DEBEVOISE & PLIMPTON LLP

FCPA Update

May 2014 ■ Vol. 5, No. 10

U.S. Appellate Court Defines Government "Instrumentality" Under the FCPA

On May 16, 2014, in affirming the convictions of Joel Esquenazi and Carlos Rodriguez for money laundering, conspiracy, and violations of the U.S. Foreign Corrupt Practices Act, the Eleventh Circuit Court of Appeals articulated a definition of what constitutes a government "instrumentality" under the FCPA.[1] This decision represents the first time an appellate court has addressed the meaning of "instrumentality" under the FCPA, which has been a key issue in enforcement given the centrality of determining who qualifies as a foreign official under the statute. As anticipated in the January 2014 issue of *FCPA Update*,[2] Esquenazi and Rodriguez lost their appeals in an opinion that implied the decision was not a close call for the Court. Notwithstanding the Court's apparent discomfort with the government's proposed multi-factor test for "instrumentality,"[3] the Court ultimately endorsed a fact-intensive approach to what entities qualify as instrumentalities under the FCPA.

Background of the Case

Esquenazi and Rodriguez owned Terra Telecommunications Corp. ("Terra"), a Florida-based company that purchased phone minutes from foreign vendors and resold the minutes to U.S.-based customers. One of Terra's vendors was Telecommunications D'Haiti, S.A.M. ("Teleco"), which has a monopoly over telecommunications services in Haiti. From the 1970s until approximately 2009, Haiti's national bank, Banque de la Republique d'Haiti ("BRH"), owned 97% of Teleco. In addition, the Haitian government appointed Teleco's board of directors, its director general, and its director of international relations. In 2008, a Haitian anti-corruption law went into effect that treated Teleco "as a public administration," requiring its agents to declare their assets and prohibiting them from accepting bribes.[4]

CONTINUED ON PAGE 2

1. *United States v. Esquenazi*, No. 11-15331, 2014 WL 1978613, at *8 (11th Cir. May 16, 2014) [hereinafter, "*Esquenazi* Decision"].
2. P. Berger, S. Hecker, A. Levine, B. Yannett, S. Michaels, P. Rohlik, N. Duarte Grohmann & J. Shvets, "Anti-Corruption Compliance 2013: Post-Guidance Trends and Signals for the Future," *FCPA Update*, Vol. 5, No. 6, at 18 (Jan. 2014), http://www.debevoise.com/files/Publication/f22e87ae-1ccc-4d42-8998-c863820682e7/Presentation/PublicationAttachment/fda5b580-5680-4cdd-89f1-dfc4ace00784/FCPA_Update_Jan2014_final.pdf.
3. *Id.*
4. *Esquenazi* Decision at *2

For original source materials related to this issue's article:

Click *here* for the *Esquenazi* decision

Click *here* for the text of the FCPA

Click *here* for the DOJ/SEC *Resource Guide*

Click *here* for an index of all *FCPA Update* articles.

If there are additional individuals within your organization who would like to receive FCPA Update, please reply to ssmichaels@debevoise.com or pferenz@debevoise.com.

"Instrumentality" Under the FCPA ■ Cont. from page 1

In 2001, Terra owed more than $400,000 to Teleco. To reduce that debt, Esquenazi, Rodriguez, and others at Terra paid bribes to Teleco officials in exchange for those officials taking steps to reduce Terra's bills. Over the next three years, Terra paid approximately $900,000 in bribes to Teleco officials, during which time Terra's bills were reduced by over $2 million. In the course of the government's investigation, Esquenazi admitted that he had bribed Teleco officials. Both Esquenazi and Rodriguez went to trial, after which a jury convicted them on all charges.[5]

Shortly after the jury's verdict, the government received and produced two declarations by Haiti's Prime Minister concerning Teleco's status in relation to Haiti's government.[6] The first declaration stated that Teleco "has never been and until now is not a State enterprise."[7] The second, submitted to clarify the first, stated that the Prime Minister was not aware that the first declaration "was going to be used in support of the argument that, after the takeover by BRH and before its modernization, [Teleco] was not part of the Public Administration of Haiti. This is obviously not the case since, during that time, [Teleco] belonged to BRH, which is an institution of the Haitian state" and "[t]he only legal point that should stand out [in the first declaration] is that there exists no law specifically designating Teleco as a public institution."[8] Esquenazi and Rodriguez moved for a new trial on the basis that the declarations should have been disclosed earlier, but the district court denied the motion.[9]

Subsequently, the district court sentenced Rodriguez to a total of five years and Esquenazi to a total of 15 years for their participation in the FPCA and money laundering schemes.[10] Esquenazi's sentence is the longest FCPA-related sentence imposed to date.[11] Both Esquenazi and Rodriguez then appealed their convictions.

