Legal Backgrounder

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WHAT IS A "FOREIGN OFFICIAL"?: VAGUE TERM COMPLICATES CORRUPT PRACTICES ACT COMPLIANCE

by
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The Foreign Corrupt Practices Act of 1977, 15 U.S.C. §§ 78dd-l, *et seq*. ("FCPA"), prohibits certain individuals and entities from corruptly paying *foreign officials* to assist in obtaining or retaining business. In the FCPA, Congress not only criminalized bribing foreign officials, but it included a companion provision focused on internal accounting controls which generally makes it a civil offense to cause an entity subject to the SEC's reporting obligations not to keep accurate books and records. *See* 15 U.S.C. § 78m(5) ("No person shall knowingly circumvent or knowingly fail to implement a system of internal accounting controls or knowingly falsify any book, record, or account described in paragraph").

The threat of enforcement actions being pursued against companies and individuals for violating the FCPA has dramatically increased for various reasons, which include more aggressive use of the law by its enforcers (the U.S. Department of Justice [DOJ] and the Securities and Exchange Commission [SEC], the globalization of business markets, and a sea-change in attitudes of officials in most developed countries about the importance of rooting out corruption. This LEGAL BACKGROUNDER focuses on a hot issue in FCPA enforcement now that foreign-owned entities are increasingly targeted in enforcement proceedings—namely, what constitutes a foreign official? The issue has received considerable attention from commentators, and now courts, for various reasons that will be discussed.

Background. Since literally *thousands* of federal criminal laws are scattered in various statutes and implementing regulations, which measures often are complex reading even for trained lawyers, it seems counter-intuitive for courts to continue presuming that the public is familiar with these laws and what they proscribe, and therefore will comply with their requirements or face the consequences of not doing so. Some laws, including the FCPA, are rightfully criticized for insufficiently describing what is or isn't permissible behavior. When such laws are used to impose heavy sanctions, we should be concerned about fundamental fairness. Our Constitution requires penal laws to provide clear lines that let us distinguish between conduct that is permissible from that which is actionable: "The Fifth Amendment . . . recognizes this difference by seeking to ensure that defendants are alerted to the precise nature of conduct that triggers criminal punishment. Although vague laws are always a concern, they are particularly problematic when they result in jail terms." Statement of Larry E. Ribstein, University of Illinois College of Law, Senate Committee on the Judiciary Hearing on "Wall Street and Fiduciary Duties: Can Jail Time Serve as an Adequate Deterrent for Willful Violations" (May 4, 2010).

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The author of a recent, provocative article suggests that the proliferation of vague penal laws coincides with the acceptance of plea bargaining by courts as a tool for managing their dockets: "Despite the ever-growing number of Americans captured by the criminal justice system through an increasingly wide application of novel legal theories and overly-broad statutes, these theories and statutes are seldom tested. No one is left to challenge their application—everyone has pleaded guilty instead." Lucian E. Dervan, *Overcriminalization 2.0: The Symbiotic Relationship Between Plea Bargaining and Overcriminalization*, J. OF LAW, ECON. & POLICY, Vol. 7, No. 4, 2011. His observations aptly describe the FCPA and how it is being enforced.

The FCPA is criticized for its lack of clarity, particularly in light of the heavy sanctions being imposed for violating its proscriptions and the steep costs borne by businesses that must continually upgrade compliance and oversight mechanisms to avoid inadvertent violations. *See, e.g.*, James R. Doty, *Toward a Reg. FCPA: A Modest Proposal or Change in Administering the Foreign Corrupt Practices Act*, 62 BUS. LAW. 1233, 1238-39 (2007) ("vagueness and ambiguity are the DNA of the FCPA"). Against this backdrop, the issue of what or who is a foreign official is next addressed.

What or Who Is a Foreign Official? The FCPA defines a *foreign official* as "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." 15 U.S.C. § 78dd-2(h)(2)(A) (emphasis added). As can be seen, this broad definition includes critical terms of art, including the term *instrumentality*, which is not defined.

The DOJ and SEC broadly interpret the term *instrumentality* to mean not only heads of state, or persons holding official titles, but also individuals working for *private* businesses that are government-owned or government-controlled, not taking into account their rank or title. Notably, the agencies take this position even though the FCPA doesn't "explicitly include employees of state-owned or controlled companies." Joel M. Cohen, et al., *Under the FCPA, Who is a Foreign Official Anyway*?, 63 BUS. LAW. 1243, 1249 (2008).

In advancing its views in FCPA litigation, the government generally has prevailed, and has even secured large settlement agreements in cases where the foreign state lacked controlling ownership of the entity involved in the alleged wrongdoing. See, for example, *United States v. Alcatel-Lucent SA*, No. 1:10-cr-20906 (S.D. Fla. Dec. 27, 2010), a case in which "the SEC and DOJ charged that Telekom Malaysia Berhad (TM) was a state-owned and controlled telecommunications provider because the Malaysian Ministry of Finance owned approximately 43 percent of TM's shares, had veto power over all major expenditures, and made important operational decisions." Mike Koehler, *Foreign Corrupt Practices Act Enforcement in 2010: Big, Bold, and Bizarre*, 6 WCR 166, Feb. 25, 2011.

Practically speaking, in determining if conduct falls within the FCPA "the percentage of ownership is just one of several factors that the government will consider"; enforcers will also look at "the foreign state's own characterization of the enterprise and its employees, i.e., whether it prohibits and prosecutes bribery of the enterprise's employees as public corruption, the purpose of the enterprise, and the degree of control exercised over the enterprise by the foreign government." O'Melveny & Myers, FOREIGN CORRUPT PRACTICES ACT HANDBOOK (6th ed.), at 19 (citing United States, Review of the Implementation of the [OECD] Convention and 1997 Recommendation at 6).

