Client Alert

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Court of Appeals Hands Down Landmark FCPA Ruling Defining the Term "Instrumentality"

By Charles E. Duross

Federal appellate court decisions interpreting the Foreign Corrupt Practices Act (FCPA) are rare. Very rare. Indeed, in the statute's 36-year history there have been barely more than a handful of appellate court decisions analyzing the meaning of the different provisions of this complex statute with which multinational corporations and scores of business executives must grapple on a daily basis.[1] On Friday, May 16, 2014, the Eleventh Circuit Court of Appeals issued a landmark ruling addressing for the first time the definition of the term "instrumentality" as it appears in the FCPA. That case, captioned *United States v. Joel Esquenazi and Carlos Rodriguez*,[2] affirmed the convictions and sentences of both defendants, and in so doing, upheld the longest sentence in the FCPA's history, Esquenazi's 15-year sentence.[3]

The Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) understandably view this decision as validating their broad interpretation of who qualifies as a "foreign official" under the FCPA.[4] At a compliance conference held just after the release of this decision, the heads of the FCPA Units at both the DOJ and SEC, Patrick Stokes and Kara Brockmeyer, respectively, described the ruling as an "important," "seminal" decision on a critical issue and said that they drew comfort from the appellate court embracing the DOJ and SEC's approach to this issue.

While this is the first time an appellate court has defined the term "instrumentality," companies hoping for additional clarity through the creation of either a bright-line rule or a clearly defined test will be disappointed, as the *Esquenazi* court embraced the non-exhaustive multi-factor test endorsed by the government and adopted by a number of district courts that faced the same issue.[5]

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[1] *See, e.g.*, *United States v. Kozeny*, 667 F.3d 122 (2d Cir. 2011); *United States v. Kozeny*, 541 F.3d 166 (2d Cir. 2008); *United States v. Kay*, 513 F.3d 432 (5th Cir. 2007); *United States v. Kay*, 359 F.3d 738 (5th Cir. 2004); *Stichting Ter Behartiging Van de Belangen Van Oudaandeelhouders In Het Kapitaal Van Saybolt Int'l B.V. v. Schreiber*, 327 F.3d 173 (2d Cir. 2003); *United States v. Liebo*, 923 F.2d 1308 (8th Cir. 1991); *United States v. Castle*, 925 F.2d 831 (5th Cir. 1991).

[2] Case No. 11-15331 (11th Cir. May 16, 2014). A copy of the court's decision is available here.

[3] *See* prior Client Alerts, "Another Successful FCPA Prosecution Against Individuals—More Terra Telecom Execs Appear Headed for Prison for Haiti Bribes"; "Telecom Exec Sentenced to Record Breaking FCPA Prison Term: 15 years"; "FCPA + Anti-Corruption Developments: 2012 End of Summer Round-Up."

[4] *See* U.S. DEP'T OF JUSTICE & U.S. SEC. AND EXCH. COMM'N, *A Resource Guide to the U.S. Foreign Corrupt Practices Act* (Nov. 12, 2012) at 20, *available at* http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.

[5] Jury Instructions, *United States v. Esquenazi*, No. 09-cr-21010 (S.D. Fla. Aug. 5, 2011), ECF No. 520; Order at 5 and Jury Instructions, *United States v. Carson*, 2011 WL 5101701, No. 09-cr-77 (C.D. Cal. May 18, 2011), ECF No. 373 and ECF No. 549; *United States v. Aguilar*, 783 F. Supp. 2d 1108, 1115 (C.D. Cal. 2011).

BACKGROUND FACTS

To summarize our previous Client Alerts (here, here, and here) the *Esquenazi* case involved a Miami telecommunications company called Terra Telecommunications (Terra) – whose business involved re-selling international long distance telephone call time – and two of its executives, Joel Esquenazi and Carlos Rodriguez, who were involved in a scheme to bribe various persons working for Telecommunications D'Haiti, S.A.M. (Teleco), which provides telecommunications services in Haiti. Esquenazi and Rodriguez were charged in a 21-count indictment with conspiracy to violate the FCPA and commit wire fraud, conspiracy to launder money, and substantive counts of FCPA violations, wire fraud, and money laundering.[6] At one point Terra owed $400,000 to Teleco, and Esquenazi and Rodriguez hatched a plan with Teleco's Director of International Relations, Robert Antoine, in which Antoine would "shave minutes from Terra's bills to Teleco in exchange for receiving from Terra fifty percent of what the company saved."[7] Those payments were disguised through certain sham companies and bogus "consulting agreements." In total, Esquenazi and Rodriguez paid Antoine and his associates $882,000. When another Teleco Director of International Relations, Jean Rene Duperval, was appointed, Esquenazi and Rodriguez continued the bribery scheme with Duperval. Again, they used a third-party intermediary, a shell company, and a bogus consulting agreement to facilitate nearly $400,000 of bribes funneled to Duperval.[8]

At trial, Esquenazi and Rodriguez contended that Antoine and Duperval were not "foreign officials" under the FCPA because Teleco was not part of a foreign government and, as a commercial enterprise, Teleco could not qualify as an "instrumentality" of a foreign government.