Arguments on Appeal

The FCPA prohibits bribes to "any foreign official" or to "any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official," for the purpose of "influencing any act or decision of such foreign official … in order to assist … in obtaining or retaining business for or with, or directing business to, any person."[12] Relevant to the *Esquenazi* case, the FCPA defines a "foreign official" as "any officer or employee of a foreign

CONTINUED ON PAGE 3

5. *Id.* at *3
6. *Id.*
7. *Id.*; *United States v. Esquenazi et al.*, 09-Cr-2101 (S.D. Fla.), Decl. of Jean Max Bellerive, dated July 26, 2011, ECF No. 543-1, http://www.scribd.com/doc/63464626/Haitian-Government-Declaration-Re-Haiti-Teleco.
8. *Esquenazi* Decision at *3; *United States v. Esquenazi et al.*, 09-Cr-2101 (S.D. Fla.), Decl. of Jean Max Bellerive, dated August 25, 2011, ECF No. 549-1, http://www.scribd.com/doc/63599157/Declaration-of-Haitian-Prime-Minister-in-Haiti-Teleco-Case.
9. *Esquenazi* Decision at *3.
10. *Id.*
11. DOJ Press Rel. 11-1407, Executive Sentenced to 15 Years in Prison for Scheme to Bribe Officials at State-Owned Telecommunications Company in Haiti, (Oct. 25, 2011), http://www.justice.gov/opa/pr/2011/October/11-crm-1407.html.
12. 15 U.S.C. §§ 78dd-2(a)(1), (3).

FCPA Update

FCPA Update is a publication of
Debevoise & Plimpton LLP

919 Third Avenue
New York, New York 10022
+1 212 909 6000
www.debevoise.com

Washington, D.C.
+1 202 383 8000

Moscow
+7 495 956 3858

London
+44 20 7786 9000

Hong Kong
+852 2160 9800

Paris
+33 1 40 73 12 12

Shanghai
+86 21 5047 1800

Frankfurt
+49 69 2097 5000

Paul R. Berger
Co-Editor-in-Chief
+1 202 383 8090
prberger@debevoise.com

Bruce E. Yannett
Co-Editor-in-Chief
+1 212 909 6495
beyannett@debevoise.com

Sean Hecker
Co-Editor-in-Chief
+1 212 909 6052
shecker@debevoise.com

Andrew M. Levine
Co-Editor-in-Chief
+1 212 909 6069
amlevine@debevoise.com

Steven S. Michaels
Executive Editor
+1 212 909 7265
ssmichaels@debevoise.com

Erich O. Grosz
Co-Managing Editor
+1 212 909 6808
eogrosz@debevoise.com

Philip Rohlik
Co-Managing Editor
+852 2160 9856
prohlik@debevoise.com

Erin W. Sheehy
Co-Managing Editor
+1 202 383 8035
ewsheehy@debevoise.com

Noelle Duarte Grohmann
Co-Deputy Managing Editor
+1 212 909 6551
ndgrohmann@debevoise.com

Jane Shvets
Co-Deputy Managing Editor
+1 212 909 6573
jshvets@debevoise.com

Michael T. Leigh
Assistant Editor
+1 212 909 6684
mtleigh@debevoise.com

Please address inquiries regarding topics covered in this publication to the editors.

Please note: The URLs in *FCPA Update* are provided with hyperlinks so as to enable readers to gain easy access to cited materials.

"Instrumentality" Under the FCPA ■ Continued from page 2

government or any department, agency, or *instrumentality* thereof."[13]

> "The Eleventh Circuit rejected all of the defendants' arguments on appeal and determined that what mattered was whether an entity was controlled by a foreign government and performed a service that, even though it might be viewed as commercial, under the circumstances of the case constituted a governmental function."

