FCPA Prosecution: Lessons from Kay

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Context

One of the more interesting prosecutions under The Foreign Corrupt Practices Act of 1977 (FCPA) is United States v. Kay, which involved the importing of rice into Haiti. One of the central holdings of the case supports an expanded scope for the FCPA and may have significant implications for entities subject to the FCPA that are engaged in overseas business.

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Background

Haiti is a desperately poor country. Established in 1804 as the result of a slave rebellion led by Toussaint L'Ouverture, Haiti has a long history of extreme poverty, political upheaval and corruption.

Since 1804, of the 50 recorded leaders of Haiti, whether Emperor, King, President, or Chairman of the Military Council, two were assassinated, seven died in office, 23 were overthrown, one was executed, and one committed suicide. Only eight of the 50 completed a full term. As a result of this extreme instability, Haiti was rated 12th in the Index of Failed States in 2009, placing it in the company of countries such as Zimbabwe, Somalia, and Burma. [1]

In addition to the political instability, Haiti was in desperate financial shape even before the tragic calamity of the major earthquake in January, 2010. With a per capita GDP of $790 in 2008, it is in the lowest segment of the global spectrum and has been described as the poorest country in the Western Hemisphere, with 80% of the population living in abject poverty.

Corruption is also rampant in Haiti, pervading all levels of government, from elected officials to the judiciary and bureaucracy. There is a well-established link between poverty and corruption and Haiti has been consistently ranked among the most corrupt nations in the world by Country-Check, along with countries such as Guinea, Iran, Afghanistan and Iraq. In recent times, numerous allegations of corruption have been made against senior officials. Former President Aristide, for example, has been implicated in a telecommunications scandal. Corruption is so pervasive, however, that it is rare that any legal action is ever taken as a result of allegations.

The Case

Against this backdrop it is perhaps not surprising that when American Rice, Inc. (ARI), a publically traded US company, began exporting rice into Haiti through its Haitian subsidiary, Rice Corporation of Haiti, Haitian customs officials demanded and expected personal payments. In return for these payments, customs duties on the imported rice and other tax liabilities were reduced on ARI's rice. This was common practice in the imported rice trade in Haiti. As the Fifth Circuit stated, "ARI believed these payments were necessary to compete with other companies that paid lower or no taxes on similar imports." [2]

Between 1995 and 1999, Douglas Murphy, President of ARI, and David Kay, Director of Caribbean Sales, paid and authorised these payments as a natural part of business activity for sales to Haiti. It was expected and the way business was done. When these payments were discovered by outside counsel advising on another matter, ARI self-reported to the Department of Justice. ARI settled, but Murphy and Kay were indicted under the anti-bribery provisions of the FCPA. The US District Court in Houston granted a motion by Kay and Murphy that the indictment failed to state an offense against them. Accordingly, the District Court dismissed the indictment. [3] "The district court concluded that, as a matter of law, an indictment alleging illicit payments to foreign officials for the purpose of avoiding substantial portions of customs duties and sales taxes to obtain or retain business are not the kind of bribes that the FCPA criminalizes." [4]

The government appealed and the Fifth Circuit disagreed. The question relevant to this discussion that was asked and answered by the Court was: Do illicit payments made to obtain a reduction of tax liabilities ever constitute the kind of bribery that is proscribed by the FCPA? In disagreeing with the District Court, the Fifth Circuit determined that such payments *could* be within the ambit of the FCPA if they resulted in a business advantage to the payor. In its analysis of the question presented, the Court looked to the words of the statue, as well as the legislative history of the Act.

The Court agreed that the words of the statute left some ambiguity in what it determined to be the central matter of the case. The FCPA prohibits certain payments to foreign officials to influence their decision-making that are intended to produce a certain outcome. The Court called it the *quid pro quo*; that is, assistance to the payor in efforts to get or keep some *business* for or with any person. The Court stated that the "principal thrust of the defendants' argument is that the business nexus element, i.e. the 'assist ... in obtaining or retaining business' element narrowly limits the statute's applicability to those payments that are intended to obtain a foreign official's approval of a bid for a new government contract or the renewal of an existing government contract."[5]

The government argued for a more expansive reading of the business nexus element, reasoning that payments that indirectly advance the business of the payor are covered by the statute. The Court found that the words of the statute potentially supported both propositions. Accordingly, as a matter of law, it concluded that the statutory language was ambiguous. It then examined the legislative history of the FCPA to determine the intention of Congress.

