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COMMENTARY

Federal Appellate Court Rules that the FCPA Prohibits Corrupt Payments to Certain Foreign Government-Owned Businesses

For the first time since the enactment of the Foreign Corrupt Practices Act ("FCPA"), a federal appellate court has defined what constitutes an "instrumentality" of a foreign government under the FCPA. Last week, the Eleventh Circuit agreed with the government that the definition of "instrumentality" under the FCPA can include state-owned entities that perform commercial functions. While the decision largely affirms the government's long-held position that the FCPA covers corrupt payments to state-owned businesses, the court's ruling could have the impact of narrowing the scope of future FCPA enforcement actions. In light of this decision, companies should ensure that their anticorruption compliance policies and procedures prohibit corrupt payments to agents and employees of businesses that are owned or controlled by foreign governments.

Haiti Teleco Case

On May 16, the Eleventh Circuit affirmed the convictions of two former owners of Terra Telecommunications Corp. ("Terra") in *United States v. Esquenazi, et al.* No. 11-15331 (11th Cir. May 16, 2014). The owners, Joel Esquenazi and Carlos Rodriguez, appealed their convictions for conspiracy to violate the FCPA, substantive violations of the FCPA, and other offenses. Esquenazi and Rodriguez were convicted after trial of paying approximately $900,000 in bribes to officials of Telecommunications D'Haiti, S.A.M. ("Haiti Teleco") to obtain a reduction of debt Terra owed to Haiti Teleco and a commercial advantage in future transactions. At the time, the Haitian government had an ownership interest in Haiti Teleco, the only provider of telecommunications services in the country. Esquenazi was sentenced to 15 years in prison, and Rodriguez was sentenced to seven years in prison.

On appeal, the defendants argued that the district court erred by instructing the jury that Haiti Teleco could be considered an "instrumentality" by virtue of the Haitian government's ownership stake, without also determining whether Haiti Teleco performed any "government function." They further argued that "instrumentality" solely applies to government entities responsible for core government functions such that bribe payments to state-owned or state-operated commercial entities did not fall under the FCPA.

Definition of "Instrumentality"

Rejecting this argument, the court found that in determining whether an entity is an "instrumentality," there is no bright-line distinction between traditional government agencies and state-owned or state-operated

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commercial entities. The court declared that an "instrumentality" of a foreign government extends to any "entity *controlled* by the government of a foreign country that *performs a function the controlling government treats as its own*" and suggested a list of nonexclusive factors to consider in deciding each of these "fact-bound questions."

The court created a two-prong test for determining whether state-owned or state-operated commercial entities meet the FCPA's "instrumentality" requirement. Under the first prong, the court must determine whether the foreign government controlled the entity. If the court determines that the entity is controlled by the foreign government, it must then proceed to the second prong and determine whether the entity performed a function "the controlling government treats as its own." With respect to the first prong—whether a foreign government controls a particular entity—the court provided a nondispositive list of factors that juries and courts could consider:

- The foreign government's formal designation of the entity;
- Whether the foreign government has a majority interest in the entity;
- Whether the foreign government has the power to hire and fire the entity's principals;
- The extent to which the entity's profits, if any, go into the governmental fisc;
- The extent to which the foreign government funds the entity should it operate at a loss; and
- The length of time these indicia have existed.

Similarly, the court provided a list of factors to consider when determining the second prong—whether the entity performs a function the government treats as its own:

- Whether the entity has a monopoly over the function it exists to perform;
- Whether the foreign government subsidizes the entity's costs;
- Whether the entity provides services to the public at large in the foreign country; and
- Whether the government and the public in the foreign country perceive the entity to be performing a governmental function.

In the court's view, Haiti Teleco would be an "instrumentality" under "almost any definition we could craft." Under the first prong of the test—control—the court found that government's control over Haiti Teleco in the relevant period was pervasive based on the following facts:

- Since its creation, Haiti Teleco benefitted from a state-sanctioned monopoly on telecommunications services in that country;
- Haiti's national bank and later its central bank owned 97 percent of the entity's equity during the relevant time period;
- The Haitian president appointed the entity's director general (the company's top position) and all of its board members; and
- "Government, officials, everyone consider[ed] Teleco as a public administration."

Under the second prong of the test, the court viewed all four of its (nonexhaustive) "function" factors as satisfied—particularly emphasizing Haiti Teleco's government-granted monopoly and "various tax advantages," which distinguished it from a public enterprise that operates "on a normal commercial basis in the relevant market." The court offered little guidance on the extent to which lesser amounts of government control and "function" would leave an entity outside the category of an instrumentality.

Impact of Decision

Esquenazi can be viewed as a significant victory for the government because it affirms the largest prison sentence ever handed down in an FCPA case, and it also affirms the Department of Justice and Securities and Exchange Commission's broad position that the FCPA applies to improper payments made to state-owned commercial entities. In light of this decision, companies should reexamine and potentially modify their anticorruption compliance policies and procedures to prohibit corrupt payments to agents and employees of commercial entities that are owned or controlled by foreign governments. Due diligence should be conducted to determine the extent to which foreign businesses are owned, invested in, or controlled by the government, and whether a business could be considered as performing a government function.

On the other hand, the decision may also place some limitations on the government's broad reading of "instrumentality" because the court required proof that "that the entity perform[s] a function the government treats as its own." Following this logic, state ownership, in and of itself, does not render an entity an "instrumentality" under the FCPA, which is not the position the government has taken in the past. This could potentially affect a variety of existing and future FCPA investigations.

The only certainty is that payments to employees of foreign state-owned entities remain a serious FCPA risk. Due to the government's longstanding view that the FCPA covers corrupt payments made to state-owned or -controlled commercial enterprises, many companies have FCPA compliance programs that prohibit this conduct. Companies that have not done so should use *Esquenazi* as an opportunity to reconsider their anticorruption policies.

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