The primary issue on appeal was whether Teleco was an "instrumentality" of the Haitian government for FCPA purposes. The terms with which "instrumentality" appears in the FCPA definition of "foreign official" – "agency" and "department" – both have been given traditional meanings, so that they apply to government officials performing traditional, core governmental functions. The issue on appeal, therefore, was whether Teleco, as a telephone service provider, constituted an "instrumentality" of the Haitian government because it was owned by the BRH. The jury found that it was, based on an instruction from the district court defining an instrumentality as "a means or agency through which a function of the foreign government is accomplished" and offering five factors by which the jury could determine whether Teleco met that definition: *(i)* whether Teleco provided services to Haiti's citizens and residents; *(ii)* whether its key officers were government officials or appointed by government officials; *(iii)* the extent of Haiti's ownership interest in Teleco; *(iv)* whether Teleco exercises exclusive or controlling power to administer its designated functions; and *(v)* whether Teleco is widely perceived and understood to be performing governmental functions.[14]

On appeal, Esquenazi and Rodriguez challenged: *(i)* the district court's instruction, arguing that it permitted the jury to convict them based only on the fact that Teleco was a government-owned entity without also requiring that it performed a governmental function; *(ii)* the sufficiency of the evidence that Teleco was a government instrumentality; and *(iii)* the FCPA's definition of "foreign official" as unconstitutionally vague because it could encompass government-owned entities that did not perform governmental functions.[15]

The Eleventh Circuit's Analysis

The Eleventh Circuit rejected all of the defendants' arguments on appeal and determined that what mattered was whether an entity was controlled by a foreign government and performed a service that, even though it might be viewed as commercial, under the circumstances of the case constituted a governmental function.

At the start of its analysis, the Court held that dictionary definitions of "instrumentality" foreclosed the argument that only an actual "part" of the government would qualify as an instrumentality.[16] The Court reasoned that so narrow a definition would undermine the "wide net over foreign bribery Congress sought to cast in enacting the FCPA."[17]

The Court then looked to the FCPA's text, and one of its prior opinions interpreting "instrumentality" in the Americans With Disabilities Act, to find that, because in the FCPA definition of "foreign official" "the company 'instrumentality' keeps is 'agency' and 'department,'" an instrumentality for FCPA purposes must be *(i)* under the control or dominion of a foreign government, and *(ii)* "doing the business of [that] government."[18]

The Court's analysis then turned to what activities constitute "doing the business of the government," a primary issue of dispute between the parties on appeal. Esquenazi and Rodriguez argued that because Teleco provided a commercial service – phone service – it was not performing a governmental function and thus could not be an instrumentality. In rejecting that argument, the Court noted the FCPA explicitly contemplates that in some instances commercial activity

CONTINUED ON PAGE 4

13. *Id.* § 78dd-2(h)(2)(A) (emphasis added).
14. *Esquenazi* Decision at *9-10.
15. *Id.* Esquenazi and Rodriguez also advanced other arguments on appeal that are not discussed in this article – for example, that they lacked "knowledge" under the FCPA and that the appearance of the Haitian prime minister's two declarations only after trial constituted a *Brady* violation. *See id.* at *13-15.
16. *Id.* at *4.
17. *Id.* (citing *United States v. Kay*, 359 F.3d 738, 749 (5th Cir. 2004)).
18. *Id.* at *5.

"Instrumentality" Under the FCPA ■ Continued from page 3

would be a governmental function. The Court pointed to the FCPA's exception for "facilitation" payments, which carves out from FCPA liability payments to foreign officials made to secure or expedite the performance of a "routine governmental action."[19] The Court noted that the FCPA defines "routine governmental action" to include "providing phone service."[20] The court stated it could not hold that an entity engaged in commercial activities was precluded from being an "instrumentality" because to do so would render meaningless portions of the facilitation payments exception to FCPA liability.

