalities in certain circumstances. To determine whether a state-owned entity ''performs a function the controlling government treats as its own,'' the Eleventh Circuit set forth a non-exclusive list of factors, including whether (1) the entity has a monopoly; (2) the government subsidizes the entity's operations; (3) services are provided by the entity to the public in the country of ownership; and (4) ''the public and the government of that foreign country generally perceive the entity to be performing a governmental function.''

Not all entities that have some degree of public ownership are likely to be ''instrumentalities'' under the test adopted by *Esquenazi*. For example, a publicly traded company in which a government holds a small position is unlikely to be deemed a governmental instrumentality absent any outsized role by the government in selecting management.

Future Implications

Esquenazi reinforces the need for businesses and investors to take a cautious approach in evaluating the anti-corruption risks associated with investing in emerging markets. The *Esquenazi* court's broad interpretation of the reach of the FCPA suggests that companies should understand that a number of business opportunities in emerging markets may very well be subject to the FCPA's mandates. Indeed, a variety of entities involved in the infrastructure, health care, telecommunication, transportation, and defense sectors could well fall within the expansive and flexible test endorsed by the Eleventh Circuit.

A number of scenarios may present closer questions. For example, foreign governments own many commercial enterprises through joint ventures with private parties. Whether these commercial enterprises are truly controlled by the foreign government and perform a function the government considers its own would be determined by the specific facts of the situation. Moreover, a business may invest in an enterprise that was originally not a governmental ''instrumentality'' under *Esquenazi* but may later evolve into one through changes in ownership structure, regulatory scheme or public perception. For example, a new government in a developing country may exercise more explicit control over a previously independent entity.

Businesses and investors operating outside of the United States should understand that the government will continue to interpret the FCPA broadly to reach interactions with individuals who have only tangential links to core government functions. In order to minimize risk, companies should continue to focus on developing and implementing robust, risk-based anti-corruption compliance programs.

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