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SECOND CIRCUIT REVIEW

Expert Analysis

Oil-for-Food Program Claims Yield Key RICO and FCPA Rulings

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This month, we discuss *Republic of Iraq v. ABB,*[1] in which the U.S. Court of Appeals for the Second Circuit affirmed a district court decision that dismissed Foreign Corrupt Practices Act (FCPA), Racketeer Influenced and Corrupt Organizations Act (RICO), and state law claims brought by the Republic of Iraq against two individuals and numerous business entities based around the world.

The plaintiff's claims were based on allegations that from 1997 to 2003, defendants had conspired with Saddam Hussein, who was then president of Iraq, to divert money from, and corrupt, the United Nations' "Oil-for-Food" program. The court's opinion, written by Judge Amalya L. Kearse, joined by Judge Ralph K. Winter, Jr., and joined in part and dissented from in part by Judge Christopher F. Droney, established that in the Second Circuit, the "in pari delicto" defense, which bars liability when the plaintiff is equally at fault, is available in RICO cases, and that the doctrine applied in this case.

The Second Circuit also held that there was no private right of action under the FCPA, thereby affirming the interpretation of the FCPA adopted by a number of judges in the Southern District of New York. Finally, the court held that the district court properly declined to exercise supplemental jurisdiction over the state law claims, despite the plaintiff's argument that such claims raised important foreign policy concerns.

Background

Saddam Hussein took power in Iraq in a military coup in 1979, and presided over an authoritarian regime until he was deposed in 2003. After Iraq invaded its neighbor Kuwait in 1990, the Security Council imposed harsh economic sanctions on Iraq, which were implemented by the United States. Motivated by suffering in the Iraqi population, the United Nations ultimately agreed to the Oil-for-Food Program, which would allow the Iraqi government to sell petroleum and petroleum products to foreign purchasers, with the proceeds of the sales going to an escrow account overseen by the United Nations. The money in the escrow account was used to purchase medicine, food, and other humanitarian goods for Iraqi civilians, as well as pay war reparations to Kuwait. About $64.2 billion was deposited into the escrow account during the program's period of operation, from 1996 to 2003; the amount that was not spent was ultimately transferred to the new Iraqi government after the fall of the Hussein regime.

Despite safeguards supposedly in place, the Hussein regime manipulated the program to earn kickbacks and curry political favor abroad. The Iraqi government caused the set price of oil to be artificially low, and thus was able to reward foreign political allies with cheap oil. The Hussein regime also demanded illicit side payments and surcharges from purchasers, which went directly to bank accounts controlled by the Iraqi government, rather than to the escrow account. Simultaneously, the government arranged kickbacks on the program's purchases of humanitarian goods. These techniques violated the terms of the program, and allegedly allowed the government to divert at least $3.35 billion from the escrow account. The plaintiff also alleged that vendors chosen by the government provided overpriced and substandard goods, and that this cost the escrow account an additional $7 billion.

This scandal came to light after Hussein was deposed in 2003. The new government of Iraq ultimately filed suit. The complaint named as defendants two individuals who have pleaded guilty to conspiracy charges in connection with corruption at the program, as well as two companies that have entered non-

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prosecution agreements and one that has pleaded guilty. The complaint also named BNP Paribas USA and several affiliates, which had been overseeing the escrow account, and had allegedly covered up misconduct. The complaint also named as defendants several vendors that had sold humanitarian goods as part of the program. It alleged that these vendors conspired to overcharge on their products and pay kickbacks to the Iraqi government.

The complaint asserted claims against all defendants under RICO, alleging that the Oil-for-Food Programme (or a related association-in-fact) was a RICO enterprise that defendants conducted through a pattern of racketeering activity in violation of 18 U.S.C. §1962(c), and conspired to do so in violation of 18 U.S.C. §1962(d). The complaint also asserted a claim against all defendants other than BNP for allegedly paying kickbacks to the Hussein regime, in violation of the FCPA, 15 U.S.C. §§78dd–1 et seq. Finally, the complaint asserted claims against various defendants under various state law theories, including breach of fiduciary duty, fraud, conspiracy to commit fraud, and unjust enrichment.[2]

Prior Proceedings

The defendants moved to dismiss the complaint on a variety of grounds. Although the district court denied the defendants' arguments to dismiss on various jurisdictional grounds under Federal Rule of Civil Procedure 12(b)(1), Judge Stein granted their motion to dismiss for failure to state a claim under Rule 12(b)(6).

The court held that the civil RICO claims were barred for three independent reasons. Most significantly, it held that, based upon the allegations in the complaint, plaintiff was at least as responsible for the conduct alleged as the defendants. The court applied the doctrine of in pari delicto, an equitable defense under which a plaintiff cannot recover when it is at equal or greater fault than the defendant.

