INSIDE THE MINDS™

UNDERSTANDING LEGAL ISSUES FOR FOREIGN GOVERNMENT CONTRACTS

LEADING LAWYERS ON NAVIGATING THE NEGOTIATION PROCESS, IDENTIFYING KEY LEGAL TERMS, AND UNDERSTANDING U.S. GOVERNMENT REGULATIONS

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Is Your Compliance Program Adequate for Doing Business with Foreign Governments: Key Issues and Strategies

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Key Legal Issues Related to Foreign Government Contracts

In a truly global economy with seemingly unlimited opportunities for companies willing to expand their respective markets and pursue contracts with foreign governments, the associated risks can be enormous. Chief among those risks is compliance with U.S. and foreign government laws and regulations dealing with anti-corruption and ethical standards for doing business with governmental entities. Accordingly, before pursuing business with foreign governments, a comprehensive assessment should be done to ensure that the company has appropriately addressed any potential exposure and liability related to anti-corruption statutes and regulations.

Activities a company may engage in to obtain contracts from foreign governments may pose significant risk to the company under the U.S. Foreign Corrupt Practices Act (FCPA), 15 U.S.C. §§ 78dd-1, et seq., and the Organization for Economic Cooperation and Development's Convention on Combating Bribery. The FCPA generally prohibits payments to foreign officials for purposes of (a) influencing a foreign official's acts or decisions, or (b) influencing a foreign official to act in violation of a lawful order to obtain or retain business. The Organization for Economic Cooperation and Development's Convention on Combating Bribery generally commits all signatories to ensure that their national parliaments pass legislation necessary to implement the convention into national law, including criminal statutes prohibiting bribery of foreign public officials. Enforcement actions by the U.S. and foreign governments have dramatically increased in recent years. For example, the Department of Justice Fraud Section has more than doubled its FCPA enforcement actions in the last two years. In Europe, multiple anti-corruption enforcement actions are underway, with the most visible being the investigation and subsequent fines and penalties involving $1.6 billion for anti-corruption violations by a global German company.

An additional area of risk associated with pursuing contracts with foreign governments relates to requirements imposed by export control restrictions. The U.S. government imposes regulatory controls on the export and re-export of U.S.-origin commodities, software, and technology. The Commerce Department Bureau of Industry and Security (BIS) regulatory regime is complex and detailed as it attempts to impose a myriad of export control restrictions on a wide variety of items and countries. In general, any "item" (defined in the export control context to include products, software, and technology) *in* the United States and any item *made* in the United States, wherever located in the world, is subject to U.S. export control restrictions. In addition to the physical export of an item, the definition of "export" under the BIS regulations covers the disclosure of technology anywhere in the world, including within the United States, to someone who is not a U.S. national or a permanent resident alien. This is the so-called "deemed export" rule.

Further, other agencies that also have jurisdiction over export control matters include the Office of Foreign Asset Controls (OFAC) of the U.S. Treasury Department, which is responsible for administering the U.S. trade embargoes in effect against various countries. Under the OFAC regulations, U.S. companies and U.S. persons are prohibited from dealings with the U.S.-embargoed countries and individuals and entities identified by OFAC as "specially designated nationals" or "SDNs." In addition, the U.S. State Department Office of Defense Trade Controls has jurisdiction over military- and defense-related items on the U.S. Munitions List.

U.S. companies involved in export activities are subject to severe penalties for export violations. Under the BIS regulations, monetary sanctions for export violations can be as high as $250,000 or twice the value of the transaction for each export violation. The BIS may also deny a company export privileges if it finds the export violation was willful. The penalties under the OFAC regulations can be as high as $1 million. The BIS and OFAC can also impose criminal sanctions, including jail terms, for export violations.

For any company engaged in mergers and acquisitions, a target company that has contracts with foreign governments also increases the risk associated with the transaction. Because contracts with foreign governments include the inherent risks associated with anti-corruption and export control requirements, acquiring a company that is pursuing and performing foreign government contracts or subcontracts may pose significant financial risks, and may even result in administrative sanctions, or civil and criminal liability, for the successor-in-interest to the foreign government contracts. As a result, merger and acquisition due diligence that includes contracts with foreign governments must be rigorous to properly assess the risk, as acquirers may be held liable for non-compliance violations even though the violations may have occurred long before the acquisition.

