

foreign corrupt practices act lawflash

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Federal Appeals Court Defines “Instrumentality” Under FCPA

Federal appeals court provides a two-step “control” and “function” analysis for determining whether an entity qualifies as an “instrumentality” under the Foreign Corrupt Practices Act.

On May 16, the U.S. Court of Appeals for the Eleventh Circuit addressed the reach of the Foreign Corrupt Practices Act (FCPA) by holding that a government “instrumentality” can include a state-owned or state-controlled entity. In *United States v. Esquenazi*,¹ the Eleventh Circuit rejected arguments by former Terra Telecommunications Corp. executives challenging the district court’s “instrumentality” jury instructions and the jury’s determination that Telecommunications D’Haiti SAM (Haiti Teleco) qualified as a government instrumentality. The Eleventh Circuit used the opportunity to define the term “instrumentality” and present a two-step “control” and “function” analysis for assessing whether an entity qualifies as a government instrumentality for the purposes of the FCPA. The decision provides greater clarity to the ambiguity inherent in the FCPA definition of a foreign entity covered by the statute and, as long argued by U.S. enforcement authorities, largely adopts an expansive test for making that determination.

FCPA and the Definition of “Instrumentality”

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 purposes of . . . influencing any act or decision of such foreign official . . . in order to assist such domestic concern in obtaining or retaining business for or with, or directing business to, any person.”² Under the statute, “foreign official” includes “any officer or employee of a foreign government or any department, agency, or *instrumentality* thereof.”³ The FCPA does not, however, define the term “instrumentality.”

The U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC) have long contended that government instrumentalities include state-owned and state-controlled entities,⁴ arguing on appeal that entities can qualify as instrumentalities for the purposes of the FCPA if they “perform a governmental function.”⁵ In contrast, former Terra President Joel Esquenazi and former Vice President Carlos Rodriguez argued on appeal that an entity must perform “traditional, core government functions” to qualify as an instrumentality.⁶

Although district courts have formerly found that “instrumentality” determinations should be based on a fact-driven analysis of the entities’ control, purpose, ownership, and function,⁷ *Esquenazi* was the first opportunity for a federal appellate court to address the government’s broad interpretation of the term. According to the Eleventh Circuit, “[a]n ‘instrumentality’ under section 78dd-2(h)(2)(A) of the FCPA is an entity controlled by the government

1. *United States v. Esquenazi*, Case No. 11-15331 (11th Cir. May 16, 2014), available at <https://www.morganlewis.com/documents/USAvsEsquenaziRodriguez.pdf>.

2. 15 U.S.C. §§ 78dd-2(a)(1)-(3).

3. 15 U.S.C. §§ 78dd-2(h)(2)(A).

4. See, e.g., FCPA Resource Guide at 20 (“The term ‘instrumentality’ is broad and can include state-owned or state-controlled entities.”).

5. *United States v. Esquenazi*, Case No. 11-15331, Appellee Government Brief at 19, available at <https://www.morganlewis.com/documents/EsquenaziBrief.pdf>.

6. *Esquenazi* at 18.

7. See, e.g., *United States v. Carson*, Case No. SACR 09-00077-JVS, 2011 WL 5101701 at *3-4 (C.D. Cal. May 18, 2011).

of a foreign country that performs a function the controlling government treats as its own.”⁸

“Control” and “Function” Analysis

Although the appeals court cautioned that “what constitutes control and what constitutes a function the government treats as its own are fact-bound questions,” the court provided nonexhaustive factors for making instrumentality determinations.⁹ When assessing whether an entity is “controlled by the government,” the Eleventh Circuit advised judges and juries to consider the following:

- 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
- The length of time these indicia have existed¹⁰

In determining whether an entity “performs a function the controlling government treats as its own,” the appeals court counseled judges and juries to consider whether any of the following criteria are met:

- The entity has a monopoly over the function it exists to carry out.
- The government subsidizes the costs associated with the entity that’s providing services.
- The entity provides services to the public at large in the foreign country.
- The public and the government of that foreign country generally perceive the entity to be performing a governmental function.¹¹

Applying this two-step analysis, the Eleventh Circuit had “little difficulty” affirming the jury’s finding that Haiti Teleco qualified as a Haitian instrumentality:

From Teleco’s creation, Haiti granted the company a monopoly over telecommunications service and gave it various tax advantages. Beginning in early 1970s, and through the years Messrs. Esquenazi and Rodriguez were involved, Haiti’s national bank owned 97 percent of Teleco. The company’s Director General was chosen by the Haitian President with the consent of the Haitian Prime Minister and the ministers of public works and economic finance. And the Haitian President appointed all of Teleco’s board members. The government’s expert testified that Teleco belonged “totally to the state” and “was considered . . . a public entity.” Although the expert also testified that “[t]here was no specific law that . . . decided that at the beginning that Teleco is a public entity,” he maintained that government, officials, everyone consider[ed] Teleco as a public administration.” Construed in the light most favorable to the jury’s verdict, that evidence was sufficient to show Teleco was controlled by the Haitian government and performed a function Haiti treated as its own, namely, nationalized telecommunication services.¹²

8. *Esquenazi* at 20.

9. *Id.* at 21.

10. *Id.*

11. *Id.* at 22–23.

12. *Id.* at 27–28.

Takeaway

The *Esquenazi* decision is the first appellate court opinion to address challenges to the DOJ's and SEC's interpretation of "instrumentality." Although the "control" and "function" analysis may not provide the bright-line guidance desired by businesses that operate in the global arena, the opinion confirms regulators' warnings that improper payments to employees of state-owned and state-controlled entities can violate the FCPA. Companies that interact with such entities should review their compliance policies to ensure that they address the factors enumerated by the court.

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