State-owned enterprises: an FCPA risk you can't ignore in Asia

Companies operating in Asia, where state-owned or controlled entities are commonplace, need to be aware of the particular risks they face. Bribes paid to employees of state-owned or state-controlled enterprises (SOEs) are bribes paid to a “foreign official.” Accordingly, payments to officers and employees of SOEs, like traditional government agency officials, for the purpose of obtaining or retaining business, constitute bribery and are prohibited by the US Foreign Corrupt Practices Act (FCPA).

State-ownership and control is common but may not be immediately apparent, making it difficult for the parties involved to discern whether the company’s employees are “foreign officials” within the meaning of the FCPA. The US Department of Justice (DOJ) and recent court rulings, including an Eleventh Circuit decision,1 provide a two-pronged, multi-factor test under which SOEs may be considered “instrumentalities” and their employees “foreign officials” as defined by the FCPA. Yet, certain questions remain unanswered.

FCPA Guide

The *Resource Guide to the US FCPA* (Guide) issued by the DOJ and the Securities and Exchange Commission (SEC) indicates that the term "instrumentality" should be interpreted broadly, requiring "a fact-specific analysis of an entity's ownership, control, status and function."[2] The Guide advises that the following non-exclusive factors be considered when determining if an entity is a government instrumentality covered by the FCPA:

- the foreign state’s extent of ownership of the entity;
- the foreign state’s degree of control over the entity (including whether key officers and directors of the entity are, or are appointed by, government officials);
- the foreign state’s characterization of the entity and its employees;
- the circumstances surrounding the entity’s creation;
- the purpose of the entity’s activities;
- the entity’s obligations and privileges under the foreign state’s law;
- the exclusive or controlling power vested in the entity to administer its designated functions;
- the level of financial support by the foreign state (including subsidies, special tax treatment, government-mandated fees, and loans);
- the entity’s provision of services to the jurisdiction’s residents;
- whether the governmental end or purpose sought to be achieved is expressed in the policies of the foreign government; and

[1] *US v. Esquenazi*, 2014 U.S. App. LEXIS 9096 (11th Cir. 2014).
[2] CRIM. DIV., U.S. DOJ & ENFORCEMENT DIV., U.S. SEC, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (Nov. 14, 2012) at 20.

- the general perception that the entity is performing official or governmental functions.

The Guide states that while "no one factor is dispositive or necessarily more important than another, as a practical matter, an entity is unlikely to qualify as an instrumentality if a government does not own or control a majority of its shares."

US v Esquenazi

On May 20, 2014, the Eleventh Circuit affirmed the convictions of Joel Esquenazi and Carlos Rodriguez for bribing officials of Telecommunications D'Haiti, S.A.M. (Haiti Teleco), who were sentenced to 15 years and 7 years imprisonment, respectively. The central question in *US v. Esquenazi* was whether Haiti Teleco was an "instrumentality" of the Haitian government within the meaning of the FCPA.

In answering this question, the court adopted the DOJ's broad interpretation of the term "foreign official" and agreed with its position that "fact-bound questions" must be answered on a case-by-case basis. In the first appellate court interpretation of "foreign official" under the FCPA, the court also established a two-pronged, multi-factor test that should be employed to determine whether a state-owned or state-controlled enterprise is an instrumentality of a foreign government.

First, the court held that in order to decide if a government "controls" an entity, courts and juries should determine:

- the foreign government's formal designation of that entity;
- whether the foreign government has a majority interest in the entity;
- the foreign government's ability to hire and fire the entity's principals;
- the extent to which the government profits from or subsidizes the entity; and
- the length of time that these indicia have existed.

Second, the court rejected the defendant's argument that "instrumentality" should only encompass entities that perform traditional, core governmental functions. Instead, courts and juries should assess whether "the entity performs a function the government treats as its own" by examining the following factors:

- whether the entity has a monopoly over the function it exists to carry out;
- whether the government subsidizes the costs associated with the entity providing services;
- whether the entity provides services to the public at large; and
- whether the public and government generally perceive the entity to be performing a governmental function.

After applying these principles, the court held that Haiti Teleco was an "instrumentality" of Haiti. The court noted that through the years the defendants were involved with Haiti Teleco, Haiti's national bank owned 97 percent of Haiti Teleco, despite the fact that the Haitian Prime Minister had authored a declaration asserting that Haiti Teleco has never been and until now is not a state enterprise. In coming to a decision, the court found persuasive other links between Haiti Teleco and the government such as the fact that (1) the Director General of the company was appointed by the Haitian president (with the consent of the Prime Minister and two other government ministers) as well as all of the company's board members; and (2) Haiti Teleco had held itself out as being an instrumentality of the Haitian government when doing so was beneficial for its business dealings.

State-owned entities in Asia

Applying the above factors to state-owned entities in Asia would likely have a wide-reaching effect due to the number of SOEs across the region. In China alone there are over 140,000 SOEs whose assets account for over 50 percent of the country's GDP. Further, in many Asia Pacific countries, SOEs enjoy a certain monopolistic status in industries including oil, gas, minerals, power, banking, insurance, telecoms, transportation, aerospace and defense.

For example, Korea, like many Asian countries, divides its SOEs into four categories: (1) government-invested, which are those established by law or invested in by the government; (2) commissioned, which receive government support; (3) government-linked, for which the government owns over 50 percent of the shares or over 30 percent with de facto control; and (4) subsidiaries.

It is government-invested and commissioned companies that a court would likely find to be “instrumentalities of foreign governments” and their employees “foreign officials” because the law often governs their existence, public funding supports their operations, and government entities appoint their officers and directors.

However, it is in the grey areas, where the lines between government and industry are blurred, that questions remain. Areas of grey arise in a variety of situations in Asia Pacific, where companies’ structures vary widely from purely state-owned corporations to subsidiaries of SOEs that do not receive direct government support. Thus, it is the government-linked public institutions and subsidiaries, which are also common in many other Asian countries, where the grey lies.

While both of these types of institutions may have some limited government connection, many are not considered public entities according to their country’s laws and maintain independent boards and officers. They may, therefore, fall outside of the definition supplied by the courts.

However, for companies like Haiti Teleco, where the government arguably has a purely commercial interest, the "instrumentality" analysis will require a thorough understanding of the nature of its links to the government.

Conclusion

Due diligence is critical when doing business with any company in Asia, particularly where the lines between government and commercial industry are blurred. In order to mitigate these risks, companies doing business in Asia should ensure that their due diligence includes an assessment based upon the factors enumerated in the Guide and Eleventh Circuit decision, but also considers the far-reaching scope of the FCPA, especially when dealing with companies which fall into the grey area.

Companies should continue to be vigilant in their dealings with SOEs, ensuring that their interactions with any employees of SOEs are in full compliance with the FCPA.

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