FCPA Anti-Bribery Provisions Related to Foreign Government Contracts

Concerning FCPA legal requirements that apply to pursuing and performing foreign government contracts, the FCPA, which is part of the Securities Exchange Act of 1934, prohibits "issuers," "domestic concerns," and certain foreign nationals and businesses from making corrupt payments to foreign officials for the purpose of obtaining or retaining business. See 15 U.S.C. §§ 78m, 78dd-1, 78dd-2, 78dd-3, 78ff. The FCPA consists of two separate groups of provisions: (1) the anti-bribery provisions, which prohibit persons covered by the FCPA from making illegal payments to foreign officials and certain other persons for the purpose of obtaining or retaining a business benefit, and (2) the accounting standards and internal control provisions, which require "issuers" to keep accurate books and records, and maintain adequate internal controls to ensure accountability under the FCPA.

Covered Parties

The anti-bribery provisions of the FCPA are applicable to three categories of covered persons:

1. "Issuers," defined as all companies, whether domestic or foreign, that have a class of securities registered pursuant to Section 13 of the Securities Exchange Act and are required to file reports pursuant to Section 15(d) of the Securities Exchange Act
2. "Domestic concerns," defined as any individual who is a citizen, national, or resident of the United States, and any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship that has its principal place of business in the United States or is organized under the laws of a state of the United States or any territory, possession, or commonwealth of the United States

3. "Any person," which includes any domestic or foreign company and any U.S. citizen or alien

It is important to note that the scope of the FCPA reaches the conduct of covered persons anywhere in the world, including foreign subsidiaries of U.S. companies, which commit any act in furtherance of a corrupt payment in the United States. Thus, a U.S. company that authorizes a payment by a foreign subsidiary, knowing that the funds will be used to make a corrupt payment, may be held liable under the FCPA.

Payment Prohibitions

The FCPA prohibits payments, offers to pay, promises to pay, or authorizing to pay "anything of value." The FCPA contemplates that "anything of value" includes not only monetary payments, but also the transfer and/or misuse of company assets such as aircraft, boats, vehicles, and real property.

Corrupt Intent

A key element of the FCPA anti-bribery prohibitions requires that the payment be made "corruptly" and "for purposes of" influencing a decision. Although these terms are not defined in the statute, the legislative history notes that the payment must be intended to induce the recipient to "misuse his official position" in order to wrongfully direct business to the payor or his client, or to obtain a preferential administrative or regulatory ruling or legislative enactment. The word "corruptly" connotes an "evil motive or purpose" and does not require that the act be "fully consummated, or succeed in producing the desired outcome."

Covered Government Officials

In general terms, the FCPA prohibits covered persons from offering anything of value to any foreign official for purposes of influencing any act or decision of the foreign official in his or her official capacity. Examples of such influence would include:

- Inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official
- Inducing such foreign official to use his or her influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality
- Securing any improper advantage in order to assist the company in obtaining or retaining business for or with, or directing business to, any person

A "foreign official" is defined to mean "any officer or employee of a foreign government or any department, agency, or instrumentality thereof…or any person acting in an official capacity for or on behalf of any such government or department, agency, or instrumentality." The term includes foreign political parties or party officials, or any candidates for political office.

The United States recognizes that the term "foreign government" includes any government, faction, or body of insurgents within a country, irrespective of recognition by the United States. Thus, Taiwan is a foreign government under the FCPA, although the United States does not formally recognize Taiwan as an independent sovereign state. In addition, officials of international organizations such as the United Nations, the World Bank, the International Monetary Fund, the World Trade Organization, the Organization of American States, the Council of Europe, and the European Union are included in the definition of foreign official.

Prohibited Payments to Third Parties

It is unlawful under the FCPA to make a payment to any person, while "knowing" that all or a portion of the payment will be offered, given, or promised, directly or indirectly, to any foreign official (or any foreign political party, official, or candidate) for the purposes of influencing any act or decision in order to assist a company in obtaining or retaining business for or with, or directing business to, any person. The "knowledge" standard encompasses the concepts of "conscious disregard" or "willful blindness" of the illegal payment. This standard includes a conscious purpose to avoid learning the truth and deliberate ignorance of known circumstances that reasonably alert one to the high probability of violations of the law.

