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Scope of Foreign Corrupt Practices Act's Bribery Provision Set

In a landmark decision of first impression, the U.S. Court of Appeals for the Fifth Circuit ruled that bribes of foreign officials to secure a reduction in a corporation's customs duties or sales taxes fall within the ambit of the Foreign Corrupt Practices Act (FCPA) so long as the bargained-for reduction in custom duties or sales taxes was intended to produce an effect that would assist in obtaining or retaining business. *United States v. Kay,* 359 F3d 738 (5th Cir. 2004).

Judge Jacques L. Weiner Jr., writing for a unanimous court, agreed with the district court's ruling that the scope of the FCPA is ambiguous but rejected the district court's conclusion that 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 kinds of bribes that the FCPA criminalizes. *Kay,* 359 F3d at 740.

Dispute Resolved

The Fifth Circuit's decision resolves a long-standing dispute concerning the FCPA's scope. Both the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ) have been steadfast in maintaining that the FCPA covers payments to reduce foreign income taxes, customs duties and sales taxes.

A grand jury indictment returned in 2001 charged David Kay and Douglas Murphy with 12-counts of FCPA violations. *Kay,* 359 F3d at 741. Both Mr. Kay and Mr. Murphy were senior executives at American Rice Inc., a company that exports rice to foreign countries including Haiti. The indictment charged Mr. Kay and Mr. Murphy with bribing and authorizing the payment of bribes to Haitian customs officials to accept false bills of lading and other documentation that intentionally understated by one-third the quantity of rice shipped to Haiti.

Furthermore, the indictment detailed how they allegedly orchestrated the bribing of Haitian customs officials to accept false bills of lading and other documentation that intentionally understated by one-third the quantity of rice shipped to Haiti, thereby significantly reducing American Rice's customs duties and sales taxes. *Kay,* 359 F3d at 741.

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In sharp contrast to the detailed misconduct by Mr. Kay and Mr. Murphy, the indictment was devoid of any factual allegations from which it could be inferred that they engaged in the illicit conduct in order to assist American Rice in obtaining and retaining business for, and directing business to American Rice (i.e., the business nexus element). *Kay,* 359 F.3d at 741.

The decision resolves a dispute on the FCPA's scope. Both the SEC and the Justice Department have said the FCPA covers payments to cut foreign income taxes, customs duties and sales taxes.

Under these facts, the district court had to answer two questions of first impression: (i) were the illicit payments violative of the FCPA, and (ii) if so, did the indictment sufficiently allege the business nexus element that is at the crux of the FCPA. *Kay,* 200 FSupp2d at 682.

With respect to the first question, the district court began its analysis by reviewing the plain language of the FCPA. *Kay,* 200 FSupp2d at 683. Reading the statute's "obtain or retain business" language together with the facilitating payment exception, the district court concluded that the plain language of the FCPA is ambiguous. Thus, the district court looked to the FCPA's 1977 legislative history for guidance on interpreting Congress' intent when it first enacted the FCPA. Rejecting the government's argument that the answer lies not in the 1977 legislative history but in the 1988 legislative history, the district court concluded that when Congress enacted the FCPA in 1977, it "chose to limit the scope of the prohibited activities under the FCPA and did not intend to cover payments made to influence any and all governmental decisions." *Kay,* 200 FSupp2d at 684. The district court pointed to the legislative history of the 1998 amendment as further support for its decision. *Kay,* 200 FSupp2d at 686. The district court reasoned that Congress, as it did in 1988 when amending other parts of the FCPA, declined to amend the FCPA's "obtain and retain" business language in 1998. *Kay,* 200 FSupp2d at 686. Thus, the district court concluded that, since Congress had on two separate occasions considered and rejected amendments that would have covered the specific conduct alleged in the indictment, the complained of conduct did not fall within the scope of the FCPA. *Kay,* 200 FSupp2d at 686.

