# WSGR ALERT

JUNE 2011

# DEFENSE CHALLENGES TO FOREIGN CORRUPT PRACTICES ACT CHARGES PROVE UNSUCCESSFUL

## *Courts Reject Defense That Recipients of Alleged Improper Payments Are Not "Foreign Officials" Under the FCPA*

Two U.S. district courts in Southern California recently rejected defense challenges that might have narrowed the applicability of the Foreign Corrupt Practices Act (FCPA). Both courts rejected arguments that the intended recipients of the alleged bribes—employees of foreign, state-owned enterprises—were not "foreign officials" under the FCPA. These rulings mark the first time that trial courts have set forth factors to be used in identifying the circumstances in which a state-owned enterprise will be considered an instrumentality of a foreign government for purposes of the FCPA.

The FCPA prohibits corrupt offers or payments to foreign officials for the purpose of obtaining or retaining business, or for the purpose of directing business to anyone. Other U.S. statutes prohibit commercial bribery regardless of the recipient's status.

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.*[1]

The defendants in the recent cases argued that the foreign, state-owned corporations that employed the bribe recipients were not "instrumentalities" of their governments, and therefore their employees were not foreign officials. In rejecting these arguments, each court set forth various factors that may determine whether the entity is an instrumentality of the foreign state for purposes of the FCPA.

### *Lindsay Manufacturing Co. (United States v. Aguilar)*

In *Lindsey Manufacturing Co.* (*United States v. Aguilar*), two executives, a Mexican intermediary, and the company, a manufacturer of equipment used by electric utilities, were convicted after a jury trial in connection with a scheme to pay bribes to officials at the *Comisión Federal de Electricidad* (CFE), a Mexican government-owned utility.[2] Before the trial, all four defendants unsuccessfully moved to dismiss the FCPA charges against them on the grounds that the CFE employees were not foreign officials.

Judge A. Howard Matz denied the defendants' motion on the basis that "a state-owned corporation having the attributes of the CFE (the bribe recipients' employer) may be an 'instrumentality' of a foreign government within the meaning of the FCPA." Judge Matz rejected the defendants' request for a categorical ruling that, as a matter of law, no state-owned entity can be an instrumentality and therefore none of its employees can be foreign officials under the FCPA. The court also rejected the defendants' contention that the plain meaning of the term "instrumentality" does not encompass state-

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[1] 15 U.S.C. §§ 78dd-(f)(1)(A), 78dd-2(h)(2)(A), 78dd-3(f)(2)(A).

[2] See *United States v. Aguilar*, No. 10-01031-AHM (C.D. Cal.) (Lindsey Manufacturing Co.); see also the U.S. Department of Justice (DOJ) press release at http://www.justice.gov/opa/pr/2011/May/11-crm-596.html (announcing on May 10, 2011, that Lindsey Manufacturing, two executives, and an intermediary were convicted on all counts in connection with a scheme to pay bribes to CFE officials; the jury reached its verdict after one day of deliberations following a five-week trial).

In another case, *United States v. John Joseph O'Shea*, No. 09-00629 (S.D. Tex. 2009), the defendant filed a similar motion on the grounds that the government incorrectly described the CFE, the same Mexican state-owned electricity distribution enterprise cited in *Aguilar*, as a *per se* "department, agency and instrumentality of a foreign government" and its officers and employees as "foreign officials." The district court has not yet ruled on the motion; a hearing was scheduled for May 31, 2011. See *O'Shea*, No. 09-00629 (S.D. Tex), Doc. Nos. 47, 50 and 58; see also the DOJ press release at http://www.justice.gov/opa/pr/2009/November/09-crm-1265.html (announcing on November 23, 2009, the arrest and indictment of O'Shea, the former general manager of a Texas company that was later acquired by and became a subsidiary of a Swiss company (ABB), who allegedly participated in a scheme to bribe CFE officials).

In two earlier cases, the courts summarily dismissed similar motions without discussing their reasoning. See *United States* v. *Nguyen*, No. 08-00522 (E.D. Pa. Dec. 30, 2009); *United States v. Esquenazi*, No. 09-21010 (S.D. Fla. Nov. 19, 2010).

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owned corporations. Rejecting the defendants' all-or-nothing approach, the court found that contrary to the defendants' claim that state-owned corporations can never be instrumentalities of foreign governments because they "'do not always' share the characteristics of departments and agencies," the court determined that such entities can be instrumentalities because they can sometimes share the characteristics of departments and agencies.