Facilitating or "Grease Payments"

Recognizing that it is common practice to make payments to government officials for certain administrative functions, the FCPA prohibitions do not apply to "any facilitating or expediting payment to a foreign official, political party, or party official the purpose of which is to expedite or to secure the performance of a routine governmental action," commonly referred to as "grease payments." This exception applies to all payments to secure routine governmental actions by any foreign official, regardless of the official's title, status, or duties. The term "routine governmental action" means only an action that is ordinarily and commonly performed by a foreign official in obtaining permits, licenses, or other official documents to qualify a person to do business in a foreign country; processing governmental papers, such as visas and work orders; providing police protection; or scheduling inspections associated with contract performance or inspections related to transit of goods across country, or actions of a similar nature. However, this does not include any decision by a foreign official regarding whether, or on what terms, to award new business to or to continue business with a particular party, or any action taken by a foreign official involved in the decision-making process to encourage a decision to award new business to or continue business with a particular party.

Defenses to Violations of the Anti-Bribery Provisions

The FCPA recognizes two specific defenses to a violation of the anti-bribery prohibitions. The first is the "foreign law defense," which provides that it is not a violation of the law if the payment, gift, offer, or promise of anything of value that was made, was lawful under the written laws and regulations of the country in question. The foreign law defense only applies where the law is in writing, and does not apply to unwritten rules, customs, or practices.

The second defense is the "reasonable business expense defense," which provides that the prohibitions under the FCPA do not apply to payments that are considered *bona fide* expenditures, such as travel and lodging expenses, incurred by or on behalf of a foreign official and directly related to (i) the promotion, demonstration, or explanation of products or services or (ii) the execution or performance of a contract with a foreign government. Thus, a visit to U.S. facilities for technical meetings and training sessions in the United States by a foreign official may be permissible. However, a payment is not a *bona fide* expenditure if "corruptly" made to influence an act or decision of the foreign official.

The Books and Records Provisions of the FCPA

The books and records and accounting provisions of the FCPA provide that an issuer (as defined above) must "make and keep books, records, and accounts, which, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the issuer." The purpose of this provision is to require that the issuer's records reflect transactions in conformance with generally accepted accounting principles and be designed to prevent undisclosed transactions such as kickbacks and bribes. Although the record-keeping requirements under the law are simple, compliance questions usually depend upon the requirement of qualitative notations rather than quantitative records. Specifically, issuers must devise and maintain a system of internal accounting controls sufficient to provide reasonable assurances that, among other things, transactions are executed in accordance with management's general and specific authorizations, and are FCPA-compliant. For example, general descriptions of "consultant expenses" are inadequate without supporting detail identifying who, when, where, and for what purpose and amount the expenses were incurred. In the event that a company is, or is considering becoming an "issuer" covered by the FCPA, it should adopt appropriate accounting procedures as required under the FCPA.

Penalties for FCPA Violations

The penalties for violating the FCPA can be severe. In addition to the adverse publicity surrounding an FCPA violation (for both the U.S. company involved and the foreign participant), a violation of the FCPA exposes a company to criminal fines of up to $2 million per incident. The amount of the fines can also be more than the amount specified in the FCPA because of the alternative fines provisions set forth in the statute. Under these provisions, individuals may be fined up to $250,000 or up to twice the amount of the gross gain or loss if the defendant derives pecuniary gain from the offense or causes a pecuniary loss to another person. The FCPA further provides that the penalty provisions do not override the provisions in other federal statutes, such as tax and money laundering laws.