The court determined that the application of the doctrine to RICO did not offend public policy, since awarding the plaintiff treble damages when it violated RICO would be "anomalous, to say the least." The court held that the actions of the Hussein regime could be attributed to the plaintiff, the new government of Iraq, and that it was clear from the allegations that the Hussein regime was at least as responsible for the allegedly wrongful conduct as the defendants were.[3]

The court also held that the plaintiff's RICO claim was impermissibly extraterritorial,[4] and that the plaintiff had failed to allege proximate cause.[5] These holdings were not addressed by the Second Circuit.[6]

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The court granted defendants' motion to dismiss plaintiff's FCPA claim with little discussion, relying on three other courts in the Southern District that had concluded that the FCPA offered no private right of action, and noting that Iraq had cited no court or jurist that had concluded otherwise.[7] After dismissing the federal claims, the court declined to exercise jurisdiction over the remaining state law claims.[8]

The Second Circuit's Decision

In its decision, the Second Circuit affirmed the decision of the district court.

RICO. The court held, as a matter of first impression in the Second Circuit, that in pari delicto is a valid defense to a RICO claim. The court noted that other courts of appeal that have addressed the question have agreed with this analysis.[9] Additionally, it held that the principle of in pari delicto, which the Supreme Court traced back to the 18th century, was well enough established that courts could assume that Congress expected it would apply.[10]

The court then determined that the in pari delicto doctrine applied to the case at hand. It applied the two-part test laid out by the Supreme Court in 1985 in *Bateman Eichler, Hill Richards v. Berner*, which held that the defense existed (in the context of the securities laws) when the plaintiff bears at least "substantially equal responsibility" for the violation and when preclusion of the suit would not be contrary to policy.[11]

First, the court held that the plaintiff was at least equally responsible for the violation. The court rejected the plaintiff's argument that the Hussein regime's wrongdoing should not be attributed to the plaintiff as "meritless." The court noted that it was well established that the "legal position of a foreign state survives changes in its government," and that it was universally recognized, including in the complaint, that at the times relevant to the complaint, the Hussein regime was the government of Iraq. The court stated that whether the Hussein regime was a "legitimate" government was irrelevant to whether its actions were attributable to the state. It also noted that the alleged violations were not acts by individual officials, but rather the coordinated policy of the government.

The court also rejected the plaintiff's argument that the government's actions could not be attributed to the state because they were in contravention of the national interest. The court noted that this so-called "adverse interest" exception to the attribution of an agent's actions to the principal was very narrow and did not apply where, as here, the agent's actions at least partially benefitted the principal.

Applying the second prong of the Bateman Eichler test, which asks whether the application of the defense would be consistent with public policy, the court held that recognition of the defense would comport with the purposes of the statute. It agreed with the reasoning stated by the U.S. Court of Appeals for the Eleventh Circuit, which had held that a culpable plaintiff's "recovery under RICO would not divest RICO violators of their ill-gotten gains; it

would result in a wealth transfer among similarly situated conspirators."[12]

FCPA. The court held, apparently as a matter of first impression, that the anti-bribery provisions of the FCPA do not provide a private right of action. The court noted that implied rights of action are increasingly disfavored and that the bill contains no language suggesting a private right of action. The court relied in part on *Lamb v. Philip Morris*, "the leading case declining to recognize such a cause of action[,]"which in turn examined the legislative history of the FCPA.[13]

The court noted that, although the House committee proposing a version of the bill contemporaneously stated that it "intend[ed] that the courts shall recognize a private right of action based on this legislation[,]"[14] this statement was not repeated by the Senate committee or the conference committee combining the bill, and that a member of the conference committee expressly disclaimed any such intention.[15]

Common-Law Claims. The Second Circuit held that the district court had properly declined to exercise supplemental jurisdiction over the plaintiff's common-law causes of action. The court rejected the plaintiff's argument that the non-statutory claims were a matter of federal common law because of their connection to foreign relations, since they "describe[] traditional types of torts by private entities."[16]

Dissent

Judge Droney dissented in part, disagreeing with the majority's decision to affirm the dismissal of the RICO claims. Droney argued that in the context of the in pari delicto analysis, the Hussein regime's illegal conduct could not be attributed to the plaintiff. Droney noted that the principle that a change in officially recognized governments did not change the responsibilities of the state was usually applied to hold states responsible for prior governments' lawful acts, rather than to release non-state actors from liability for their illegal acts.

Droney also reached a different conclusion on the results of the Bateman Eichler test. He argued that even if the Hussein regime's conduct could be imputed legally to the plaintiff, the plaintiff could not be held responsible for the purposes of in pari delicto absent some "direct conduct." He noted that it was particularly inappropriate to hold a state responsible for a government's conduct when the government was an authoritarian regime that had seized power in a military coup. As for the second prong, he reasoned that treating the entire Iraqi state as complicit in the regime's conduct would tend to contradict, rather than conform with, U.S. foreign and humanitarian policy at the time, which treated the Hussein regime as distinct from the Iraqi people that the Oil-for-Food program was intended to help.[17]

This case establishes that the in pari delicto defense applies to civil RICO claims. This decision by the Second Circuit brings the Second Circuit into conformity with the Fifth and Eleventh Circuits.

