Factors to Use in a Foreign Government Instrumentality Analysis under the FCPA

In a guest post on this Blogsite yesterday, my colleague Michael Volkov, criticized the two district courts which have passed on the question of whether a state owned enterprise (SOE) can be an "instrumentality thereof" under the Foreign Corrupt Practices Act (FCPA). The two cases were the Lindsey Manufacturing case and the Carson case. Volkov stated, "*By deciding these cases using fact specific standards, the courts have failed to clarify this issue by adopting a more focused and simple inquiry. Unfortunately, the courts have now obscured even more the application of the FCPA*." No doubt inspired by my "This Week in the FCPA" partner, Howard Sklar, I will take a contrarian view from Mike.

I. The Defendants' Claims

The issue was presented as starkly as possible to both courts. The defendants in both cases argued that employees of state-owned enterprises could never be 'foreign officials' under the FCPA. The defendants made five general arguments, which were

First, in the absence of an express definition, the Court must give the term its ordinary meaning as used in the statute. As used in the FCPA, the term "instrumentality" refers to a governmental unit or subdivision that is akin to a "department" or an "agency," the two terms that precede it in the statute.

Second, the Government's proposed interpretation would lead to absurd results. Among other things, if it were adopted, the Government's definition would transform persons no one would consider to be foreign government employees – specifically citing the example of employees of the US company CITGO, because it is owned by the Venezuelan national oil company PDVSA.

Third, the extensive legislative history of the FCPA makes clear that Congress did not intend the statute to cover payments made to employees of state-owned business enterprises. Rather, the FCPA was aimed at preventing the special harm posed by the bribery of foreign government officials.

Fourth, as other statutes and proposed legislation make clear, Congress knows how to define the term "instrumentality" in terms of government ownership of a commercial enterprise where it desires to do so. But it did not do so in the FCPA.

Fifth, in construing statutes, courts should avoid interpretations resulting in unconstitutional vagueness. Adopting the Government's amorphous and expansive interpretation of "instrumentality" here would result in exactly the type of unconstitutional vagueness that must be avoided.

But courts made quick and direct refutations of the defendants' points 2-5. The major guidance provided by courts was in creating an inquiry to define the term instrumentality in response to defendants' Point 1. We therefore turn to the respective courts holdings on what factors should go into an analysis to determine if a state-owned enterprise is a foreign government instrumentality under the FCPA.

II. Court Ruling in Lindsey Manufacturing

The court in Lindsey Manufacturing responded to the defendants' claims by pointing to various characteristics of foreign government 'instrumentalities' that would provide coverage under the FCPA. The court listed five non-exclusive factors:

- The entity provides a service to its citizens, in many cases to all the inhabitants of the country.
- The key officers and directors of the entity are government officials 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, such as entrance fees to a national park.
- The entity is vested with and exercises exclusive or controlling power to administer its designated functions.
- The entity is widely perceived and understood to be performing official functions.

In Lindsey Manufacturing the foreign governmental entity at issue was the Mexican national electric company CFE. The trial court found that the entity had all of the characteristics listed in the five non-exclusive factors. It was created as a public entity; its governing Board consisted of high ranking government officials; CFE described itself as a government agency and it performed a function that the Mexican government itself said was a government function, the delivery of electricity. (I would also note that the US entity CITGO does not meet this test, so much for the absurd result prong.)

III. The Carson Case

In the Carson case, the court denied the "foreign official" challenge ruling that "the question of whether state-owned companies qualify as instrumentalities under the FCPA is a question of fact." The court cited the following factual inquiries to determine whether a business entity constitutes a government instrumentality" including (1) The foreign state's characterization of the entity and its employees; (2) The foreign state's degree of control over the entity; (3) The purpose of the entity's activities; (4) The entity's obligations and privileges under the foreign state's law, including whether the entity exercises exclusive or controlling power to administer its designated functions; (5) The circumstances surrounding the entity's creation; and (6) The foreign state's extent of ownership of the entity, including the level of financial support by the

state (e.g., subsidies, special tax treatment, and loans). The Court specifically noted that the factors were non-exclusive and no single factor is dispositive. Later in its opinion the court added additional guidance with the following, "*Admittedly, a mere monetary investment in a business by the government may not be sufficient to transform the entity into a government instrumentality. But when a monetary investment is combined with additional factors that objectively indicate that the entity is being used as an instrumentality to carry out governmental objectives, that business entity would qualify as a governmental instrumentality*." Lastly, as it is a factual inquiry, the question will go to the jury.

IV. Conclusion

I do not find these factors set out by either court obscure or vague. I believe that both courts provided guidance to the compliance practitioner in the form of a guideline or checklist that can be used to determine if a counter-party has these characteristics of a foreign government instrumentality. In fact, these are factors (or ones similar as they are non-exclusive) that a compliance officer should have been using to make a determination of a counter-party's status even before these cases came down the pike. With CFE, the decision seems very straight forward. In the Carson case, there were several entities which had employees to which bribes were paid. These entities included CNOOC, PetroChina, China Petroleum Material and Equipment Corp., National Petroleum Construction Corp., Dongfang Electric Corp., Gouohua Electric Power and Petronas. Some of these companies clearly meet the Carson test, some may take additional research. The moniker "Know Your Customer (KYC)" is one that is well known in marketing circles and should becoming equally as well known in the compliance arena.

Mike and I hope to post several point-counter-point blogs over the next couple of weeks setting out our respective positions on other issues. I hope that you will find them both enjoyable and informative.