Officers, directors, shareholders, agents, or other employees of a domestic company who willfully violate the anti-bribery provisions are subject to a $100,000 criminal fine or imprisonment of up to five years, or both. In addition, both the domestic company and its agents or employees who willfully violate the anti-bribery provisions are subject to a civil penalty of up to $10,000 imposed in an action brought by the attorney general or the SEC. In an enforcement action, a court may also impose an additional fine not to exceed the greater of (i) the gross amount of the pecuniary gain to the defendant because of the violation or (ii) a specified dollar limitation. The dollar limits, ranging from $5,000 to $100,000 for a natural person and $50,000 to $500,000 for any other person, are based on the egregiousness of the violation. Foreign and domestic nationals are both equally liable for criminal and civil enforcement penalties. Further, monetary penalties imposed upon individuals may not be paid by the company.

BIS Export Regulations

The BIS regulatory regime for export controls is complex and detailed (consisting of twenty-five different chapters in the Export Administration Regulations (EAR)) as it attempts to impose a myriad of export control restrictions on a wide variety of items and countries. In general, any "item" (defined in the export control context to include products, software, and technology) in the United States and any item made in the United States, wherever located in the world, is subject to U.S. export control restrictions. In addition, foreign products incorporating more than a *de minimis* amount of U.S.-origin components, or technology and products manufactured outside the United States that are a direct product of U.S.-origin technology, are also within the U.S. export control jurisdiction. The exporter should examine the Commerce Control List (CCL), determine the Export Control Classification Numbers (ECCNs) applicable to its items, and review the country chart to determine whether (a) the item to be exported is a restricted export item, (b) the country to which the item is to be exported is a restricted export destination, and (c) if the item is controlled, whether any export license exceptions apply.

The CCL

The CCL, maintained by the BIS, identifies specific items that are subject to some level of export control, and assigns an ECCN to such items. (The CCL set forth at Part 774 of the EAR is divided into ten categories. An online version can be found at w3.access.gpo.gov/bis/ear/ear_data.html.) It is important to note that the level of export control applicable to an item will depend on (a) the level of sophistication of the item, (b) the reason the item is subject to export controls, and (c) the country to which the item may be exported. Thus, it is often the case that a particular item may be exported to developed countries without an export license, but the same item may require an export license to be exported to developing countries. The CCL does not list items subject to the jurisdiction of other federal agencies, and it does not list specifically items that are within a "basket category." See 15 C.F.R. § 774.1. If an item is not specifically identified and assigned an ECCN, it falls within the basket category of the CCL. Such basket category items are classified under the ECCN "EAR99." See 15 C.F.R. § 734.3. While EAR99 items are not subject to any of the reasons for control identified on the country chart, exporters should be aware that an export license may still be required for some of the items falling within EAR99 based on the general export prohibitions contained in the EAR (discussed below).

The ECCN designation of an item is the primary means of determining what export restrictions apply. The ECCN listings also identify the reasons for control that apply to a particular item, and whether certain license exceptions are applicable. See 15 C.F.R. § 730.8. The ECCN is designed to work in tandem with the country chart to determine whether an export license may be required for a particular country. The exporter should be aware that different ECCN classifications apply to a commodity and to the technology or software associated with that commodity. Accordingly, different export restrictions may apply to each. It is common to have situations where the export of a commodity to a particular country is permitted, while the export of the technology associated with that commodity to the same country is prohibited without an export license.

The Country Chart

The BIS regulations contain a comprehensive country chart identifying, on the vertical axis, the countries of the world and, on the horizontal axis, the "reason for control" that may be applicable to a particular ECCN. The reasons for control appearing on the country chart (and their abbreviated designation) are: Anti-Terrorism (AT), Chemical and Biological Weapons (CB), Crime Control (CC), Firearms Convention (FC), Missile Technology (MT), Nuclear Non-Proliferation (NP), National Security (NS), and Regional Stability (RS). See 15 C.F.R. § 738 Supplement 1. Each ECCN identifies the reason for control over the export of the item, which may include reasons in addition to those identified in the country chart. See 15 C.F.R. § 738.2. Some reasons for control have more than one column, in which case the ECCN will identify the appropriate column for that product. For example, the ECCN may list as a reason for control "NP Column 2." The country chart will then identify whether, for the control reason given in the ECCN, exports to a particular country are permitted without a license. If an "X" appears in the box intersecting the designated country and the reason for control, an export license is required unless a license exception is applicable. The ECCN also states whether, and under what conditions, certain license exceptions apply.

