

### Financial Turmoil and the Expanding Reach of the FCPA

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The current worldwide financial crisis may lead to unexpected results for U.S. businesses and individuals in their efforts to comply with the Foreign Corrupt Practices Act (FCPA). As foreign governments bail out, and in some instances nationalize, commercial and investment banks, employees of those previously private financial institutions may become “foreign officials” for purposes of the FCPA. Thus, companies must determine whether their dealings with those institutions now implicate the FCPA.

The FCPA prohibits the payment of anything of value to a foreign official for the purpose of obtaining or retaining business or to secure an improper advantage. A “foreign official” includes

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.

See 15 U.S.C. § 78dd-1(f)(1)(A). Even though the statute does not mention the concept of government ownership or control over an entity, the Department of Justice (DOJ) and the Securities and Exchange Commission (SEC) have interpreted the definition of “foreign official” within the context of ownership or control.

Recent cases as well as Department of Justice (DOJ) opinions and staff announcements make clear that 100% ownership by a government of a particular entity is surely sufficient to make an employee of that entity a “foreign official” for the purpose of the FCPA. Even where the government enters a traditionally commercial field, employees of state-owned enterprises have been deemed “foreign officials” by virtue of state ownership. See, e.g., *York International Corp.* (members of the executive committee representing government interests in the construction of a luxury hotel and convention center complex owned by the United Arab Emirates); *AGA Medical Corp.* (doctors employed by state-owned hospitals in China); *Baker Hughes Inc.* (officials of KazakhOil, a state-owned oil company in Kazakhstan).<sup>1</sup> In each case, the employees representing the state-owned enterprise were deemed foreign officials under the FCPA.

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1. Detailed descriptions of all enforcement actions cited in this LawFlash are available on our website at <http://morganlewis.com/documents/fcpa/FCPAEnforcementActions.pdf>.

But it is also likely that an entity's employees would be considered foreign officials if the government holds a controlling interest in the entity. In a series of recent prosecutions, several Willbros Group subsidiaries and employees were charged with FCPA violations for making illicit payments to, among others, officials of a Nigerian government-owned company that was a majority (55%) partner in a joint venture with multinational oil companies. The payments were made to secure the joint venture's award of business to the Willbros subsidiaries and its partners, which required approval from the government-owned majority partner. *See also Con-Way, Inc.* (officials of numerous majority government-owned airlines in the Philippines); and *Schnitzer Steel Industries, Inc.* (officials of steel mills that were "partially owned by the Government of China"). In each case, the payments were made to officials who could control the award of business or could ensure preferential treatment by the government entity.

The government has not specified what level of control is required to deem an entity a state instrumentality. The DOJ has apparently judged that any "state-owned entity" is an instrumentality of a foreign government and therefore employees of such entities are foreign officials. *See* cases cited above and DOJ Opinion Release No. 94-01 (assuming that employee of state-owned entity was a foreign official under the FCPA).

In determining whether the recent foreign bailouts will change a formerly private entity into a government instrumentality, the analysis must start with a search for indicia of control. It does not appear that new regulations by themselves transform the bank or fund into a government-controlled entity for FCPA purposes. Regulations always operate in the background, and private enterprises will not be deemed government-controlled entities unless those regulations amounted to government control of the enterprises' operations.

There have been a variety of proposed government interventions, however, that inject a form of government control into private companies that is far more profound than conventional background regulation. The following discussion analyzes the different scenarios that may come into play with financial institutions in the post-bailout stages. For those institutions that are government controlled, American citizens and businesses must apply their FCPA policy and compliance procedures to such institutions, even if such institutions were private two weeks ago.

### **Financial Institutions That Have Been Nationalized and Sovereign Wealth Funds**

If the government completely nationalizes the financial institution, which reportedly is what has happened in Iceland, then such institution does become a state-controlled entity, and any U.S. business dealing with employees of that entity should ensure that its interactions with regard to entertainment, expenses, travel, and lodging with respect to its business with the formerly private entity do not violate the FCPA.

In addition, employees of sovereign wealth funds all but certainly will be treated as government officials. Steve Tyrrell, Chief of the Fraud Section in DOJ's Criminal Division, has observed that sovereign wealth funds have been playing a larger role in the domestic securities markets as companies search for increasingly scarce supplies of capital. Mr. Tyrrell was quoted in a news article stating that the "recent boom of sovereign wealth funds is an area at the top of the Justice Department's hit list." He suggested at a recent Securities Industry and Financial Markets Association conference that securities firms should treat employees of sovereign wealth funds as government officials for purposes of the FCPA.

### **Purely Passive Government Investments**

At the other extreme, some governments will make purely passive investments (capital infusions into market, loan guaranties, etc.) into financial institutions. If that is the case, then in all likelihood employees

of such institutions will not be considered to be foreign officials. If there is no control, then there should be no issue as to whether the financial institution has become a foreign government instrumentality.

## **Other Investments**

When a foreign government's involvement falls somewhere in the middle of the spectrum between total control and purely passive investor, U.S. firms will need to evaluate a variety of factors to measure the level of foreign government control. United States firms should carefully scrutinize the investment agreement (or comparable legislation) for each particular transaction to understand the foreign government's role.