Recognizing that this was a central defense, the government introduced evidence to support that Teleco was, in fact, an instrumentality of the Haitian government, given that: (a) the Haitian government owned 97% of Teleco; (b) at Teleco's inception, it was given a monopoly on telecommunications services in Haiti; (c) Teleco was given significant tax advantages; (d) the Haitian government appointed two members of Teleco's board; (e) the President of Haiti appointed the Director General of Teleco (the company's highest position) by an executive order that was also signed by the Haitian Prime Minister, the minister of public works, and the minister of economy and finance; (f) an expert witness concluded that Teleco belonged "totally to the state" and "was considered . . . a public entity"; and (g) Esquenazi and Rodriguez sought to secure political risk insurance, which was only necessary when dealing with a foreign government, and in that process the general counsel of Terra referred to Teleco as an "instrumentality" of the Haitian government."[9]

If this evidence of Teleco's relationship to the Haitian government was sufficient to show that Teleco was its "instrumentality" by law, Antoine and Duperval should be deemed foreign officials, the bribery of whom is prohibited under the FCPA. Of course, the difficulty faced by the Eleventh Circuit was that neither the statute nor any appellate court had defined "instrumentality."

[6] *Esquenazi*, Case No. 11-15331 at 2.

[7] *Id*. at 5-6.

[8] *Id*. at 6-7.

[9] *Id*. at 3-5.

USE OF THE TERM "INSTRUMENTALITY" IN THE FCPA

The FCPA makes it unlawful, among other things, "to make use of the mails or any means or instrumentality of interstate commerce corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to . . .*any foreign official* for purposes of . . . influencing any act or decision of such foreign official in his official capacity . . .in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person."[10] The FCPA states that "[t]he term 'foreign official' means any officer or employee of a foreign government or any department, agency, or *instrumentality thereof*, or of a public international organization, or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality, or for or on behalf of any such public international organization."[11] The FCPA is silent, however, on what is meant by "instrumentality."

DEFINING "INSTRUMENTALITY"

Because the meaning of instrumentality is not defined, on appeal Esquenazi and Rodriguez argued forcefully that state-owned entities like Teleco were never intended to be covered by the FCPA as an "instrumentality," and even if state-owned entities could be covered by the FCPA, entities like Teleco, which engaged in wholly commercial enterprises, did not fall within the ambit of the term "instrumentality."[12] While the appeal covered a number of issues, including the knowledge requirement, money laundering charges, and sentencing calculations, much of the opinion was dedicated to this issue of first impression.

In analyzing the meaning of "instrumentality," the *Esquenazi* court first looked to dictionary definitions.[13] For example, the court found that Black's Law Dictionary defines instrumentality as "[a] means or agency through which a function of another entity is accomplished, such as a branch of a governing body."[14] The court therefore rejected the contention that only an actual part of the government would qualify as an instrumentality.[15] It also analyzed "instrumentality" under the canon of *noscitur a sociis* (that is, "a word is known by the company it keeps"). The court concluded that "the company 'instrumentality' keeps is 'agency' and 'department.'"[16] Based upon that context, the court held that for an entity to qualify as an "instrumentality" it:

- must be under the control or dominion of the government; and
- must be doing the business of the government.[17]

[10] 15 U.S.C. § 78dd-2(a)(1) (emphasis added).

[11] 15 U.S.C. § 78dd-2 (h)(2)(A).

[12] *Esquenazi*, Case No. 11-15331 at 14.

[13] *Id*. at 10-11.

[14] Black's Law Dictionary at 870 (9th ed. 2009).

[15] *Esquenazi*, Case No. 11-15331 at 11 (finding that such "contention is too cramped and would impede the 'wide net over foreign bribery' Congress sought to cast in enacting the FCPA").

[16] *Id.* at 12-13.

[17] *Id*. at 13.

Following that analysis, the *Esquenazi* court defined instrumentality as follows:

> An 'instrumentality' under section 78dd-2(h)(2)(A) of the FCPA is an entity controlled by the government of a foreign country that performs a function the controlling government treats as its own.[18]

The court held that the factors comprising government control and a "function the government treats as its own," are fact-bound determinations,[19] and provided non-exhaustive lists of factors for courts and juries to consider in assessing the "government control" and "government function" elements.

THE GOVERNMENT CONTROL ELEMENT

In determining whether a government "controls" the entity at issue, the *Esquenazi* court listed the following factors for consideration:

- 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 governmental 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.[20]

THE GOVERNMENT FUNCTION ELEMENT

In determining whether the entity at issue "performs a function the government treats as its own," the *Esquenazi* court listed the following factors for consideration:

- 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.[21]

In addressing the issue of what functions count as the government's business, the court rejected the narrower construction advanced by the defendants that a government-controlled entity providing commercial services could

[18] *Id.* at 20.

[19] *Id.*

[20] *Id.* at 21.