The Court initially noted that in the legislative history, Congress itself had carved out an exception to the universe of foreign official bribes. The exception to the FCPA is the "grease" or facilitating payment; that is, a payment to a foreign official made to prompt that official to perform a non-discretionary, ministerial act, such as providing police protection, processing governmental papers such as visas and work orders, mail pick-up and delivery, and like activities. Congress intended that the Act apply to *corrupt* activity, that is, the misuse of the official's discretionary authority.

Were there other types of official bribery that were not meant to be included within the scope of the Act? The Court looked to an SEC Report that was one of the bases of the FCPA and found four types of illegal payments that were of concern: 1) payments "made in an effort to procure special and unjustified favors or advantages in the enactment or administration of the tax or other laws" of a foreign country; (2) payments "made with the intent to assist the company in obtaining or retaining government contracts"; (3) payments "to persuade low-level government officials to perform functions or services which they are obliged to perform as part of their governmental responsibilities, but which they may refuse or delay unless compensated", and (4) political contributions.[6] The SEC concerns would certainly have included the activities alleged of Kay and Murphy.

The Court explained that the Senate Report,[7] upon which the final Act was based, addressed the SEC concerns. But the Senate chose to broaden the scope of prohibited activity to payments made to obtain or retain any business, not just government contracts. With regard to bribes meant to affect the administration of revenue laws, the Court concluded that Congress intended that they be included in the prohibitions of the Act. "Congress thus made the decision to clamp down on bribes intended to prompt foreign officials to misuse their discretionary authority for the benefit of a domestic entity's business in that country."[8]

The Court reasoned that there was little difference between the payment of a bribe to a government official to illegally influence the award of a contract and the payment of a bribe to a government official to illegally reduce a tax liability so as to make a properly awarded, but underbid, contract profitable. In each case, the corrupt activity provides the payor an unfair business advantage over the competition. The Court remanded the case to the District Court to determine if the payments made and authorized by Kay and Murphy "were intended to lower ARI's cost of doing business in Haiti enough to have a sufficient nexus to garnering business there or to maintaining or increasing business operations that ARI already had there, so as to

come within the scope of the business nexus element as Congress used it in the FCPA."[9]

The Court then reviewed the legislative histories of the 1988 and 1998 Amendments to the FCPA to determine if they affected its analysis. In both, the Court found support for its conclusions. The 1988 Amendment codified the facilitating payment exception and established the two affirmative defenses to the Act. Of the universe of prohibited payments, Congress chose specifically to exclude those covered by the exception and affirmative defenses. These codifications seem to support a broad reading of the statute. The Court also focused on a portion of the 1988 Conference Report that "retaining business" includes payments such as those made "to a foreign official *for the purpose of obtaining more favorable tax treatment*."[10] This was interpreted as a reflection of the initial concerns of Congress and the SEC when the FCPA was enacted in 1977. The Court concluded that this activity should be considered within the ambit of the statute.

The Court found nothing in the legislative history of the 1998 Amendment that altered its holding. The 1998 Amendment was enacted to conform the FCPA to the Organization of Economic Cooperation and Development's Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (the "Convention"). In fact, the placement of language with regard to "improper advantage" required by the Convention was interpreted as a confirmation by Congress that had already intended for a broad interpretation of the statute and was not necessary to add to the *quid pro quo* of the bribe, i.e. to obtain or retain business.

Having concluded that bribes paid to a foreign official to reduce taxes could be within the ambit of the FCPA, the Fifth Circuit sent the case back to determine if the tax savings would assist in obtaining or retaining business. On remand, the District Court convicted Kay and Murphy and sentenced them to 37 and 63 months confinement respectively. [11]

Kay and Murphy appealed their convictions to the Fifth Circuit. They maintained their argument that bribes paid to lower ARI's tax liability did not have a sufficient nexus to the prohibited objective of obtaining or retaining business as well as a number of other grounds. They argued that because the Fifth Circuit had determined the statute was ambiguous as a matter of law, the first impression interpretation of the "obtain or retain business" requirement by the Fifth Circuit could not be applied to them without violating their Due Process rights to fair notice of what the statute prohibits. They also argued that they could not "willfully" violate the FCPA without proof that they knew their conduct violated the FCPA, and that the jury had been incorrectly instructed on the "willfulness" element. The Court rejected all their arguments and let the convictions stand. [12] The defendants petitioned for a Writ of Certiorari which was denied by the United States Supreme Court on October 6, 2008. [13]

Lessons

Are there lessons from this litigation for entities trying to comply with the FCPA?

