

## *Appellate Court Clarifies FCPA “Instrumentality” Definition*

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On Friday, May 16, 2014, the Eleventh Circuit Court of Appeals weighed in on a multi-year debate surrounding who is a “foreign official” under the U.S. Foreign Corrupt Practices Act (“FCPA”). While litigants have challenged the government’s broad interpretation with mixed success before, this is the first time that an appellate court has provided guidance on the critical issue of the reach of the FCPA. The Eleventh Circuit used this opportunity to provide a definition of “instrumentality” under the FCPA and offer a non-exhaustive list of factors for the two-step analysis it set forth to define when employees of a state-owned entity would be considered public officials under the FCPA. In affirming the convictions of two defendants for violating the FCPA, the Eleventh Circuit generally agreed with the U.S. government’s position that an entity is an instrumentality of a foreign government if it is “controlled by the government of a foreign country” and “performs a function the controlling government treats as its own.”<sup>1</sup> While recognizing that this analysis is fact-specific, the court provided a list of factors to apply to each of the definition’s two parts.

Below we set forth the relevant FCPA legal background, discuss the case background and Eleventh Circuit’s analysis, consider the “instrumentality” definition and list of factors, and offer important takeaways from the decision.

### **Legal Background: “Instrumentality” and the FCPA**

As relevant to this analysis, 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 such domestic concern in obtaining or retaining business for or with, or directing business to, any person.”<sup>2</sup> The key issue in this case concerned the definition of a “foreign official,” which is defined in relevant part as “any officer or employee of a foreign government or any department, agency, or instrumentality thereof.”<sup>3</sup>

In enforcing the FCPA and issuing the Resource Guide to the FCPA,<sup>4</sup> the Department of Justice (“DOJ”) and Securities and Exchange Commission (“SEC”) had taken a broad view of the scope of what could be a foreign government “instrumentality,” including employees of state-owned entities as “foreign officials.”<sup>5</sup> At the time of the appeal in *Esquenazi*, only two other trial courts had set forth factors as to what constitutes an “instrumentality” of a foreign government to determine who is a “foreign official” under the statute. In *United States v. Noriega*, a district court identified five factors in

analyzing whether an entity constituted an “instrumentality” for purposes of the FCPA: 1) the entity provides a service to its citizens; 2) the key officers are appointed by government officials; 3) the entity is largely financed through government appropriations; 4) the entity is vested with controlling power; and 5) the entity is widely understood to be performing official functions.<sup>6</sup> One month later, another district court in a lengthy and well-reasoned opinion articulated six factors in considering the issue: 1) the government’s characterization of the entity; 2) the state’s degree of control; 3) the purpose of the entity’s activities; 4) the entity’s obligations under state law, including monopoly power; 5) the circumstances surrounding the entity’s creation; and 6) the state’s ownership interest, including any financial support.<sup>7</sup> No appellate court, however, had opined on the validity of those factors.

## Case Background

On October 25, 2011, Joel Esquenazi and Carlos Rodriguez, the former president and vice president of Terra Telecommunications Corp. (“Terra”), were sentenced for their roles in a scheme to bribe officials at a Haitian telecom company. After a jury trial, Esquenazi and Rodriguez were found guilty of seven counts of violating the FCPA, 12 counts of money laundering, one count of money laundering conspiracy and one count of conspiracy to violate the FCPA and commit wire fraud. Esquenazi was sentenced to 15 years — the longest sentence in FCPA history — and Rodriguez was sentenced to seven years.

Terra purchased phone time from foreign vendors and resold the minutes to customers in the United States. One of Terra’s main vendors was Telecommunications D’Haiti, S.A.M. (“Teleco”), a Haitian telecom company owned and controlled by the Haitian government. In 2001, Terra owed Teleco more than \$400,000, so Esquenazi negotiated an improper side payment to Teleco officials in order to reduce Terra’s debt, according to testimony at trial.<sup>8</sup> Esquenazi admitted during an investigation by the Internal Revenue Service that, over the next three years, he paid bribes to Teleco officials.<sup>9</sup>

The government presented evidence in order to demonstrate that Teleco was an “instrumentality” of the Haitian government. A former Teleco Director of International Relations testified that Teleco had been owned and controlled by Haiti since the 1970s.<sup>10</sup> An insurance broker testified that, during their negotiations with Teleco, Esquenazi and Rodriguez sought to purchase a type of political risk insurance that could only be purchased related to contracts with foreign governments.<sup>11</sup> An expert testified to the significant tax advantages and monopoly power conferred upon Teleco by the Haitian government.<sup>12</sup> The expert also testified that the Haitian President appointed all the Teleco board members.<sup>13</sup> The expert said there was no law that indicated that Teleco was a public entity but “everyone consider[ed] Teleco as a public administration.”<sup>14</sup> Based on this and other evidence admitted at trial, the jury convicted both defendants.<sup>15</sup>