In perhaps the most provocative portion of its analysis, the Court also reviewed the United States's obligations under the Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ("OECD Convention") and found support for its view that a broad array of activities potentially could qualify as governmental functions for FCPA purposes. The United States ratified the OECD Convention in 1998, and Congress amended the FCPA that same year to comply with the OECD Convention. In those 1998 amendments, Congress's only change to the FCPA's definition of "foreign official" was to add "public international organization."

From that limited change, the Court discerned that Congress must have considered the rest of the definitional language to fully comply with the United States's obligation to include under the FCPA's definition of "foreign official" an employee 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" in the relevant market "without preferential subsidies or other treatment."[21] Based on that conclusion regarding legislative intent, the Court ruled that nothing in the FCPA supports the limitation suggested by the defendants that an "instrumentality" is only an entity that performs a "core governmental function." The Court held that to adopt that limitation would risk placing the United States out of compliance with its OECD Convention obligations.[22]

In holding that a broad array of activities potentially could qualify as governmental functions for FCPA purposes, the Court concluded that whether a particular entity ultimately performed a governmental function should be determined based on whether the foreign government "*treats* the function the foreign entity performs as its own."[23]

The Court's Definition of "Instrumentality"

Although the Court stated that "we believe Teleco would qualify as a Haitian instrumentality under almost any definition we could draft" – suggesting that the facts rendered this an easy case for the DOJ – the Court set out a two-part rule for when an entity constitutes an "instrumentality" for FCPA purposes. The Court defined an instrumentality as *(i)* "an entity controlled by the government of a foreign country" *(ii)* "that performs a function the controlling government treats as its own."[24]

The Court acknowledged that its test was fact-intensive, and it provided a number of non-exclusive factors that should guide courts and businesses. In deciding whether a foreign government "controls" an entity, the Court looked to the OECD Convention commentary on when an entity is controlled by a government and to U.S. Supreme Court opinions deciding whether certain domestic entities were agents or instrumentalities of the United States. Specifically, the Court identified the following factors as important:

- the foreign government's formal designation of the entity;
- whether the government has a majority interest in the entity;

CONTINUED ON PAGE 5

19. *Id.*; 15 U.S.C. § 78dd-2(b).
20. *Esquenazi* Decision at *5.
21. *Id.* at *6 (quoting OECD Convention art. 1.4 & cmt. 14, 15). The Court noted that the Fifth Circuit also looked to the United States's obligations under the OECD Convention in construing the FCPA language prohibiting bribery for the purpose of "obtaining or retaining business." *Id.* at *7 (citing to *United States v. Kay*, 359 F.3d 738, 754 (5th Cir. 2004)).
22. *Id.*
23. *Id.* (emphasis in original).
24. *Id.* at *8.

"Instrumentality" Under the FCPA ■ Continued from page 4

- governmental authority to hire and fire officers at the entity;
- the extent to which the entity's profits flowed directly into government coffers or the government funds the entity if it fails to break even; and
- the length of time these indicia have existed.[25]

> "[T]he Court suggested that government control of the entity and whether an entity's finances are treated as part of the 'public fisc' also may be indicative of whether the entity performs a governmental function."

Again looking to OECD commentary and U.S. Supreme Court opinions, the Court then suggested a list of factors that should guide courts and businesses in deciding whether an entity performed a governmental function:

- 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.[26]

Additionally, in an earlier footnote, the Court suggested that government control of the entity and whether an entity's finances are treated as part of the "public fisc" also may be indicative of whether the entity performs a governmental function.[27]

Esquenazi in Broader Context

The DOJ and SEC for years have contended that the term "instrumentality" covers both entities performing core government functions and commercial entities in which a foreign government maintains some level of ownership. The joint DOJ and SEC FCPA "Resource Guide" states that "[w]hether a particular entity constitutes an 'instrumentality' under the FCPA requires a fact-specific analysis of an entity's ownership, control, status, and function."[28] The Resource Guide then sets out a long but non-exclusive list of factors to be considered, many, but not all of which, also were considered by the *Esquenazi* Court.[29]

For example, in considering whether an entity performs a governmental function, it is not clear that the Resource Guide's "exclusive or controlling power vested in the entity to administer its designated functions" factor is the same as the *Esquenazi* decision's consideration of "whether the entity has a monopoly over the function it exists to carry out."[30] Moreover, it is not clear from the *Esquenazi* decision why monopoly power should be indicative of a governmental function; particularly in light of the fact that many private entities with some level of government ownership or that receive some level of government financial support enjoy market dominance in the services they provide.

