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May 9, 2011

Court Issues Significant Guidance Concerning When State-Owned Corporations May Constitute Foreign Government "Instrumentalities" Under FCPA

On April 20, 2011, a federal district judge in California issued a rare and significant decision on the question of who is a "foreign official" within the meaning of the Foreign Corrupt Practices Act (FCPA). The decision, issued in the case of *U.S. v. Noriega*, provides important guidance on a dispositive FCPA question for companies in many different industries, particularly those whose customers include corporations that are wholly or partially controlled by foreign governments – such as state-owned hospitals, oil companies and banks.

The FCPA, among other things, prohibits giving, offering or promising anything of value to a foreign official in order to obtain or retain business or to secure an improper business advantage. The statute defines "foreign official" to include "any officer or employee of a foreign government or any department, agency, or instrumentality thereof." Both the Department of Justice (DOJ) and the Securities and Exchange Commission, which share enforcement authority under the FCPA, have long considered government-owned corporations to be "instrumentalities" of the government for FCPA purposes, and their employees therefore to be "foreign officials." Because most FCPA cases are settled without any contested litigation on the merits, the government's position has gone largely unchallenged in the courts.

In *U.S. v. Noriega*, the DOJ charged Lindsey Manufacturing Company, two of its executives, and two of its agents with violating the FCPA in an alleged conspiracy to bribe officials at the Comisión Federal de Electricidad (CFE), an electric utility company that is wholly owned by the Mexican government. A key factual predicate for the indictment was DOJ's assertion that CFE is an "instrumentality" of the Mexican government, rendering all of its officers and employees "foreign officials" under the FCPA.

In moving to dismiss the charges, the defendants directly challenged the government's longstanding position that state-owned corporations are "instrumentalities" of foreign governments under the FCPA. They claimed that because the FCPA does not define the term "instrumentality," the

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ordinary meaning of the word should prevail, which would not include state-owned corporations. The defendants also asserted that the legislative history and purpose of the FCPA do not support the government's view that state-owned corporations fall within the parameters of the FCPA.[1] Finally, the defendants claimed that the government's position gives rise to "absurd results," and that, if the term "foreign official" does include state-owned corporations, the statute is unconstitutionally vague.

The DOJ countered that the defendants' argument was premature, that the plain language of the term government "instrumentality" includes state-owned entities and is consistent with the legislative history of the FCPA, and that the defendants misapplied the legal standard governing the void-for-vagueness doctrine.

On April 1, 2011, U.S. District Judge A. Howard Matz of the Central District of California issued an oral ruling denying the defendants' motion to dismiss, and on April 20 he issued a written opinion explaining his reasoning in further detail. In his written opinion, Judge Matz found that state-owned corporations that share similar characteristics to government agencies and departments may be "instrumentalities" under the FCPA. Judge Matz ultimately did not base his opinion on the legislative history of the FCPA, noting that the history was "inconclusive" and did not clearly indicate an intention to either include or exclude all state-owned corporations.

In his decision, Judge Matz provided a helpful but non-exclusive list of illustrative criteria for determining whether a state-owned entity is sufficiently similar to a government agency or department to consider it a government "instrumentality." Those questions include whether the entity provides a service to the citizens; whether the key officers and directors of the entity are either government officials or appointed by government officials; whether the entity is financed in large measure through governmental appropriations or through revenues obtained by the government; whether the entity is vested with and exercises exclusive or controlling power to administer its designated functions; and whether the entity is widely perceived and understood to be performing functions traditionally performed by the government. Importantly, although in this case the court found that CFE may be an instrumentality of the Mexican government, the court's opinion leaves ample room for argument in future cases that other state-owned corporations – such as those that do not share many characteristics with government departments and agencies, and those that are only partially owned by a foreign government – may not fall within the FCPA's reach.[2]

We note that this is not the first time the government's position on the definition of government "instrumentality" has been challenged, but it is the first detailed judicial treatment of the issue. In two prior cases – *United States v Nguyen*, No 2:08-CR-522 (E.D. Pa) and *United States v Esquenazi*, No. 1:09-cr-21010 (S.D. Fla) – efforts to challenge the government's position were unsuccessful, but the courts in those cases provided little or no explanation of their reasoning. We further note that similar challenges are currently pending in two other cases – *United States v. Carson*,

[1] The motion included a 150-page affidavit from FCPA professor and blogger Michael Koehler on the legislative history of the FCPA.
[2] The *Noriega* case is currently in the midst of trial, which began on April 5, 2011.

also in the U.S. District Court for the Central District of California, and *United States v. O'Shea* in U.S. District Court for the Southern District of Texas – so further judicial guidance on this critical issue should be forthcoming.[3]

If you would like to discuss the issue addressed in these cases, or if you have other questions about FCPA compliance and risks, please do not hesitate to contact us.

[3] The *Carson* case involves government-affiliated electrical utility companies in Korea, Malaysia, the United Arab Emirates, and China, and the *O'Shea* case coincidentally involves the same Mexican CFE at issue in the Noriega case.