After Esquenazi and Rodriguez were convicted, the government received a declaration by the Haitian Prime Minister that stated “Teleco has never been and until now is not a State enterprise.”<sup>16</sup> A later declaration by the Prime Minister clarified: “The only legal point that should stand out in this statement is that there exists no law specifically designating Teleco as a public institution.”<sup>17</sup> Based on this evidence, Esquenazi and Rodriguez moved for a new trial, which the district court denied.<sup>18</sup> Esquenazi and Rodriguez appealed, challenging primarily the definition of “instrumentality” used at trial.

## Challenges on Appeal

On appeal, Esquenazi and Rodriguez challenged the district court's "instrumentality" jury instructions, which listed five factors that the jury could consider to determine whether Teleco was an instrumentality of the Haitian government.<sup>19</sup> Esquenazi and Rodriguez argued that this instruction caused the jury to convict them based on the fact that Teleco was a government-owned entity, without considering whether the function was a government function.<sup>20</sup> In addition, Esquenazi and Rodriguez argued that there was insufficient evidence for the jury to determine that Teleco was an instrumentality of the Haitian government.<sup>21</sup>

## Eleventh Circuit Analysis

The Eleventh Circuit addressed each of these arguments and rejected all of the defendants' arguments (and others unrelated to the definition of instrumentality), affirming the convictions and setting forth a two-step analysis for determining whether an entity is an instrumentality of a foreign government, falling under the purview of the FCPA.

The court began its analysis of the "instrumentality" definition by looking to dictionary definitions and quickly rejected the defendants' argument "that only an actual part of the government would qualify as an instrumentality."<sup>22</sup> As the court explained, such a reading would be too "cramped" and would impede the "wide net over foreign bribery" Congress sought to cast in enacting the FCPA.<sup>23</sup> To expand its understanding, the court turned to an earlier case discussing an "instrumentality" under the American with Disabilities Act, from which it reasoned that "an entity must be under the control or dominion of the government to qualify as an 'instrumentality' within the FCPA's meaning."<sup>24</sup>

Noting that an instrumentality "must be doing the business of the government," the court sought to determine what constitutes the "business of the government."<sup>25</sup> Defendants had argued that entities providing commercial services or other services that would not be considered "core government functions" are not doing the business of the government and, therefore, are not instrumentalities.<sup>26</sup> The court looked at the text of the FCPA and its 1998 amendment and rejected the defendants' arguments.

First, the court identified that "commercial services" were specifically contemplated by the FCPA's statutory language. The court relied upon the statutory language describing the FCPA's facilitation payment exception, which defines "routine governmental action" as including, among other things, "providing phone service."<sup>27</sup> As the court explained, "[i]f an entity involved in providing phone service could never be a foreign official so as to fall under the FCPA's substantive prohibition, there would be no need to provide an express exclusion for payments to such an entity."<sup>28</sup> Therefore, the court rejected the defendants' argument seeking to exclude commercial services, saying: "that a government-controlled entity provides a commercial service does not automatically mean it is not an instrumentality."<sup>29</sup>

In examining what type of commercial services were contemplated under the FCPA, the court next focused on the FCPA's 1998 amendment, which was intended to meet the obligations created by the United States' ratification of the Organization for Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions ("OECD Convention").<sup>30</sup> To come into compliance with the OECD Convention, Congress modified the FCPA by adding only the phrase "public international organization" to the definition of "foreign official."<sup>31</sup> The court in *Esquenazi* therefore reasoned that in doing so, Congress determined that the FCPA's definition of "instrumentality" already included "public entities" as defined by the OECD, i.e.,

“any enterprise, regardless of its legal form, over which a government, or governments, may, directly or indirectly, exercise a dominant influence.”<sup>32</sup>

In addition, the court rejected the defendants’ argument that the definition of instrumentality is limited “only to entities that perform traditional, core government functions.”<sup>33</sup> Rather, the Court determined that the instrumentality analysis must consider whether the foreign government considers the “function” performed by the company as a “governmental function.” The court concluded that “the most objective way to make that decision is to examine the foreign sovereign’s actions, namely, whether it treats the function the foreign entity performs as its own.”<sup>34</sup>