Exports and Deemed Exports

In addition to the physical export of an item, the definition of "export" under the BIS regulations covers the disclosure of technology anywhere in the world, including within the United States, to someone who is not a U.S. national or a permanent resident alien. See 15 C.F.R. § 734.2(b). This is the so-called "deemed export" rule. Thus if a U.S. engineer working in California goes on a business trip to Japan to present certain technology, the disclosure of what the engineer knows to a non-U.S. national, even without providing any written material, would be an export. Similarly, if an engineer from China is visiting California and tours a production facility, the disclosure of information to the visiting engineer (and even the viewing of the production facilities) would be an export. In both cases, if the technology "exported" was subject to export controls, the disclosure of the technology could be a violation of the BIS regulations if no export license was acquired from the BIS prior to the export. See id.

Re-Export Restrictions

As noted above, the scope of the U.S. export controls also extends to re-exports of U.S.-origin products from abroad to other countries. This export restriction is in place to prevent an indirect export to a prohibited country when such export could not be made directly. Thus, because a particular item can be exported to Japan without any export restrictions, it does not necessarily mean this same product can be re-exported from Japan to a third country. U.S. export restrictions may apply to the third country (i.e., that item could not be exported directly from the United States to that third country without an export license). In addition, a second type of re-export prohibition relates to items that either (i) incorporate more than a *de minimis* level of controlled U.S. items, or (ii) are a "direct product" of controlled U.S. technology or software. In this context, an item that is "controlled U.S. origin" means the re-export to a particular country would require an export license if it was exported directly from the United States. See 15 C.F.R. §§ 736.2(b)(3), 738.3(a).

De Minimis Exception

In general, re-exports of a foreign-made product or software incorporating controlled U.S.-origin commodities valued at 25 percent or less of the total value of the foreign-made product or software are considered *de minimis* and thus outside the scope of the EAR and not subject to U.S. export controls (except that for the embargoed and terrorist designated countries, the *de minimis* level is set at 10 percent). See 15 C.F.R. § 734.4(c)-(d). The *de minimis* restriction is designed to avoid the circumvention of export controls by exporting components to a permitted destination and then using these components to produce items to be exported to a prohibited destination.

"Direct Product" Restriction

The "direct product" restriction applies only to re-exports that are a direct product of controlled U.S.-origin technology or software to a limited number of countries (generally the communist and former communist countries). See 15 C.F.R. § 736.2(a)(3). "Direct product" is defined in the BIS regulations as an item that is the immediate product (including processes and services) produced directly by the use of controlled U.S.-origin technology or software. See 15 C.F.R. § 734.3(a). Unfortunately, the regulations do not give much more guidance on this issue, and the exporter must make a determination of whether an item is a "direct product" within this definition. This restriction becomes relevant to the extent the research and development activities are undertaken in the United States and the results of that research are exported to another country for the manufacture and sale of a particular item. The BIS does, however, differentiate between fundamental research where the results are published and shared with the scientific community at large, and proprietary research. See 15 C.F.R. § 734.8. It is likely that the item manufactured from the U.S.-origin technology would be considered a direct product subject to U.S. export control restrictions.

General Prohibitions under the EAR

The regulations consolidate into ten "general prohibitions" export restrictions that apply to all items, including those that fall within a specific ECCN, as well as all EAR99 items that are not subject to any CCL-specific export licensing requirements. These ten general prohibitions are as follows. See 15 C.F.R. § 736.2(b).

1. Export and re-export of controlled items to prohibited countries
2. Re-export and export from abroad of foreign-made items incorporating more than a *de minimis* amount of controlled U.S. content
3. Re-export and export from abroad of foreign-produced direct products of U.S. technology and software to certain designated countries
4. Export to persons on the BIS's table of denial orders (which lists natural and legal persons denied export privileges due to prior violations of the EAR)
5. Export or re-export to prohibited end uses or end users (primarily military uses and users)
6. Export or re-export to embargoed destinations
7. Actions that would support proliferation activities

8. Permitting in-transit shipments or items to be unladen from vessels or aircraft in certain prohibited countries
9. Violating any BIS order, term, or condition of an export license or license exception
10. Proceeding with a transaction with knowledge that a violation has occurred or is about to occur

These prohibitions serve as a checklist to determine whether a particular export or re-export may be in violation of the EAR.