The court set forth five non-exclusive factors that, if present, indicate that an entity may sufficiently resemble a government department or agency to be considered an instrumentality under the FCPA:

- The entity provides a service to the citizens.
- 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, 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 (i.e., governmental) functions.[3]

Because the CFE exhibited these characteristics, the court denied the defendants' motion.[4]

***Control Components, Inc. (United States v. Carson)***

On July 31, 2009, Control Components (CCI) pleaded guilty to violating the FCPA and the Travel Act by paying bribes totaling approximately $4.9 million to officials of foreign, state-owned companies and $1.95 million to officers and employees of foreign and domestic privately owned companies in 36 countries, by which it earned approximately $46.5 million in net profits. Two former CCI executives pleaded guilty to conspiring to bribe officers and employees of foreign, state-owned companies on behalf of CCI.[5]

Four additional former CCI executives moved to dismiss the FCPA-related charges on the grounds that employees of state-owned companies in Korea, China, Malaysia, and the United Arab Emirates were not foreign officials. On May 18, 2011, Judge James V. Selna denied the motion.[6]

Judge Selna rejected the defendants' arguments that, among other things, no employee of a state-owned corporation—regardless of the corporation's functions or characteristics—could be a "foreign official." The court set forth a six-factor test to consider, none of which were dispositive or controlling.[7] They include:

- 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 law, 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 (e.g., subsidies, special tax treatment, and loans).

In denying the defendants' motion, the court held that whether or not the employees of the state-owned entity were foreign officials was a question of fact for the jury to decide. The court therefore left open the possibility that, if the evidence presented at trial did not establish the six factors, the court would consider a renewed motion by the defense.

**Whether a State-Owned Corporation Is an "Instrumentality" and its Employees Are "Foreign Officials" Will Be Determined by the Facts of Each Case**

In each of the above cases, the court set forth a series of factors to be considered in determining whether or not a particular state-owned entity is an instrumentality of the foreign state. Regardless of the specific test used, the definition will be determined by the specific facts of the case.

In other cases—perhaps where the foreign government lacks a controlling interest in the entity or the enterprise's functions are substantially commercial—a future court may find that the enterprise was not an instrumentality and its employees were not foreign officials. In such cases, however, U.S. prosecutors may bring charges under other

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[3] *Aguilar*, No. 10-01031-AHM, Doc. No. 474, filed 4/20/11, at 9.

[4] See *Aguilar*, No. 10-01031-AHM, Doc. No. 474 at 9-10.

[5] See *United States v. Carson*, No. 09-00077-JVS (C.D. Cal.); see also the DOJ press release at http://www.justice.gov/opa/pr/2009/July/09-crm-754.html (announcing on July 31, 2009, a guilty plea by Control Components Inc. to a decade-long scheme to obtain business by paying bribes in 36 countries); *United States v. Control Components, Inc.*, No. 09-cr-00162-JVS (C.D. Cal.), Criminal Information, available at http://www.justice.gov/criminal/fraud/fcpa/cases/control-inc/07-22-09cci-info.pdf.

[6] *Carson*, No. 09-00077-JVS, Doc. No. 373. The trial of the four remaining individual defendants in *Carson* has not yet taken place.

[7] *Carson*, No. 09-00077-JVS, Doc. No. 373 at 5.

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statutes (such as Mail and Wire Fraud, 18 U.S.C. §§ 1341, 1343; the Travel Act, 18 U.S.C. § 1952, which prohibits bribery in interstate or foreign commerce based on state law violations; and a variety of state laws prohibiting commercial bribery).[8] Moreover, foreign prosecutors may bring charges under their own laws, some of which (for example, the UK Bribery Act) also prohibit bribery in strictly commercial transactions.

To avoid risk, companies must continue to implement, evaluate, and enhance their compliance programs. A robust and effective compliance program will continue to be key in preventing and, if necessary, remediating improper offers and payments in connection with foreign business transactions.

For more information, or if you have questions about the Foreign Corrupt Practices Act, please contact Leo Cunningham (lcunningham@wsgr.com), Robert Gold (rgold@wsgr.com), Elizabeth Peterson (epeterson@wsgr.com), Mark Rosman (mrosman@wsgr.com), Steven Schatz (sschatz@wsgr.com), Bahram Seyedin-Noor (bnoor@wsgr.com), or Michael Sommer (msommer@wsgr.com) in Wilson Sonsini Goodrich & Rosati's white collar criminal defense practice.

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[8] See e.g., *Carson*, No. 09-00077-JVS, Doc. No. 1, filed April 8, 2009; *United States v. SSI Int'l Far East, Ltd.*, No. 06-cr-398 (D. Ore. 2006) (a subsidiary of Schnitzer Steel paid bribes and kickbacks to personnel at a privately owned scrap-metal purchaser in South Korea, and privately and government-owned purchasers in China; the case was charged under the FCPA and the Travel Act).

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650 Page Mill Road
Palo Alto, CA 94304-1050
Tel: (650) 493-9300 Fax: (650) 493-6811
email: wsgr_resource@wsgr.com

www.wsgr.com