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Eleventh Circuit Defines "Instrumentality" Broadly Under the FCPA

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On May 16, the Court of Appeals for the Eleventh Circuit became the first federal appellate court to define an important element of the Foreign Corrupt Practices Act ("FCPA") – what constitutes an "instrumentality" of a foreign government and, thus, who is a foreign official. In *United States v. Esquenazi*,[1] a three-judge panel adopted a broad, fact-based definition of that term. Affirming the criminal convictions of both appellants, the court held that, in order to satisfy the statute, an "instrumentality" had to be an entity that both (1) is controlled by a foreign government and (2) performs a function that the foreign government "treats as its own." The court provided clear guidance to trial judges and juries by setting out the critical elements to be determined when applying the two-pronged test.

The panel's ruling represents a major victory for the Department of Justice, and puts to rest a major issue of contention in recent foreign corruption prosecutions of individuals, by affirming the position taken by the Department since the FCPA was enacted. It also provides a clear warning to companies that conduct business internationally to examine closely the level of government control and functions of the entities with which they deal, regardless of the entities' official designation or formal ownership.

Background

The anti-bribery provisions of the FCPA prohibit giving, offering, or authorizing to give or offer, anything of value to any "foreign official," directly or indirectly, in order to obtain or retain business or gain an unfair advantage. 15 U.S.C. §§ 78dd-2(a)(1), (3). The FCPA defines a "foreign official" as "any officer or employee of a foreign government or any department, agency, or instrumentality thereof." *Id.* § 78dd-2(h)(2)(A). The statute, however, does not define the term "instrumentality." Where a bribe recipient has a connection to a foreign government that is less formal or direct than that of an official foreign government department or state agency, the potential application of the FCPA was not heretofore as evident. Nevertheless, the government has consistently taken a broad view of what can constitute an "instrumentality" under the FCPA.

Following a jury trial in 2011, Joel Esquenazi and Carlos Rodriguez, former executives of Terra Telecommunications Corp. ("Terra"), a Florida-based company that purchased telephone time from foreign vendors, were convicted of substantive FCPA violations, in addition to conspiracy and money laundering. The convictions stemmed from kickback payments made by their company, Terra, indirectly to a director of Haiti's state-owned telecommunications company, Telecommunications D'Haiti, S.A.M. ("Teleco"). Rodriguez was sentenced to seven years in prison and Esquenazi was sentenced to 15 years in prison – the longest incarceration term in FCPA history.

On appeal, the defendants-appellants did not dispute that Terra made payments to the Teleco director. Rather, they argued that the district court's jury instruction with regard to the definition of "instrumentality" was impermissibly broad and that, in any event, Teleco was not an instrumentality of

the Haitian government. They also contended that there was insufficient evidence adduced at trial to prove that they knew that Teleco was an instrumentality of Haiti.

"Instrumentality" Defined

The Eleventh Circuit panel rejected appellants' narrow definition of what constitutes an instrumentality, which would have limited the term only to an entity that was formally recognized by a foreign government as a public entity or as part of the government, or to an entity that conducted traditional, narrowly defined, "core" governmental functions.

The court's opinion relied extensively on the Commentaries to the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions,[2] the dictionary definition of the term "instrumentality," and the context of the statute itself. The court highlighted the "'wide net over foreign bribery' Congress sought to cast in enacting the FCPA,"[3] and Congress' intent to comply with the United States' OECD Convention obligations when it amended the FCPA in 1998.[4] Thus, the appellate panel adopted its two-pronged definition of "instrumentality" under the FCPA – "[A]n entity controlled by the government of a foreign country that performs a function the controlling government treats as its own."[5]

The court emphasized that "[c]ertainly, what constitutes control and what constitutes a function the government treats as its own are fact-bound questions." However, although the court concluded that "Teleco would qualify as a Haitian instrumentality under almost any definition we could craft," it acknowledged that it was "mindful of the needs of both corporations and the government for *ex ante* direction about what an instrumentality is." [6] It, therefore, announced a list of "some factors that may be relevant [to courts and juries] deciding the issue."[7] It listed among the critical factors to be considered in determining whether an entity is controlled by the government of a foreign country:

1. "the foreign government's formal designation of that entity;"
2. "whether the government has a majority interest in the entity;"
3. "the government's ability to hire and fire the entity's principals;"
4. "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
5. "the length of time these indicia have existed."[8]

The panel then listed the following factors to examine when determining the second prong of the test, namely, whether an entity performs a function that the foreign government treats as its own:

1. "whether the entity has a monopoly over the function it exists to carry out;"
2. "whether the government subsidizes the costs associated with the entity providing services;"
3. "whether the entity provides services to the public at large in the foreign country;" and
4. "whether the public and the government of that foreign country generally perceive the entity to be performing a governmental function."[9]

Importantly, the court rejected a definition that would categorically define any service provided by a government-controlled entity as establishing an "instrumentality" of a foreign government. Indeed, the panel emphasized that the mere "provision of a service by a government-owned or controlled entity is **not** by itself sufficient" for an entity to be considered an instrumentality of a foreign government.[10]

"Instrumentality" Applied

Applying the standard it enunciated, the appellate panel affirmed the convictions of both appellants, finding the trial judge's instructions were "not erroneous" because they did not misstate the law and "substantially cover[ed] [all] factors"[11] and that there was sufficient evidence to support the verdicts. Reviewing the evidence *de novo*, the court found that Teleco was an instrumentality of the Haitian government, even though it had no formal designation as such. In particular, the court noted that Teleco was a "monopoly" and enjoyed "various tax advantages;" it was 97% owned by the national bank of Haiti; the President of Haiti appointed all of its directors; and the prosecution's expert had testified that Teleco "belonged 'totally to the state' and 'was considered . . . a public entity,'" and that "everyone consider[ed] Teleco as a public administration" that provided "nationalized telecommunication services."[12] Notwithstanding the lack of evidence that Teleco was defined by statute as a Haitian public entity, the other factors cited were "sufficient to show Teleco was controlled by the Haitian government and performed a function Haiti treated as its own. . . ."[13]