[21] *Id.* at 22-23.

never qualify as an "instrumentality."[22] Rather, focusing on the facilitating payment exception of the FCPA, the court concluded that because "[r]outine governmental action" in the FCPA is defined as "'an action . . . ordinarily and commonly performed by a foreign official in,' among other things, 'providing *phone service*,'" Congress expressly contemplated that some instrumentalities would, in fact, provide commercial services.[23] Moreover, the court analyzed Congress's amendments to the FCPA in 1998 to implement the mandates of the OECD Anti-Bribery Convention,[24] which came into force in February 1999. The court found that Congress's approach to amending the FCPA "seems to demonstrate that Congress considered its preexisting definition already to cover 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.'"[25] Based on this analysis, the court rejected the defendants' invitation to limit the term only to entities that perform traditional, core government functions.[26] Indeed, the court held that had it, in fact, interpreted the term "instrumentality" so narrowly it would have "put United States out of compliance with its international obligations."[27]

Having established the legal standard, the *Esquenazi* court quickly found that the district court's jury instructions were legally sound and that the government had proved, based on the extensive evidence described above, that Teleco was, as a matter of fact, an instrumentality of the Haitian government; that it was controlled by the Haitian government, and that in providing nationalized telecommunication services, performed a function Haiti treated as its own.[28] As the *Esquenazi* opinion makes clear, it is hard to imagine a stronger set of facts for the DOJ than those presented in this case and the Eleventh Circuit therefore affirmed the convictions of Esquenazi and Rodriguez.[29]

[22] *Id*. at 13-14.

[23] *Id*. (emphasis added).

[24] Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (OECD Convention), Dec. 17, 1997, S. Treaty Doc. No. 105-43, 37 I.L.M. 1 (ratified Dec. 8, 1998, entered into force Feb. 15, 1999), *available at* http://www.oecd.org/daf/anti-bribery/ConvCombatBribery_ENG.pdf.

[25] *Esquenazi*, Case No. 11-15331 at 14-16 (citing the OECD Anti-Bribery Convention art. 1.4(a) & cmt. 14, 15).

[26] In so doing, the court, in a footnote, also suggested that it was easier for courts and businesses to determine what entities the government thinks are its own than trying to determine which functions are considered core or traditional government functions. *Id*. at 19 n.8. Interestingly, the *Esquenazi* court relied, in part, on the availability of the little-used opinion release procedure, under which the public can request that the Attorney General render opinions on the application of the statute to specific facts, to determine any close calls as to whether the government believes that a particular state-controlled entity would be considered an "instrumentality" under the FCPA. *Id*. It will remain to be seen whether Footnote 8 results in a noticeable uptick in opinion releases issued by the DOJ.

[27] *Id*. at 18-19.

[28] *Id*. at 24-27 ("In light of our construction of the term, we have little difficulty concluding sufficient evidence supported the jury's necessary finding that Teleco was a Haitian instrumentality.").

[29] *Id*. at 20 ("[W]e believe Teleco would qualify as a Haitian instrumentality under almost any definition we could craft . . . .").

IMPLICATIONS FOR FUTURE FCPA ENFORCEMENT

As with the *FCPA Resource Guide*, many businesses were hoping that the *Esquenazi* decision would bring additional clarity to the question of "who is a foreign official" under the FCPA. But close observers were not surprised by the Eleventh Circuit's decision, both because of the series of district court decisions across the country that had followed the same course before and because of the strong facts supporting the conclusion that Teleco was, indeed, an instrumentality of the Haitian government.

That said, the *Esquenazi* court repeatedly referenced Commentary 15 to the OECD Anti-Bribery Convention, which states that a public enterprise (i.e., an instrumentality) does not include an enterprise that "operates on a normal commercial basis in the relevant market, i.e., on a basis which is substantially equivalent to that of a private enterprise, without substantial subsidies or other privileges."[30] This factor could be significant in countries like China, where there exist 144,000 state-owned enterprises,[31] many of which may operate on a normal commercial basis without any support from the state. It remains to be seen whether the *Esquenazi* decision and its embracing of Commentary 15 will result in the DOJ and the SEC being more restrained in applying the "instrumentality" label to state-owned enterprises that otherwise look and operate like ordinary commercial enterprises.

Moreover, *Esquenazi* demonstrates that companies cannot rely on "public" or "private" labels to determine whether an entity is an instrumentality under the FCPA. On one hand, the court affirmed that the mere provision of a service by a government-owned entity is not sufficient to meet its new test. On the other hand, as was the case in *Esquenazi*, the provision of an ostensibly private or commercial service may be found to be a government function depending on the particularities of the local jurisdiction. In the face of this uncertainty, and with an appellate court adopting an expansive definition of instrumentality, companies should ensure that their compliance programs are structured to sufficiently evaluate whether the entities with which they are conducting business are under the control of a foreign government and performing a government function – even if that function is considered commercial in nature.

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[30] OECD Anti-Bribery Convention cmt. 15.

[31] Xinhuanet, China Focus: China pledges further reforms for state-dominated sectors (Oct. 24, 2012), available at http://news.xinhuanet.com/english/indepth/2012-10/24/c_131928023.htm.

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