Although the BIS asserts jurisdiction over virtually every item within the United States and controlled U.S.-origin items wherever located, it is important to note that the actual number of items subject to export licensing requirements is limited, as are the number of countries to whom exports are restricted. See 15 C.F.R. § 730.7. It is important to note that an item or activity may be subject to EAR as well as control programs of other agencies such as the OFAC. See 15 C.F.R. § 734.2(a). Further, the trend has been to decontrol products and technology since the end of the Cold War. This trend has also been helped by the acceleration of technological change. However, the current "war on terrorism" has caused the United States to strengthen its export control regime and place greater emphasis on export compliance.

Obtaining a BIS Export License: Filing Processes and Exceptions

If an item is identified on the CCL and subject to export control restrictions, and no license exemption applies, a BIS export license is required in order to permit that item to be exported to a particular country. See 15 C.F.R. § 736.2(b)(1)-(3). Obtaining an export license requires the submission of an export license application to the BIS. The license application is fairly straightforward. In general, the information required for the license application includes the item to be exported (including detailed technical data on the item), the country of importation, and the parties to the transaction (including any intermediate consignees). See 15 C.F.R. §§ 748.4, 748.6. For certain applications, it may be necessary to obtain signed statements from the importer or the trade regulatory authority of the importing country.

There is no filing fee associated with the license application, and its preparation does not take a significant amount of time. The application requires information on the parties to the transaction, the item (and its ECCN) to be exported, along with supporting documentation on the transaction and the items to be exported. The BIS requires that license applications be submitted electronically on its "SNAP-R" system. Processing a license application usually takes at least six to eight weeks. Therefore, the time delay in getting the export license, and the risk that the license could be denied, should be factored into any export transaction that requires a license. It is also possible to request a license from OFAC to engage in a transaction with an embargoed country. As a practical matter, however, such licenses are generally not granted.

The CCL indicates whether certain license exceptions may be applicable to the item covered by a particular ECCN. See 15 C.F.R. Part 740. The "list-based" license exceptions that may appear under each ECCN include:

- Limited Value Shipment (LVS): This exception applies to shipments valued under a certain dollar amount as specified in the ECCN listing for that product.
- Shipment to Country Group B (GBS): This exception permits exports and re-exports to Country Group B destinations (which are most of the countries of the world other than the communist and former communist countries).
- Civil End-Users (CIV): This exception authorizes exports and re-exports only to civil end users for civil end uses in Country Group D:1 (which are the communist and former communist countries not listed in the GBS group).
- Restricted Technology and Software (TSR): This exception permits exports and re-exports of certain technology and software to destinations in Country Group B, provided that a prior written assurance is obtained from the importer that the technology or software will not be re-exported to Country Groups D:1 or E:1 (the embargoed countries) or to nationals of countries in those groupings.
- Computers (APP): This exception permits exports and re-exports of computers to certain countries depending on (1) the specific

country involved and (2) the operating capacity of the computer measured in Weighted Tera FLOPS (WT).

- Encryption Commodities and Software (ENC): This covers export and re-export of encryption items and "information security" test, inspection, and production equipment.

The Country Group listings are used by the BIS to classify countries according to similar export control concerns. See 15 C.F.R. § 738.1. Thus former COCOM members (Group A:1) are exempt as a group from many export restrictions, while the communist and former communist countries (Group D:1) are subject to more stringent export controls. In addition to the above license exceptions, which appear on the specific ECCN itself, the regulations also contain additional license exemptions that may be available. These include, for example:

- Temporary Imports, Exports, and Re-exports (TMP): This license exception permits various temporary exports and re-exports—exports and re-exports of items temporarily in the United States, and exports and re-exports of beta test software.
- Technology and Software Unrestricted (TSU): This covers certain operating and sales technology and software updates, and "mass market" software.
- Additional Permissive Re-Exports (APR): This covers, for example, exports to and among Country Group A:1.