The Practical Importance of Esquenazi

The *Esquenazi* decision is an important victory for law enforcement that will encourage the Department and the Securities and Exchange Commission in their continuing pursuit of potential FCPA violations. Arguably, the victory was not absolute since the panel refused to adopt a definition of "instrumentality" that would have categorically

covered every state-controlled entity that merely provided *any* service. Nevertheless, the opinion supports the government's long-held position that "instrumentality" should be read broadly, and makes clear that even those entities that do not have a formal designation as a state enterprise may also fall within the FCPA.

The *Esquenazi* court's broad definition of "instrumentality" and factors to be considered by a court and a jury in making that determination have significant implications for companies subject to the FCPA. Under this opinion, foreign banks, investment funds, utility companies, universities and hospitals could be considered instrumentalities, which means that providing anything of value, including potentially giving gifts, meals or entertainment, to the employees of these entities could be considered violations of the FCPA.

Prosecutors in the future – as they have in the past – may seek to include an Interstate Travel in Racketeering ("ITAR"), 18 U.S.C. § 1952, charge, in addition to the FCPA charge, in a case in which they are uncertain if they will be able to present sufficient evidence that the recipients of payments were employees of a government-controlled entity that provided services that the government treated as its own.

More importantly, companies with potential FCPA exposure must consider *Esquenazi* as both a clear warning and as clear guidance. The *Esquenazi* opinion highlights the importance of conducting comprehensive due diligence on third parties with whom an entity is conducting business to ensure that any instrumentality covered by the FCPA is treated with the required care. Companies should not take comfort from the fact that an entity they deal with is not formally recognized as part of a foreign state or form a credible view of legal risk based on an evaluation of direct government ownership percentage alone. Rather, companies should ensure that their third-party due diligence and training of employees fully covers the critical elements enunciated by the Eleventh Circuit panel.

Endnotes

1 *United States v. Esquenazi, et al.*, 2014 WL 1978613, No. 11-15331 (11th Cir. May 16, 2014).

2 S. Treaty Doc. No. 105-43, 37 I.L.M. 1 (ratified Dec. 8, 1998, entered into force Feb. 15, 1999).

3 *Esquenazi* at *11 (quoting *United States v. Kay*, 359 F.3d 738, 749 (5th Cir. 2004)).

4 The court reasoned that shortly after ratifying the OECD Convention, Congress explicitly considered whether the FCPA complied with that treaty. Yet the only change it made to the definition of "foreign official" was "the addition of 'public international organization.'" (*See* 15 U.S.C. 78dd-2(h)(2)(A)). Thus, Congress must have concluded that the statute already "cover[ed] 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.'" *Esquenazi* at *16 (quoting OECD Convention, art. 1.4, cmt 14).

5 *Id.* at *20.

6 *Id.*

7 *Id.* at *20-21.

8 *Id.* at *21. The court noted that these factors are "informed by" the Commentaries to the OECD Convention. *Id.* (citing OECD Convention, art. 1.4, cmt 14 (stating that an entity is "deemed" to be under governmental control "inter alia, when the government or governments hold the majority of the enterprise's subscribed capital, control the majority of votes attaching to shares issued by the enterprise or can appoint a majority of the members of the enterprise's administrative or managerial body or supervisory board")).

9 *Id.* at *22-23. The court noted that these factors were also derived "in part from the OECD Convention." *Id.* (citing OECD Convention, art. 1.4, cmt. 15 ("[A] public enterprise shall be deemed to perform a public function" if it does not "operate[ ] 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 preferential subsidies or other privileges."); OECD Convention, art. 1.4, cmt. 12 ("'Public function' includes any activity in the public interest, delegated by a foreign country. . . .")).

10 *Id.* at *25 (emphasis in original).

11 The relevant portion of the district court's jury instructions stated:

> An instrumentality of a foreign government is a means or agency through which a function of the foreign government is accomplished. State-owned or state-controlled companies that provide services to the public may meet this definition.
>
> To decide whether Telecommunications D'Haiti or Teleco is an instrumentality of the government of Haiti, you may consider factors including, but not limited to:
>
> One, whether it provides services to the citizens and inhabitants of Haiti. Two, whether its key officers and directors are government officials or are appointed by government officials. Three, the extent of Haiti's ownership of Teleco, including whether the Haitian government owns a majority of Teleco's shares or provides financial support such as subsidies, special tax treatment, loans or revenue from government mandated fees. Four, Teleco's obligations and privileges under Haitian law, including whether Teleco exercises exclusive or controlling power to administer its designated functions. And five, whether Teleco is widely perceived and understood to be performing official or governmental functions.

Id. at *24-26.

12 *Id.* at *27-28.

13 *Id.* at *28. The court also considered and rejected appellants' argument that a post-trial declaration from the Haitian Prime Minister that Teleco was "not a State enterprise" required the district court to conduct a *Brady* hearing. *Id.* at *36-39. Because the particular evidence was not in the prosecution's possession prior to or during trial, the court held that the district court did not abuse its discretion when it refused to conduct such a hearing. Id. The Eleventh Circuit noted that the Prime Minister had later clarified his initial declaration and explained that Teleco was "fully funded and controlled by [the Haitian national bank], which is a public entity of the Haitian State." *Id.* at *37; *see also id.* at *8. Thus, the opinion concluded that these declarations were neither dispositive nor inconsistent with the conclusion that Teleco was an instrumentality of the Haitian government.

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