Fifth Circuit Reversal

On appeal, the Fifth Circuit reversed. Although the Fifth Circuit agreed with the district court that the plain language of the FCPA is ambiguous, it completely rejected the district court's analysis of the FCPA's legislative history. *Kay,* 359 F3d at 743-744. The Fifth Circuit agreed that neither the ordinary meaning nor the provisions surrounding the disputed text are sufficiently clear to make the statutory language susceptible of but one reasonable interpretation. *Kay,* 359 F3d at 745. Finding that Congress chose to phrase the business nexus "obliquely" and to say "nothing to suggest how remote or how proximate the business nexus must be," the Fifth Circuit ruled that it cannot conclude on the basis of the language of the provision itself that the statute is either as narrow or as expansive as the parties respectively claim. *Kay,* 359 F3d at 745-46.

Analysis

The Fifth Circuit began its analysis of the FCPA's legislative history with a review of the 1977 legislative history. *Kay,* 359 F3d at 747. In particular, the Fifth Circuit focused on the Senate's legislative proposal, because the FCPA's final language was drawn from both it and the SEC's report on questionable and illegal corporate payments and practices. *Kay,* 359 F3d at 747.

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Observing that Congress 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[,]" and that Congress's concern with the "immorality, inefficiency, and unethical character of bribery presumably does not vanish simply because the tainted payments are intended to secure a favorable decision less significant than winning a contract bid[,]" the Fifth Circuit noted that although the statute's ultimate language of "obtaining or retaining business" mirrors identical language in the SEC Report, the FCPA, incorporating the Senate Report's language, prohibits payments that assist in "obtaining or retaining business," not just government contracts as highlighted in the SEC's Report. *Kay,* 359 F3d at 748.

Thus, the Fifth Circuit surmised that in using the word "business," when it easily could have used the phraseology of the SEC Report, Congress intended the FCPA to apply to payments beyond the narrow scope of the payments sufficient to "obtain or retain government contracts." *Kay,* 359 F3d at 748.

Foreshadowing its ultimate conclusion that the payments of bribes to affect the administration of tax, customs and other laws affecting the revenue of foreign states fall within the ambit of the FCPA, the Fifth Circuit reasoned that there is little difference between a company that bribes a foreign official to award a contract and a company that obtained a contract lawfully by submitting the lowest bid and, either before or after doing so, bribing a different government official to reduce taxes and thereby ensuring that the under-bid venture is nevertheless profitable. *Kay,* 359 F.3d at 749. Both could violate the FCPA because "[a]voiding or lowering taxes reduces operating costs and thus increases profit margins, thereby freeing up funds that the business is otherwise legally obligated to expend." *Kay,* 359 F3d at 749. However, the question of whether bribing a foreign official to reduce customs and sales taxes violates the FCPA turns on whether the bribe was intended to lower the company's cost of doing business enough to have a "sufficient nexus to garnering business there or to maintaining or increasing business operations" that the company already had so as to come within the scope of the FCPA's business nexus element. *Kay,* 359 F3d at 749.

In settling for an expansive reading of the FCPA's scope, the Fifth Circuit believed Congress' intent in enacting the FCPA was "bribe[s] paid to engender assistance in improving the business opportunities of the payor or his beneficiary, irrespective of whether that assistance be direct or indirect, and irrespective of whether it be related to administering the law, awarding, extending, or renewing a contract, or executing or preserving an agreement." *Kay,* 359 F3d at 750. In light of this analysis of the FCPA's 1977 legislative history, the Fifth Circuit reasoned that the FCPA's subsequent 1988 and 1998 legislative history is only important to the extent it confirms or conflicts with the interpretation of the 1977 legislative history. *Kay,* 359 F3d at 750.

