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Recent Challenges to Definition of "Foreign Official" Reinforce Government's Broad Interpretation

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Critics of the Foreign Corrupt Practices Act ("FCPA"),[1] which prohibits U.S. individuals or businesses from bribing foreign officials to gain a commercial advantage, have long criticized the law's broad scope, arguing that its vague terminology and lack of interpreting case law can leave international corporations operating in a grey zone with respect to who is and is not a "foreign official" covered by the law. In response to the U.S. government's increasingly aggressive approach in prosecuting individuals for alleged FCPA violations, several defendants recently have taken a stand on this unsettled ground, challenging the government's interpretation as a matter of law. While these challenges do not represent the first attack on the Department of Justice's ("DOJ") definition, they appear to be the first to elicit extensive judicial analysis on the topic.[2] But rather than weaken the government's authority, recent decisions have reinforced DOJ's expansive construction of the term "foreign official," placing employees of state-owned enterprises ("SOEs") squarely within the FCPA's scope.

Broad Interpretation by Enforcement Agencies

The FCPA's anti-bribery provisions define a "foreign official" as:

> [A]ny 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.[3]

Historically, U.S. enforcement authorities have interpreted the term to apply not only to officials of a foreign government, but also to employees of SOEs by virtue of the SOE's status as an "instrumentality" of the state. This reasoning has been extended to instances where the SOE in question is not wholly-owned by the foreign government. Even less than majority control has been shown sufficient to bring the employees of SOEs within the ambit of the law.[4] While card-carrying foreign officials are easy enough to recognize, what about the representative of a subdivision of a business unit owned by a foreign government?[5] A director of an oil company funded through government investment?[6] A doctor at a state-owned hospital?[7] It was in these "foreign official" grey zones that defendants in three recent cases hoped to defeat their FCPA prosecutions.

Into the Fray

Lindsey Manufacturing

Family-owned power product producer Lindsey Manufacturing Co., two of its executives and one of its sales agents were accused of paying officials at Mexico's state-owned electric utility Comisión Federal de Electricidad ("CFE") $5.5 million in bribes (including a boat and a Ferrari) to secure contracts worth $19 million.[8] The *Lindsey* defendants argued that, even if the allegations against them were true, the CFE officials were not "foreign officials" as a matter of law as *no* state-owned corporation could be an 'instrumentality' of the state.

Federal court judge A. Howard Matz rejected defendants' all-or-nothing approach and offered a "non-exclusive list" of factors relevant to such a determination.[9] Nor was he moved by the defendants' reading of legislative history, which they argued indicated Congress' intent to deliberately exclude SOEs from the FCPA's scope.[10] Instead, he concluded that the question of whether the CFE officials qualified as 'government officials' was one for the jury as the fact-finder to decide which deliberated a mere one day before convicting the defendants on all counts. The verdict, which included the first conviction at trial of a corporate defendant on FCPA charges, was a decisive victory for DOJ. The speed with which the jury returned its verdict was something of a surprise given that Judge Matz had openly questioned the strength of the government's case during the trial.[11] It suggests that jurors may have been persuaded by the visible evidence of alleged bribes at trial, such as the Ferrari, and spent little time analyzing the legal question of whether the recipients arguably were not "foreign officials" covered by the FCPA.

Control Components

Stuart Carson and other former executives at valve manufacturer Control Components Inc. ("CCI") are charged with paying $4.9 million in bribes to employees of state-owned oil and power firms in China, Malaysia and the United Arab Emirates in exchange for supply contracts.[12] As in *Lindsey* and *O'Shea*, the CCI defendants argued that, as a matter of law, the SOE employees they allegedly bribed fell outside the definition of "foreign officials" and were thus beyond the FCPA's reach. At the base of their argument lay a common complaint: the absence of a bright-line rule to guide corporations operating in ambiguous situations and the government's unwillingness to articulate one.[13]

Like Judge Matz, Judge James Selna held that the "question [of which entities may be considered instrumentalities of the government for the purposes of the FCPA] is a fact-specific question that depends on the nature and characteristics of the business entity."[14] Unlike Judge Matz, Judge Selna refused to consider the legislative history, finding that "the statutory language [of the FCPA] is unambiguous and the statutory scheme is coherent and consistent."[15] While stopping far short of a bright line rule, Judge Selna did acknowledge that government investment alone may be insufficient to render a commercial interest a government instrumentality: "when a monetary investment is combined with additional factors that objectively indicate the entity is being used as an instrument to carry out governmental objectives, that business entity would qualify as a governmental instrumentality."[16] The trial for the CCI defendants currently is scheduled for 2012.