An exporter, therefore, should be aware of these additional license exceptions, which, if applicable, may permit an export that would otherwise be restricted. These license exceptions, if applicable, are identified by the exporter on the shipper's export declaration, which must accompany the shipping documentation of the export.

Enforcement of U.S. Export Control Requirements

The BIS takes a very aggressive stance on enforcing U.S. export control requirements, and the penalties for violating export control laws can be severe, involving potentially millions of dollars and up to ten years in jail. Therefore the exporter must be responsible for "knowing" whether an export violation has occurred or is about to occur. (This knowledge requirement relates to general prohibition number ten above.) In addition, the exporter should have in place a record-keeping system to be able to demonstrate that its exports did not cause any violation of the EAR. In evaluating whether the exporter is liable for an export violation, the BIS will often need to determine the exporter's "knowledge" that a violation has or is about to occur. Knowledge is defined in the EAR as follows:

> Knowledge of a circumstance (the term may be a variant, such as "know," "reason to know," or "reason to believe") includes not only positive knowledge that the circumstances exists or is substantially certain to occur, but also an awareness of a high probability of its existence or future occurrence. Such awareness is inferred from evidence of the conscious disregard of facts known to a person and is also inferred from a person's willful avoidance of facts. 15 C.F.R. § 772.1

Thus an exporter cannot merely say they did not have affirmative knowledge of a violation, because there may be circumstances where the exporter would have "reason to know" that a violation would occur if the export was shipped. For example, the knowledge element likely would be found by the BIS if an exporter shipped a controlled item to a country that is known to be a high risk for re-export, and the exporter failed to perform adequate diligence of the end user and take appropriate measures to minimize re-export.

Managing Risk in Foreign Government Contracts: Establishing Rigorous Compliance Programs

The only meaningful legal strategy for managing the risks involved with foreign government contracts is to insist on robust and extensive compliance processes and systems. For example, a U.S. company pursuing or performing contracts with foreign governments should adopt compliance programs for both the FCPA and export control, which will act to deter unlawful conduct by company personnel and representatives, and may be used as a defense if the activities of an employee or representative are in violation of company policy and either the FCPA or export control laws and regulations. If it is demonstrated that an errant employee or distributor acted independently, in violation of company policy, and outside the scope of his or her employment, such factors may serve to mitigate the company's potential penalties, fines, and administrative sanctions.

Compliance programs are most effective if the "tone is set from the top," and that includes a clearly articulated corporate policy by senior management, such as formal adoption of the compliance program and a statement of corporate policy, typically done by the board of directors, the executive officer, or the legal department. Formal adoption is recommended in order to give emphasis to the seriousness of the company's compliance obligations. The statement of corporate policy usually notes that it is the company's policy to comply with applicable laws, and that the compliance program was developed to ensure that under no circumstances shall the company engage in conduct in contravention of the U.S. laws and regulations. The policy statement should also note that company employees are responsible for complying with the procedures of the program and will be sanctioned for violating the policy. Effectiveness of compliance programs is also enhanced by appointing an individual as being responsible for implementation of the compliance programs, and the responsible individual should have sufficient authority to permit proper enforcement. The role of the responsible individual is to ensure that the compliance programs are effectively implemented, and to serve as a contact person to resolve any compliance-related issues. The compliance program should also contain sufficient detail to provide clear direction on its implementation.

FCPA Compliance Measures

The specific provisions of a compliance program should provide employees with an understanding of the scope of prohibited and permitted payments under the FCPA. Typical components of an FCPA compliance program include the following:

- Discussion of the general prohibitions of the FCPA
- Express prohibitions on making any payments in violation of the FCPA, and clear guidance on permitted "grease" or facilitating payments under the FCPA

- Explanation of the accounting standards to be maintained, and policies dealing with cash payments
- Procedures for selection and retention of foreign commercial agents

In addition, under the FCPA, it is the responsibility of a company to investigate the background, as well as to monitor the activities of its outside agents, consultants, distributors, and representatives. To ensure FCPA compliance, a company should conduct a due diligence review of its distributors, consultants, and representatives prior to their engagement. This includes an investigation of the reputation of the person in question. While such an investigation needs to be thorough and well documented, there is no requirement to hire a private investigator, but the investigation should be sufficient to demonstrate the company's diligence in confirming the ethics of its agents. If the person has a reputation for demanding illegal payments, knowledge of prior activities may be imputed to the company. As part of an investigation, a company should be especially wary of consultants who request suspicious accommodation, such as payment to a bank account outside of the host country, in-kind payment of fees, or other unusual arrangements. Background information on distributors, consultants, and agents may be obtained through the U.S. embassies and consulates, attorneys, accountants, investigators, and industry trade associations. There are also third parties who perform diligence on agents and intermediaries, such as TRACE International.