1988 Legislative History Key

In rejecting the district court's analysis, the Fifth Circuit reasoned that, because Congress amended the FCPA in 1988, the 1988 legislative history was central to understanding the "original scope of the [FCPA] and concomitantly to the business nexus element." *Kay,* 359 F3d at 752. Moreover, the Fifth Circuit gave deference to language in 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.'" *Kay,* 359 F3d at 753. The Fifth Circuit believed this language to be particularly instructive because, when the FCPA was first enacted in 1977, the SEC was concerned with exactly these types of payments. *Kay,* 359 F3d at 752. This language in the 1988 Conference Report, "reflects the concerns that initially motivated Congress to enact the FCPA" in the first place and thus deserves to be considered in determining the scope of the FCPA's reach. *Kay,* 359 F.3d at 752.

The Fifth Circuit said that Congress' concern with the immorality of bribery does not vanish because the tainted payments are to secure a decision less significant than winning a contract bid.

Similarly, the Fifth Circuit found that the FCPA's 1998 legislative history supported its broad reading of the scope of the FCPA. In 1998, the Senate ratified and Congress implemented the Combating Bribery of Foreign Public Officials in International Business treaty passed by the Organization of Economic Cooperation and Development (the OECD). As amended, the FCPA now "prohibits payments to foreign officials not just to buy any act or decision, and not just to induce the doing or omitting of an official function to assist…in obtaining or retaining business for or with, or directing business to, any person, but also the making of a payment to such a foreign official to secure an 'improper advantage' that will assist in obtaining or retaining business." *Kay,* 359 F3d at 754.

Giving short shrift to the district court's finding and appellees' arguments that by adding the "improper advantage" language to the two existing kinds of prohibited acts, Congress again declined to amend the FCPA, the Fifth Circuit found that there was no need for Congress to amend the business nexus element by adding the OECD's "improper advantage" language because "Congress already intended for the business nexus element to apply broadly, and thus declined to be redundant." *Kay,* 359 F3d at 754.

Although the Fifth Circuit concluded that a bribe paid to a government official in consideration for unlawful evasion of customs duties and sales taxes could fall within the ambit of the FCPA, it added that "this conduct does not automatically constitute a violation of the FCPA: It still must be shown that the bribery was intended to produce an effect that would assist in obtaining or retaining business." *Kay,* 359 F3d at 756. In assessing whether the *Kay* indictment satisfied this pleading requirement, the Fifth Circuit had to decide whether it is enough for the indictment to simply parrot the language of the statute rather than alleging facts from which such an inference could be drawn.

The answer to this question turns on whether the obtain or retain business element of the FCPA goes to the "core of the criminality" under the FCPA. If the business nexus element goes to the core of the FCPA's criminality, the indictment would be insufficient. Holding that the business nexus element did not go to the core of the FCPA's criminality, the Fifth Circuit ruled that the indictment's paraphrasing of the FCPA's language was sufficient as a matter of law. *Kay,* 359 F3d at 761. The Fifth Circuit reasoned that, when read as a whole, the core of the FCPA's criminality is seen to be bribery of a foreign official to induce him to perform an official duty in a corrupt manner." *Kay,* 359 F3d at 761. The business nexus element merely serves to delimit the scope of the FCPA by "eschewing applicability to those bribes of foreign officials that are not intended to assist in getting or keeping business, just as the 'grease' provisions eschew applicability of the FCPA to payments to foreign officials to cut through bureaucratic red tape and thereby facilitate matters." *Kay,* 359 F3d at 761.

Curiously, however, the Fifth Circuit stated that, on remand, the defendants may choose to submit a motion asking the district court to compel the government to allege more specific facts regarding the business nexus element of the FCPA. *Kay,* 359 F3d at 761 n. 96. It is unclear why the Fifth Circuit, having concluded that the indictment was sufficient, felt it necessary to suggest that the appellees seek more specific facts regarding the business nexus element. While some may see this suggestion as a silver lining, the government should have no difficulty in developing facts during its investigation that would allow it to meet this pleading requirement.

Conclusion

With the Fifth Circuit's decision a major boost for their respective FCPA programs, the SEC and DOJ have signaled their intention to aggressively pursue violations of the FCPA. It remains to be seen, however, whether another circuit court will get an opportunity to reach a conclusion different from that of the Fifth Circuit.