O'Shea

John O'Shea, former regional manager at a Texas-based unit of ABB Ltd., a multinational power and automation technology company that provides products and services to numerous foreign state-owned utilities, was charged with offering kickbacks of up to 10% of ABB revenue to officials at the Comisión Federal de Electricidad, the same state-owned power company at the center of *Lindsey*.[17] Prior to the

Lindsey ruling, O'Shea's lawyers filed a motion to dismiss echoing similar arguments challenging the government's definition of what constitutes a "foreign official." The Court has yet to issue a ruling, but the weight of recent decisions does not augur well for O'Shea.

The Death Valley of Definitional Challenges

These latest unsuccessful challenges to the "foreign official" definition in criminal cases join earlier failed attempts to take on the government's interpretation of key elements of the FCPA. In the *Bourke* case, what constituted "knowledge" was in question.[18] In the *Meade* trial, "intent" was at issue.[19] *Kay and Murphy* challenged the so-called business nexus element – the requirement that the illicit payments be made for the purpose of "obtaining or retaining business."[20] In each of these cases, defendants lost, showing the unwillingness of the courts to second-guess the government's interpretation of the statute.

Legislative Help to the Rescue?

The failures of recent judicial challenges to the government's expansive view of the term "foreign official" in FCPA cases are likely to have broader repercussions beyond the cases of the individual criminal defendants. Corporate defendants under investigation by DOJ in FCPA matters are likely to gain little traction when arguing with the government over who constitutes a foreign official. DOJ will simply cite to the *Lindsey* and *CCI* rulings as precedent for its interpretation. Risk-averse companies may be forced to accept this position, thereby reinforcing an interpretation that sweeps in individuals and officials at SOEs who arguably are beyond the scope of the FCPA.

This trend can impact not only the disposition of an investigation but also the monetary amount of any potential settlement if it is determined that the FCPA has been violated. For in most such instances, a company will resolve any case by settlement, as it is the rare corporate defendant that would be willing to risk a federal indictment simply to challenge DOJ's interpretation of the term "foreign official" in federal court. Moreover, the recent rulings suggest that such a challenge may have little prospect of success with courts apparently inclined, as in *Lindsey* and *CCI*, to defer the matter to the fact-finder, most often a jury. And if the *Lindsey* case provides any indication, the gift of a Ferrari means graft in the eyes of the jury regardless of the legal strength of the government's case.

In short, while the *Lindsey* and *CCI* rulings do not foreclose the possibility of a successful challenge to the DOJ's interpretation down the road, they make it more remote. And future criminal defendants may be reluctant to challenge the government and more inclined to reach plea agreements, further reinforcing the decisions and DOJ's position.

While judicial relief has proven elusive, legislative help for international corporations may be on the horizon. Under intense pressure from corporate interest groups including the U.S. Chamber of Commerce, the House Judiciary Committee has agreed to consider several recommended changes to the FCPA, including clarification of the "foreign official" definition. Until then, multinationals will need to be wary of the "foreign official" grey zone and carry a clear roadmap to avoid its pitfalls.

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[1] 15 U.S.C. §§ 78dd-1, et seq.

[2] *See U.S. v. Nguyen, et al.*, No. 2:08-cr-00522 (E.D. Pa. 2008) and *U.S. v. Esquenazi, et al.*, 1:09-cr-21010 (S.D. Fla. 2009). In both cases, defendants filed motions to dismiss arguing that the targets of the alleged bribes were not "foreign officials" under the statute. The *Nguyen* court denied the motion without opinion and the *Esquenazi* court issued only a perfunctory ruling.

[3] 15 U.S.C. § 78dd-2(h)(2)(A).

[4] *See U.S. v. Kellogg Brown & Root LLC*, No. 09-071 (S.D. Tex. 2009) ($402 million criminal fine leveled against engineering and construction company KBR for allegedly bribing officials of Nigerian joint venture with 49% state ownership).

[5] *See Nguyen*, *supra* note 2.

[6] *See KBR*, *supra* note 4.

