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5th Circuit: Some Payments to Overseas Contacts Are Not O-*Kay*

Callout:
The court held that payments that provide a competitive advantage, even if not directly linked to proposed or existing business, could violate the FCPA.

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by CHARLES R. PARKER and STACY WILLIAMS

In its April 2004 International Energy Outlook, the U.S. Department of Energy (DOE) projects that, by the year 2025, world consumption of marketed energy will expand by 54 percent from 2001 levels. This increased consumption will come largely from non-industrialized countries. For example, the same DOE report projects that, by the year 2025, developing nations will consume 94 percent as much oil as industrialized nations, compared to the 64 percent they consumed in 2001.

This expansion in energy consumption increasingly will provide energy companies opportunities with countries and governments with which they previously have had little contact. To compete in this landscape, attorneys for energy companies must have a clear understanding of U.S. laws restricting the business practices that companies may employ in securing or maintaining business opportunities in foreign countries. One such law is the Foreign Corrupt Practices Act (FCPA).

The FCPA prohibits payments to a foreign official that are intended to "assist the [payor] in obtaining or retaining business," according to 15 U.S.C. §§78dd-1(a), 78dd-2(a). However, the FCPA does not prohibit all payments intended to induce a foreign official to use his or her position favorably for the payor. For example, the

FCPA exempts "grease" payments to foreign officials that are intended to expedite "routine governmental action," according to 15 U.S.C. §§78 dd-1(b) & (f)(3)(A) (B). Likewise, the FCPA's reach is limited by its requirement that the payment be made to obtain or retain business — the business nexus requirement, according to 15 U.S.C. §§78 dd-1(a)(1).

Certainly, payments made to foreign officials to win a bid would assist in obtaining business and therefore be barred — see, for example, the 5th U.S. Circuit Court of Appeals' 1991 decision in *United States v. Castle*.

But what about payments that are not directly related to an existing or proposed contract that give a company a competitive advantage? The 5th Circuit addressed the breadth of the FCPA's business nexus requirement in its Feb. 4 decision in *United States v. Kay*. According to the opinion, the court held that payments that provide a competitive advantage, even if not directly linked to proposed or existing business, could violate the FCPA. The 5th Circuit's opinion is the first to address this issue in the federal courts.

U.S. v. Kay

According to the opinion in *Kay*, the government charged David Kay and Douglas Murphy with violating the FCPA by allegedly paying Haitian officials to understate customs duties and sales taxes on raw rice shipped to their plant in Haiti for processing and sale there and elsewhere. Even though the alleged payments were not directly linked to any "business," the government argued that the alleged payments violated the FCPA because reduced customs duties and sales taxes always will provide the payor with an unfair advantage in obtaining or retaining business.

According to the opinion, while the 5th Circuit rejected the government's *per se* view of the FCPA, the court did hold that the alleged conduct at issue in *Kay* could violate the FCPA if the company had intended those alleged payments 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 administrating the law, awarding, extending, or renewing a contract, or executing or preserving an agreement." The 5th Circuit held that at trial, the government would have had to have proven "how the tax benefit was intended to assist in obtaining or retaining business, and what was the business or business opportunities sought to be obtained or retained?"

Significance of *Kay*

For lawyers representing businesses operating in foreign countries, *Kay* is significant in several respects. First, the 5th Circuit rejected the argument that the

FCPA's reach is limited solely to obtaining or retaining government contracts. Thus, any payments to a foreign official that provide a company with a competitive advantage for any business could violate the FCPA. Texas attorneys must review and possibly revamp their clients' FCPA compliance procedures to ensure that a company's employees understand that the FCPA does not relate solely to business solicited from a foreign government.

Second, *Kay* makes it clear that a payment made to a foreign official need not directly relate to specific business to violate the FCPA. In the future, practitioners must make clear to the client company's personnel that only payments that fit squarely into one of the FCPA's exceptions will be considered legal. *Kay* is the first federal court ruling to adopt such an expansive view of the FCPA's reach. Thus, conduct previously believed to be legal may not be under *Kay*.

Third, *Kay* is significant because the required nexus between the payment and the quid pro quo is not clear. Practitioners should be wary of any payment a client company made that is not clearly within one of the exceptions. A company will not want to be in the unenviable position of trying to prove that any payment made was not made with the goal of "obtaining or retaining" business. As the 5th Circuit wrote, "[e]ven a modest imagination can hypothesize myriad ways that an unwarranted reduction in duties and taxes . . . could assist in obtaining or retaining business."

While the conduct at issue in *Kay* was the reduction in tax benefits, an active or modest imagination also could come up with a theory as to how any advantage a company receives from a payment to a foreign official could provide a competitive advantage and, thus, help the company to obtain or retain business.

Finally, *Kay* is significant because the government likely will view the decision as vindication of its broad view of the FCPA's reach. Thus, it is possible that the government will expand the amount and types of cases it prosecutes under the FCPA.

Lawyers representing energy companies who do business overseas should follow *Kay* closely because of its potential impact regarding international payment practices. Unless and until the appeals courts makes any changes, *Kay* is the law in the 5th Circuit and will be persuasive authority for other courts considering the same issue.