The Fifth Circuit attempted to give guidance with regard to the scope of prohibited activity covered by the FCPA. It acknowledged that the statute was not intended to criminalize, at least for FCPA purposes, all bribes to foreign officials. The court recognized the universe of bribes to foreign officials and set forth certain classes of those bribes that are both excluded from criminality under the statute, as well as those that are forbidden. Purely private bribes are excluded. Also excluded by the 1988 Amendment are "grease' or facilitating payments, made to cause the payee to perform a nondiscretionary ministerial action. That amendment also decriminalizes bribes that are permitted under local law and those paid for the purpose of demonstrating a product or in connection with the performance of a contract. Finally, those bribes that do not have a business nexus, i.e. those that do not help the payor obtain or retain business or give the payor some competitive advantage, are not prohibited by the anti-bribery provisions of the FCPA. This analysis could result in an anomaly in which a bribe that brought no additional competitive advantage but improved the margins of an already profitable contract; in other words, a bribe made out of a motive of pure greed, would not be a violation of the FCPA

because it had no business nexus.

But, while the Court stated that it was not Congress' intent to criminalize *all* bribes to foreign officials and listed bribes that were not within the congressional prohibition, it rejected the narrow view of the defendants that a prohibited bribe had to be one that was made specifically to obtain or retain business. The decision gave judicial support to the broad view the government had adopted in its enforcement actions even before the case. In matters that were resolved by the Department of Justice and Securities and Exchange Commission prior to the 2004 Kay decision, settlements or admissions were predicated on bribes for 1) refunds of previous tax payments,[14] 2) changes to laws and regulations relating to land development that benefitted the payor.[15] 3) reductions in general tax obligations,[16] 4) encouragement of the repeal or modification of regulations limiting foreign investments[17] and 5) obtaining customs clearance for illegally imported goods.[18]

Since the 2004 Kay decision, settlements or admissions have been effected for payments for reasons as disparate as reductions in annual employment tax obligations,[19] customs clearance for goods or equipment that were improperly or illegally imported[20] and obtaining false governmental inspection reports and irregular quality certificates.[21]

With the increase of investigations and aggressive interpretations of the FCPA by regulators, prudent covered entities should carefully examine their FCPA compliance programs. An obvious action would be to broaden an FCPA compliance program to become a general anti-corruption program in conformance with the Federal Sentencing Guidelines for Organizations.[22]

An entity that has a comprehensive ethical culture that prohibits all bribes has much less concern over the breadth of the scope of the FCPA. In passing the FCPA, Congress noted that the payment of bribes was unethical, bad business and had a negative effect on US foreign relations. These considerations continue to apply whether or not a bribe is a grease payment, fits into one of the affirmative defenses in the statue, or has no business nexus.

A broader anti-corruption program is a better policy than a strict FCPA compliance program.

This broader anti-corruption program should also increase the scope of awareness and training in the entity. A focus on obtaining or retaining business as the emphasis of the FCPA may assume that awareness and training be limited to the business development and sales functions, as well as the finance and legal personnel who support them.

While the greatest FCPA risk is within the sales function, any function that may interface with foreign officials should understand the entity policy and be trained. A broader view would also include functional areas such as supply chain, program management, real estate and corporate. In addition, those third parties that are retained to help the entity overseas, if they interface with any level of government, should be subject to due diligence and an understanding of the entity's anti-corruption policies.

The tax consultant who will resolve an outstanding tax issue with a foreign government for a success fee may be as much of an FCPA risk as the agent who secures a government contract for a commission. If type certification of a new product is required for import to a foreign market, does a bribe to a foreign official for that certification have enough business nexus to be a violation? Does a bribe for a permit or a zoning variation for a new office space come within the business nexus rule? Does your entity want to be the test case for one of these questions?

Kay and the aggressive enforcement of the FCPA should put covered entities on notice. The legal environment will continue to be challenging. Virtually all functions of a covered entity could put the entity at risk. Rigorous application of a comprehensive anti-corruption program can reduce the risk.

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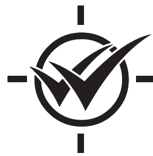

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