In the pending *United States v. Carson* prosecution, 8:09-cr-00077-JVS (C.D. Cal.), the defense unsuccessfully challenged the foreign official issue in a motion to dismiss. In denying the motion to dismiss, the trial judge held that the issue was a question of *fact*, not law, and set out the following as a non-exclusive list of characteristics of government agencies that meet the description of an *instrumentality*:

- The entity provides a service to the citizens . . . of the jurisdiction;
- The key officers and directors of the entity are, or are appointed by, government officials;
- The entity is financed, at least in large measure, through governmental appropriations or through revenues obtained as a result of government-mandated taxes, licenses, fees or royalties . . .;
- 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 (i.e., governmental) functions].

See Judge Selna Concludes 'The Question of Whether State-Owned Companies Qualify as Instrumentalities Under the FCPA is a Question of Fact', FCPA PROFESSOR: A FORUM DEVOTED TO THE FOREIGN CORRUPT PRACTICES ACT (May 19, 2011) (summarizing Order Denying Defendants' Motion to Dismiss Counts 1 through 10 of the Indictment).

For various reasons, the U.S. government's successful FCPA enforcement track record isn't remarkable. For one thing, businesses that face an FCPA action and the related threats accompanying it (such as negative press, follow-on litigation, and possible suspension and debarment) really have no choice but to settle on the best terms they can negotiate. As a result, few courts have had opportunities to decide if the government's theories of FCPA liability pass legal muster. This phenomena has been aptly labeled *prosecutorial common law* (*See* Michael Levy, *Prosecutorial Common Law*, Guest Blog for the "FCPA Professor" (Mar. 16, 2011)) in recognition of the facts that putative *corporate* defendants likely won't challenge the government and most *individual* defendants don't have the finances and fortitude to put the government to the test in court.

Challenges to the Government's Expansive Theory. Somewhat surprisingly, in this past year the legitimacy of the government's interpretation of the term *instrumentality* for FCPA purposes was brought to the forefront by defendants in three FCPA prosecutions. Fortunately, the issues also were well briefed and supported. *See* (1) *United States v. Lindsey Manufacturing*, styled *United States v. Noriega et al*, 2:10-cr-01031-AHM (C.D. Cal.); (2) *United States v. Carson*, 8:09-cr-00077-JVS (C.D. Cal.); and (3) *United States v. O'Shea*, 4:09-cr-00629 (S.D. Tex.).

Although the core issue of what constitutes a foreign official under the FCPA may seem to be somewhat semantic or arcane, as one commentator observes, the "[defendants'] logic is easy to follow. Congress passed the FCPA in 1977 with a clear intent to address foreign bribery of government officials. *The FCPA was not designed to prohibit private, or commercial bribery*." Michael Volkov, '*What is an Instrumentality Thereof'? Let's Keep it Real*, The FCPA Blog, Mar. 9, 2001. (Emphasis added). By comparison, the recently enacted UK Bribery Act *is* designed to prohibit commercial bribery, which is something that should gravely concern multinational companies and their employees who conduct any business there.

As mentioned above, the defendants and the government have argued in competing pleadings about why the dictionary meaning of the term *instrumentalities*—when used with other tools that courts regularly employ to resolve such questions, such as canons of statutory construction, constitutional avoidance doctrines, and analogous published cases—supports their respective positions about the meaning of the term *foreign official* in the FCPA, and whether it should include employees of private companies in which a foreign government has an interest. In addition to these technical legal arguments, the parties have tried to advance common sense arguments to support their positions.

For example, in the Lindsey Manufacturing case, the defendants argued that the flaws in the government's theory are illustrated by considering the absurd results that its use will inevitably lead to,

noting that "[i]f it were true that state owned corporations were contemplated by the FCPA then some U.S. Citizens, living and working in the U.S., but employed by foreign state owned corporations, such as CITGO, would qualify as 'foreign officials.'" [*Lindsey Manufacturing Defendants']Motion to Dismiss the First Superseding Indictment*, at p. 20, No. 2:10-cr-01031-AHM (C.D. Cal., filed Feb. 28, 2011). Not so (or least not in these cases) replied the government, pointing out the following (among other facts) it would prove in the *Lindsey Manufacturing* case:

> The [First Superseding Indictment] alleges that "Comisión Federal de Electricidad ('CFE') was an electric utility company owned by the government of Mexico" that, at the time "was responsible for supplying electricity to all of Mexico other than Mexico City." FSI ¶ 3. The FSI further alleges that "Official 1 [Nestor Moreno] was a Mexican citizen who held a senior level position at CFE" and "became the Sub-Director of Generation for CFE in 2002 and the Director of Operations in 2007." FSI ¶ 4.
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> Under the Mexican Constitution, the supply of electricity is solely a government function. (Exhibit C) (Mexican Constitution, translated by the Organization of American States). Specifically, Article 27 provides:
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> > It is exclusively a function of the general Nation to conduct, transform, distribute, and supply electric power which is to be used for public service. No concessions for this purpose will be granted to private persons and the Nation will make use of the property and natural resources which are required for these ends.

Government's Opposition to Defendants' Motion to Dismiss the First Superseding Indictment; Memorandum of Points and Authorities; Exhibits, at 2-3.

Although the Lindsey defendants were convicted after a five-week trial, they have sought a new trial alleging prosecutorial misconduct. *See Busy Times in Three Key FCPA Cases: Lindsey Manufacturing, Carson and the "Sting" Case*. The Carson and O'Shea cases are each set to be tried in 2012.

The Government's Expansive Interpretations of the FCPA Remain. While the regulated community may not like the government's aggressive interpretations of the FCPA, unless and until the courts or Congress take action to change this from happening, the practical reality is that companies and individuals ignore this at their peril.