## The Court’s Definition of Instrumentality

Based on that reasoning and the facts discussed, the Eleventh Circuit ruled that “Teleco would qualify as a Haitian instrumentality under almost any definition we could craft.”<sup>35</sup> However, of greater importance, the court provided clarification as to the criteria for determining, under the facts of each individual circumstance, whether an entity constitutes an “instrumentality”, that will provide guidance for enforcement agencies, businesses and other courts.<sup>36</sup> The court provided a two-part definition, stating that an “instrumentality” is an entity (1) “controlled by the government of a foreign country” that (2) “performs a function the controlling government treats as its own.”<sup>37</sup>

As further guidance, the court provided a list of non-exhaustive factors for each part of the instrumentality analysis. For the first part, analyzing whether a government controls an entity, the court stated that:

*courts and juries should look to [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 [finances], and, by the same token, [5] the extent to which the government funds the entity if it fails to break even; and [6] the length of time these indicia have existed.*<sup>38</sup>

Second, to decide whether the entity performs a function the government treats as its own, the Eleventh Circuit stated that:

*Courts and juries should examine [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.*<sup>39</sup>

The court noted that it did not create these factors anew; rather the factors found support in Supreme Court precedent and guidance from the OECD Convention.<sup>40</sup>

## Takeaways

This decision is the first appellate court opinion to address challenges to the DOJ’s and SEC’s interpretation of “instrumentality” which in many ways have defined the reach of the FCPA. As such, this court’s definitive opinion would appear to curtail the on-going debate over what constitutes a government instrumentality and whether improper payments to state-owned entities could be a violation of the FCPA. Businesses have struggled over the extent to which they should treat employees of state-owned entities as public officials. While this decision provides some clarity as to the factors to consider, it is far from the bright line rule that businesses have been seeking in crafting their

compliance programs and struggling with the challenges of operating in the international business environment. In this decision, the Eleventh Circuit provided additional factors beyond those proposed by the enforcement agencies and those that this trial court and other trial courts had used in examining the issues at the trial level. The Eleventh Circuit, however, found no need to elaborate on the application of those factors to the matter at issue, and therefore, this opinion provides little guidance to companies seeking certainty. Moreover, the court did not even discuss the relative weight of the factors, for example, whether majority ownership may be of greater importance than the formal designation of the entity. Rather, the court noted that it believed “Teleco would qualify as a Haitian instrumentality under almost any definition we could craft.”<sup>41</sup>

The court thought it would be “easy to decide what functions a government treats as its own” based on objective factors like control, exclusivity, governmental authority to hire and fire, subsidization, and whether an entity’s finances are treated as part of the public’s finances. The court added its view that both courts and businesses “have readily at hand the tools to conduct that inquiry.”<sup>42</sup> Businesses, however, have found that, not only is gathering that type of information both time consuming and expensive, but also it is often difficult to determine the level of actual control a government has over a facially commercial operation.

The court also avoided opining on the factors with greater specificity by noting that the FCPA “contains a mechanism by which the Attorney General can render opinions on requests about what foreign entities constitute instrumentalities.”<sup>43</sup> Taking heed of this instruction, under appropriate circumstances, companies should consider using this FCPA Opinion Procedure to gain further guidance from the Department of Justice over what factors are most important in determining the status of a state-owned entity — a process that relatively few companies have taken advantage of during the decades of its existence. This decision, however, ultimately leaves the burden with companies to determine who exactly is a foreign public official by trying to discern ownership and control, often in jurisdictions that lack transparency and sufficient, objective sources of information.

Consequently, it is advisable for companies to review their current compliance policies to ensure that they address the factors laid out by the Eleventh Circuit. Anti-corruption training procedures must ensure that employees recognize that the FCPA covers interactions with a wide variety of state-owned entities. In addition, businesses must evaluate their anti-corruption policies and procedures, whether due diligence or meals and entertainment policies, so that they address all of the factors discussed in this opinion. Companies must take proactive steps to research and review the third parties with whom they currently conduct business in order to understand whether an entity might be considered an instrumentality based on the factors expressed by the Eleventh Circuit. Companies should pay special attention to third parties that interact with state-owned entities that meet some but not all of the *Esquenazi* factors, and seek additional guidance or establish additional risk-based protections for interactions with such companies.