The majority briefly responded to the dissent, denying that there was any requirement in the Bateman Eichler test that a plaintiff's responsibility for the unlawful conduct be personal rather than "derivative." Additionally, it pointed out that the relevant policy concerns for the second prong of the Bateman Eichler test would not be U.S. humanitarian or diplomatic policy, but rather the policy behind the specific statute at issue—RICO.[18]

Implications

This case resolves two issues of first impression in the Second Circuit, and clarifies the law favorably for defendants. First, this case establishes that the in pari delicto defense applies to civil RICO claims. This decision by the Second Circuit brings the Second Circuit into conformity with the Fifth and Eleventh Circuits. The application of the in pari delicto defense to civil RICO claims raises a further barrier to plaintiffs' pursuit of civil RICO claims in this circuit.

Second, this decision places the judicial imprimatur of the Second Circuit on the rule that there is no private right of action under the FCPA. While numerous courts within the Second Circuit had already reached this conclusion,[19] as had other circuit courts,[20] this decision reaffirms and reinforces that doctrine, creating a degree of legal certainty for FCPA defendants concerned about potential civil liability.

The court's more controversial discussion about when government conduct can properly be attributed to a state may be significant when, as here, a new government attempts to hold members or co-conspirators of a previous government responsible for alleged misconduct.

1. *Republic of Iraq v. ABB*, No. 13-0618, 2014 WL 4637201 (2d Cir. Sept. 18, 2014).
2. Id. at *2–*6.
3. *Republic of Iraq v. ABB*, 920 F.Supp.2d 517, 547–548 (S.D.N.Y. 2013) (citing *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985)).
4. Although the court stated that "[t]he RICO statutes do not apply extraterritorially," id. at 544, this holding as stated was probably abrogated by the Second Circuit in *European Community v. RJR Nabisco*, 764 F.3d 129, 137 (2d Cir. 2014), which held that RICO applies extraterritorially when the statute forbidding the predicate act applies extraterritorially. On appeal in this case, the Second Circuit did not address this part of the district court's holding. *Republic of Iraq*, 2014 WL 4637201, at *1.
5. *Republic of Iraq*, 920 F.Supp.2d at 549–50.
6. *Republic of Iraq*, 2014 WL 4637201, at *1.
7. *Republic of Iraq*, 920 F.Supp.2d at 551 (citing *RSM Prod. Corp. v. Fridman*, 643 F.Supp.2d 382, 412 (S.D.N.Y. 2009); *J.S. Serv. Ctr. Corp. v. Gen. Elec. Tech. Servs. Co.*, 937 F.Supp. 216, 226–27 (S.D.N.Y. 1996); *Citicorp Int'l. Trading Co. v. W. Oil & Ref. Co.*, 771 F.Supp. 600, 607 (S.D.N.Y. 1991)).
8. Id.
9. See *Official Committee of Unsecured Creditors of PSA v. Edwards*, 437 F.3d 1145, 1152–56 (11th Cir. 2006); *Rogers v. McDorman*, 521 F.3d 381, 387–91 (5th Cir. 2008).
10. *Republic of Iraq*, 2014 WL 4637201, at *13 (citing *Bateman Eichler, Hill Richards, Inc. v. Berner*, 472 U.S. 299, 306 (1985); *Astoria Federal Savings & Loan Ass'n v. Solimino*, 501 U.S. 104, 108 (1991)).
11. *Bateman Eichler, Hill Richards*, 472 U.S. at 306.
12. *Republic of Iraq*, 2014 WL 4637201, at *14–*17 (quoting *Official Committee of Unsecured Creditors of PSA v. Edwards*, 437 F.3d 1145, 1155 (11th Cir. 2006)).
13. Id. (citing *Lamb v. Philip Morris*, 915 F.2d 1024 (6th Cir. 1990)).
14. H.R.Rep. No. 95–640, at 10 (1977).
15. *Republic of Iraq*, 2014 WL 4637201, at *17 (citing S.Rep. No. 95–114 (1977); H.R. Rep. 95–831 (1977); 123 Cong. Rec. 38,601, 38,602 (1977)).
16. Id. at *22.
17. Id. at *25–*31.
18. Id. at *18–*19.
19. See *RSM Prod. Corp. v. Fridman*, 643 F.Supp.2d 382, 412 (S.D.N.Y. 2009); *J.S. Serv. Ctr. Corp. v. Gen. Elec. Tech. Servs. Co.*, 937 F.Supp. 216, 226–27 (S.D.N.Y. 1996); *Citicorp Int'l. Trading Co. v. W. Oil & Ref. Co.*, 771 F.Supp. 600, 607 (S.D.N.Y. 1991).
20. *Lamb v. Phillip Morris*, 915 F.2d 1024 (6th Cir. 1990).