Businesses and individuals operating internationally or facing FCPA charges have argued that the DOJ and SEC's expansive definition is legally flawed – for example, in a letter commenting on the joint DOJ and SEC FCPA "Resource Guide," the U.S. Chamber of Commerce asserted that entities ordinarily should perform a governmental or quasi-governmental function to be considered instrumentalities for FCPA purposes.[31] The *Esquenazi* decision stated that a foreign government's mere ownership stake in an entity is insufficient to render the entity an "instrumentality," and required that the entity also perform a governmental function, seemingly recognizing the validity of the Chamber of Commerce's concern. Still, the Court sided with the government in articulating an expansive, fact-intensive

CONTINUED ON PAGE 6

25. *Id.*
26. *Id.* at *9.
27. *Id.* at *8 n.8.
28. DOJ & SEC, "A Resource Guide to the U.S. Foreign Corrupt Practices Act," 20-21 (Nov. 4, 2012) [hereinafter "FCPA Resource Guide"], http://www.justice.gov/criminal/fraud/fcpa/guide.pdf.
29. *Compare id.* at 20 *with Esquenazi* Decision at *8.
30. *Compare* FCPA Resource Guide at 20 *with Esquenazi* Decision at *9.
31. U.S. Chamber of Commerce, Letter to Lanny A. Breuer and George S. Canellos regarding "FCPA Resource Guide," at 3 (Feb. 19, 2013), http://www.ethic-intelligence.com/wp-content/uploads/2013_Coalition_Letter_to_DOJ_and_SEC_re_Guidance.pdf. Debevoise advised the Chamber of Commerce in commenting on the Resource Guide.

"Instrumentality" Under the FCPA ■ Continued from page 5

test for what constitutes both foreign government control and what activities can qualify as a governmental function, and its decision likely should bolster the DOJ's and SEC's current enforcement strategy. Moreover, enforcement agencies may consider the issue of what constitutes an "instrumentality" to be resolved, despite the fact that the *Esquenazi* definition is controlling only on Alabama, Georgia, and Florida federal courts.

Although the opinion represents the first binding appellate court ruling on what constitutes an "instrumentality," the *Esquenazi* court's definition leaves some questions unanswered and certainly leaves room for businesses and individuals to challenge FCPA prosecutions. The Court did not discuss the relative weight to be afforded the factors it advanced as important in its decision that Teleco was an instrumentality of Haiti's government. For example, is majority ownership or control by the foreign government of greater importance than some of the other factors; does it operate as a threshold for control status, as the FCPA Resource Guide suggests it typically should?[32] Similarly, would a government official's ownership of an otherwise private entity, or a government official's membership on the board of directors of an otherwise private entity, without more, qualify the entity as an instrumentality if it performed a governmental function?

Outstanding questions like these might bolster calls for some kind of legislative effort to clarify what constitutes a "foreign official," including clarification of what constitutes an "instrumentality" – for example, whether ownership by a foreign official can qualify an entity as an instrumentality, and if so, whether the foreign official must be of a certain rank or ownership must reach a certain percentage.

The Court's interpretation of "instrumentality" in light of the United States' obligations under the OECD Convention also raises questions as to how courts might apply that theory in interpreting other parts of the FCPA. For example, should the facilitation payments exception in the FCPA be narrowly construed in light of its arguable conflict with the OECD Convention, which recommends that such payments be treated as unlawful?[33] The DOJ and SEC FCPA Resource Guide takes a disapproving view of facilitation payments and cites to the OECD's recommendation against them.[34] The *Esquenazi* "treaty obligation" analysis could cause enforcement agencies to assert an even narrower interpretation of the exception – and potentially other parts of the FCPA – in future cases.

Because the Eleventh Circuit panel endorsed a fact-based approach similar to that enforcement agencies and prior district courts have taken in recent years,[35] the Court's decision is unlikely to alter significantly compliance-related best practices.