[7] *See U.S. v. AGA Medical Corp.*, No. CR 08-172 (D. Minn. 2008) (resulting in a deferred prosecution agreement and $2 million fine for payments made to physicians of Chinese state-owned hospitals in exchange for purchasing defendants' medical products).

[8] *U.S. v. Noriega, et al.*, No. 10-1031 (C.D. Ca. 2010).

[9] *Id.*, Criminal Minutes – General, Order Denying Mot. Dismiss (April 20, 2011) at 9. The five factors include:

- the entity provides a service to its citizens, frequently to the entire populace, of the jurisdiction;
- the key officers and directors of the entity are, or are appointed by, government officials;
- the entity is largely financed through governmental appropriations or tax, license or similar revenue;
- the entity is vested with and exercises exclusive or controlling power to administer its designated functions; and
- the entity is widely perceived and understood to be performing official functions.

[10] *Id.* at 14. "Although [the legislative history] does not demonstrate that Congress intended to include all state-owned corporations within the ambit of the FCPA, neither does it provide support for Defendants' insistence that Congress intended to *exclude* all such corporations from the ambit of the FCPA."

[11] Aruna Viswanatha, Lindsey Defendants Guilty on All Counts, May 10, 2011, http://www.mainjustice.com/justanticorruption/2011/05/10/breaking-lindsey-defendants-guilty-on-all-counts.

[12] *U.S. v. Carson, et al.*, No. 09-77 (C.D. Ca. 2009).

[13] "[T]he Government does not have a definition of 'instrumentality' that can withstand judicial scrutiny because, among other things, it is unable to say what would make one state-owned enterprise, but not another, an 'instrumentality' under the FCPA." *Id.*, Supplement to Defendants' Reply Brief at 2.

[14] *Id.*, Criminal Minutes – General, Order Denying Mot. Dismiss (May 18, 2011) at 12, citing *Nguyen* and *Esquenazi*, *supra* note 2. Judge Selna laid out his own set of relevant factors that substantially, though not perfectly, overlap with those set forth by Judge Matz in *Noriega*:

- the foreign state's characterization of the entity and its employees;
- the foreign state's degree of control over the entity;
- the purpose of the entity's activities;
- the entity's obligations and privileges under the foreign state's laws, including whether the entity exercises exclusive or controlling power to administer its designated functions;
- the circumstances surrounding the entity's creation; and
- the foreign state's extent of ownership of the entity, including the level of financial support by the state.

[15] *Id.* at 11.

[16] *Id.* at 7.

[17] *U.S. v. John Joseph O'Shea*, No. 09-cr-00629 (S.D. Tex. 2009).

[18] *U.S. v. Kozeny, et al.*, No. 05-cr-518 (S.D.N.Y. 2005). Defendant Frederick Bourke, whose business partner was accused of bribing government officials in Azerbaijan to privatize the country's oil industry, claimed not to have direct knowledge of the scheme. The government characterized this as "conscious avoidance" and ultimately won a ruling to instruct the jury that a finding that Bourke "consciously avoided" learning about the bribes was equivalent to guilt. A jury found him guilty of conspiracy to violate the FCPA and the Travel Act and one count of making false statements to the FBI. Bourke appealed his conviction on April 1, 2010.

[19] *U.S. v. David H. Mead & Frerik Pluimers*, Cr. No. 98-240-01, (D.N.J. 1998). David Meade, Executive Vice President and Chief Executive Officer of Saybolt North America, Inc., claimed that he was unaware that a $50,000 bribe to Panamanian officials was illegal as it originated from Saybolt's Dutch parent, Saybolt International. Mead was convicted of conspiracy to violate the FCPA's anti-bribery provisions.

[20] *U.S. v. David Kay & Douglas Murphy*, H-01-914-S (S.D.Tex. 2004). Former American Rice, Inc. Vice President David G. Kay was accused of bribing Haitian customs officials to underreport the amount of rice imported into Haiti, thus reducing import taxes, with the tacit consent of American Rice's management. Defendants argued that because the bribes were designed to lower taxes, not secure business, they fell outside the scope of the FCPA. The Fifth Circuit held that that "business nexus" test was met because the defendants believed that the payments were necessary to remain competitive. The court ultimately fined Kay and sentenced him to 37 months in prison.

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