In light of this appellate decision, enforcement agencies can be expected to view the legal wrangling over the definition of “instrumentality” as resolved. Companies can take little comfort in considering this an open area of law as courts may have little patience for further challenges to the definition of “instrumentality.” While future litigants may be able to tinker at the margins of the definition, the *Esquenazi* decision has made clear that the definition of “instrumentality” is broad enough that the FCPA prohibits bribes paid to certain state-owned entities. In the years to come, businesses will look for further guidance from the courts or through future DOJ Opinion Procedure releases on where exactly that line is drawn.





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<sup>1</sup> *United States v. Esquenazi*, No. 11-15331 (11th Cir. May 16, 2014).

<sup>2</sup> 15 U.S.C. §§ 78dd-2(a)(1), (3).

<sup>3</sup> *Id.* § 78dd-2(h)(2)(A) (emphasis added).

- <sup>4</sup> A *Resource Guide on the U.S. Foreign Corrupt Practices Act*, (2012) ("FCPA Guide"), available at <http://www.justice.gov/criminal/fraud/fcpa/guide.pdf>.
- <sup>5</sup> FCPA Guide at 20.
- <sup>6</sup> Minutes in Chamber Order at 9, *United States v. Noriega*, 2:10-cr-01031-AHM (C.D. Cal. Apr. 20, 2011).
- <sup>7</sup> *United States v. Carson*, No. 09-77, 2011 WL 5101701 at \*3-4 (C.D. Cal. May 18, 2011).
- <sup>8</sup> *Esquenazi*, at 5.
- <sup>9</sup> *Id.* at 6-8.
- <sup>10</sup> *Id.* at 3-4.
- <sup>11</sup> *Id.* at 3.
- <sup>12</sup> *Id.*
- <sup>13</sup> *Id.* at 4.
- <sup>14</sup> *Id.* at 4 (alteration in original).
- <sup>15</sup> *Id.* at 7-8.
- <sup>16</sup> *Id.* at 8.
- <sup>17</sup> *Id.*
- <sup>18</sup> *Id.* The district court found that the evidence did not qualify as *Brady* material and that no evidentiary hearing or further discovery related to the declaration was warranted. Order Denying Defendants' Motion for Judgment of Acquittal or New Trial, *United States v. Esquenazi*, No. 1:09-cr-2101 (S.D. Fl. Oct. 14, 2011)
- <sup>19</sup> *Esquenazi*, at 24-25. Esquenazi and Rodriguez made several other arguments not relevant here.
- <sup>20</sup> *Id.*
- <sup>21</sup> *Id.* at 27.
- <sup>22</sup> *Id.* at 11 (emphasis in original).
- <sup>23</sup> *Id.* at 11 (quoting *United States v. Kay*, 359 F.3d 738, 749 (5th Cir. 2004)).
- <sup>24</sup> *Id.* at 13.
- <sup>25</sup> *Id.*
- <sup>26</sup> *Id.*, at 14, 18.
- <sup>27</sup> *Id.* at 14 (quoting 15 U.S.C. § 78dd-2(h)(4)(A)).
- <sup>28</sup> *Esquenazi*, at 14.
- <sup>29</sup> *Id.* at 14.
- <sup>30</sup> Dec. 17, 1997, 37 I.L.M. 1 (ratified Dec. 8, 1998, entered into force Feb. 15, 1999). The OECD Convention requires its parties to criminalize the bribery of foreign public officials in international business transactions. See FCPA Guide, at 7.
- <sup>31</sup> *Esquenazi*, at 16 (citing Pub. L. No. 105-366, 112 Stat. 3302).
- <sup>32</sup> *Esquenazi*, at 15-17 (citing OECD Convention at art. 1.4, cmt.14). The OECD commentary further states: "An official of a public enterprise shall be deemed to perform a public function unless the enterprise operates 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." *Esquenazi*, at 15-16 (citing OECD Convention at art. 1.4, cmt.15).
- <sup>33</sup> *Esquenazi*, at 18-20.
- <sup>34</sup> *Id.* at 19 (emphasis in original).
- <sup>35</sup> *Id.* at 20.
- <sup>36</sup> *Id.* at 20.
- <sup>37</sup> *Id.*
- <sup>38</sup> *Id.* at 21.
- <sup>39</sup> *Id.* at 22-23.
- <sup>40</sup> *Id.* at 21-24.
- <sup>41</sup> *Id.* at 20.
- <sup>42</sup> *Id.* at 19-20 n.8.

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<sup>43</sup> *Id.* at 19-20 n.8. The Department of Justice opinion procedure allows parties to submit information to DOJ, after which DOJ issues an opinion about whether the proposed conduct falls within its enforcement policy. See FCPA Guide at 86-87.