The decision did not provide the type of bright-line rule that businesses long have sought in order to most effectively craft corporate compliance programs. Moreover, the Court's factors are sufficiently lacking in detail and conceivably different enough from the FCPA Resource Guide that, at least until other courts of appeals or district courts outside the Eleventh Circuit adopt the *Esquenazi* opinion's analysis, businesses arguably now face a more complicated task in trying to decide whether they are dealing with an instrumentality of a foreign government. Companies certainly should review their compliance programs to ensure they address the factors laid out by the *Esquenazi* court.

The Court also made clear, in the event it was not before, that companies bear the burden of researching foreign entities with which they seek to conduct business.[36] The Court suggested that businesses "have readily at hand the tools to conduct that inquiry" and pointed specifically to the DOJ's FCPA Opinion Procedure.[37] That procedure has well-documented limitations,

CONTINUED ON PAGE 7

32. FCPA Resource Guide at 21-22.
33. OECD Working Group on Bribery in International Business Transactions, Recommendation for Further Combating Bribery of Foreign Public Officials in International Business Transactions, at ¶ VI (Nov. 26, 2009), http://www.oecd.org/daf/anti-bribery/44176910.pdf.
34. FCPA Resource Guide at 20-21 ("While no one factor is dispositive or necessarily more important than another, as a practical matter, an entity is unlikely to qualify as an instrumentality if a government does not own or control a majority of its shares.").
35. *Id.* at 20-21; *United States v. Carson et al.*, No. 09-Cr-77 (C.D. Cal. May 18, 2011); *United States v. Aguilar*, 10-Cr-1031 (C.D. Cal. Apr. 20, 2011).
36. *Esquenazi* Decision at *8, *9 & n.8.
37. *Id.* at *8 n.8.

"Instrumentality" Under the FCPA ■ Continued from page 6

"In the end, the Court's expansive, multi-factored definition of what entities could constitute an 'instrumentality' reinforces the need for companies to pay close attention to their FCPA compliance programs[.]"

though: the difficulty of obtaining an opinion that would remain reliable if the facts of a situation change in any potentially material way; the infeasibility of the 30-day timeline for opinions in fast-moving situations such as joint ventures and mergers and acquisitions; potential exposure of a company's international business activities to competitors; and potential exposure of the opinion seeker to enforcement actions.[38]

Similarly, the Court also suggested that "it will be relatively easy to decide what functions a government treats as its own … by resort to objective factors" like those advanced by the Court in deciding that Teleco was an "instrumentality" of Haiti's government.[39] As companies long have known, it can be expensive and time-consuming to make such determinations, particularly in countries such as Russia, China, and various countries in Central and Latin America and in Africa where information about companies and state ownership is less than transparent and objective.

In this regard, one "best practices" headline to be gleaned from the *Esquenazi* decision is that companies should scrutinize with particular care entities that hold a monopoly over a service in a foreign country. Teleco's monopoly position over telecommunications in Haiti appeared to be an important indicator in the Court's decision that it performed a "governmental function,"[40] despite phone service being one that in the U.S., and European-based countries is commonly associated with the private sector.

In the end, the Court's expansive, multi-factored definition of what entities could constitute an "instrumentality" reinforces the need for companies to pay close attention to their FCPA compliance programs and to take particular care when doing business with entities in countries that routinely rank poorly in measures of transparency and corruption.

Sean Hecker
Andrew M. Levine
Colby A. Smith
Bruce E. Yannett
Michael T. Leigh

Sean Hecker, Andrew M. Levine, and Bruce E. Yannett are partners and Michael T. Leigh is an associate in the firm's New York office. Colby Smith is a partner in the firm's Washington, D.C. office. They are members of the Litigation Department and White Collar Litigation Practice Group. They may be reached at shecker@debevoise.com, amlevine@debevoise.com, casmith@debevoise.com, beyannett@debevoise.com, and mtleigh@debevoise.com

38. OECD, Working Group on Bribery in International Business Transactions, Phase 3 Report on the Implementing the OECD Anti-Bribery Convention in the United States (Oct. 2010), http://www.oecd.org/daf/anti-bribery/UnitedStatesphase3reportEN.pdf.

39. *Esquenazi* Decision at *8 n.8.

40. *Esquenazi* Decision at *11.