For example, in Britain, the government has considered plans in which its central bank would take equity interests in banks, but would not exercise any voting rights associated with the stock or would only become involved in limited matters such as setting limits on executive compensation. In Russia, the government plans to make loans to banks and have its state-run development bank make loans to companies to help repay foreign debts, thus avoiding direct involvement in banking operations. In Germany, the government has opened credit lines and provided guarantees on certain loans, but has been reluctant to take equity stakes in banks. If the government owns more than 50% of a firm's stock or provides more than 50% of a firm's capital, however, there may be an issue as to whether the DOJ will consider that firm a government instrumentality, even if the government does not exercise any day-to-day control of the firm's operations.

Guaranteeing loans and deposits, or purchasing distressed assets to relieve strains on a bank's balance sheets, would probably not be equated with government control, but could be construed that way if other factors were at play. For example, legislation in the United Kingdom may also require the appointment of government representatives as nonexecutive members of the board of directors of certain financial institutions. In such cases, a careful review of the government's powers as set forth in any legislation, regulation, and/or agreement would be prudent.

United States firms should determine if traditional government employees have been newly appointed to manage a bank's operations. They should also evaluate whether the bank's employees' roles have changed since the government bailout, for example, by implementing new government-mandated lending criteria or seeking approval from government officials for certain transactions. In summary, the U.S. firm should try to determine the extent of ownership and control that the foreign government exerts or is allowed to exert over the financial institution.

Morgan Lewis has experience in all facets of the banking, securities, and private equity industries, as well as experience handling FCPA compliance, counseling, and defense needs.

If you have questions or require more information about the issues discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

### **Washington, D.C.**

Kathleen Collins	202.739.5642	<a href="mailto:kcollins@morganlewis.com">kcollins@morganlewis.com</a>
Amy J. Conway-Hatcher	202.739.5953	<a href="mailto:aconway-hatcher@morganlewis.com">aconway-hatcher@morganlewis.com</a>
Barbara Van Gelder	202.739.5256	<a href="mailto:bvangelder@morganlewis.com">bvangelder@morganlewis.com</a>
Mark E. Matthews	202.739.5655	<a href="mailto:mark.matthews@morganlewis.com">mark.matthews@morganlewis.com</a>
Christian J. Mixter	202.739.5575	<a href="mailto:cmixter@morganlewis.com">cmixter@morganlewis.com</a>
Brian M. Privor	202.739.5283	<a href="mailto:bprivor@morganlewis.com">bprivor@morganlewis.com</a>
Mark A. Srere	202.739.5049	<a href="mailto:msrere@morganlewis.com">msrere@morganlewis.com</a>

**Brussels**

Izzet M. Sinan +32 2 507 7522 [isinan@morganlewis.com](mailto:isinan@morganlewis.com)

**Frankfurt**

Jürgen Beninca +49 61 71 40 07 19 [jbeninca@morganlewis.com](mailto:jbeninca@morganlewis.com)

**Houston**

Hugh E. Tanner 713.890.5180 [htanner@morganlewis.com](mailto:htanner@morganlewis.com)

**Los Angeles**

John F. Hartigan 213.612.2630 [jhartigan@morganlewis.com](mailto:jhartigan@morganlewis.com)  
Alicia Villarreal 213.612.7245 [avillarreal@morganlewis.com](mailto:avillarreal@morganlewis.com)

**London**

Robert A. Goldspink +44 20 3201 5517 [rgoldspink@morganlewis.com](mailto:rgoldspink@morganlewis.com)

**New York**

Leslie R. Caldwell 212.309.6260 [lcaldwell@morganlewis.com](mailto:lcaldwell@morganlewis.com)  
Kelly A. Moore 212.309.6612 [kelly.moore@morganlewis.com](mailto:kelly.moore@morganlewis.com)  
Robert M. Romano 212.309.7083 [rromano@morganlewis.com](mailto:rromano@morganlewis.com)

**Paris**

Thierry Dalmasso +33 1 53 30 44 39 [tdalmasso@morganlewis.com](mailto:tdalmasso@morganlewis.com)

**Philadelphia**

Eric Kraeutler 215.963.4840 [ekraeutler@morganlewis.com](mailto:ekraeutler@morganlewis.com)  
Zane David Memeger 215.963.5861 [zmemeger@morganlewis.com](mailto:zmemeger@morganlewis.com)  
Eric W. Sitarchuk 215.963.5840 [esitarchuk@morganlewis.com](mailto:esitarchuk@morganlewis.com)  
R. Stephen Stigall 215.963.4981 [sstigall@morganlewis.com](mailto:sstigall@morganlewis.com)

**San Francisco**

John H. Hemann 415.442.1355 [jhemann@morganlewis.com](mailto:jhemann@morganlewis.com)  
William H. Kimball 415.442.1277 [wkimball@morganlewis.com](mailto:wkimball@morganlewis.com)  
Lisa Tenorio-Kutzkey 415.442.1309 [ltenorio-kutzkey@morganlewis.com](mailto:ltenorio-kutzkey@morganlewis.com)

**Tokyo**

Lisa Yano +81 3 5219 2507 [lyano@morganlewis.com](mailto:lyano@morganlewis.com)

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