A company should also ensure that its agreements with agents, consultants, distributors, and representatives require that they agree not to compensate any government official, and to act in accordance with certain other FCPA compliance provisions. It is important to note that requesting an agent or other representative to merely comply with the FCPA may be insufficient. Rather, the agreement should set forth specific compliance provisions. Typical FCPA compliance provisions are the following:

> <u>Ethical Business Conduct</u>. [Agent, consultant, or company] hereby represents and warrants that:
>
> (a) In carrying out its responsibilities under the Agreement, [agent, consultant, or company] and its

owners, officers, directors, employees, or agents thereof have not and will not pay, offer, or promise to pay, or authorize the payment directly or indirectly, of any money, gift, or anything of value to any government official or employee or any political party or candidate for political office for the purpose of influencing any act or decision of such official or of the government to obtain or retain business, or direct business to any person (any such payment is a "Prohibited Payment"). A Prohibited Payment, as defined above, does not include: (i) modest facilitating payment to low-level government employees for the purpose of expediting or securing a routine administrative action ordinarily performed by such employees, provided the recipient of such service or action is entitled to receive such service or action and the payment is customary and appropriate in the [Country]; and (ii) the payment of reasonable and *bona fide* expenditures, such as travel and lodging expenses, which are directly related to the promotion, demonstration, or explanation of products or services, or the execution of performance of a contract with a foreign government or agency thereof; provided such payments are permissible under local law and customer guidelines.

(b) No owner, partner, officer, director, or employee of [agent, consultant, or company], or of any affiliate company of [agent, consultant, or company], is or will become an official or employee of the government during the term of this [agent, consultant, or company] without the prior written approval of the Company.

(c) [Agent, consultant, or company] recognizes that the Company is not fully familiar with the laws, rules, orders, regulations, policies, and customs of [Country] and that the Company has entered into this Agreement on material reliance on [agent, consultant, or company]'s representation and warranty that this Agreement and the relationship created between the Company and [agent, consultant, or company] does not violate any law, rule, or regulation of [Country], including laws regulating elections. [Agent, consultant, or company] further represents and warrants that neither the receipt of fees under this Agreement nor performance of the services under this Agreement is in any respect a violation of the laws, rules, orders, prohibitions, regulations, or policies of the [Country].

(d) In the event the Company has reason to believe that a breach of any of the representations and warranties in this Article has occurred or may occur, the Company may withhold further commission payments until such time as it has received confirmation to its satisfaction that no breach has occurred or will occur. The Company shall not be liable to [agent, consultant, or company] for any claims, losses, or damages whatsoever related to its decision to withhold commission payments under this provision.

(e) In the event the Company has reason to believe that a breach of any of the above representations and warranties has occurred or may occur, the Company shall have the right to audit the [agent, consultant, or company] in order to satisfy itself that no breach has occurred. Upon request by the [agent, consultant, or company], the Company shall select an independent third party to conduct an audit to certify to the Company that no breach has occurred or will occur. The [agent, consultant, or company] shall cooperate fully in any audit conducted by or on behalf of the Company.

(f) In the event of a breach of any of the above representations and warranties, the Agreement shall be void *ab initio* without the requirement of any written notice of cancellation. Any claims for payment by the [agent, consultant, or company] with regard to any transaction for which breach of the representations has occurred, including claims for sales or services previously provided, shall be automatically terminated and cancelled, and all commission payments previously paid shall be promptly refunded to the Company. The [agent, consultant, or company] shall further indemnify and hold the Company harmless against any and all claims, losses, or damages arising from or related to such breach or cancellation of the Agreement, or both.

(g) Unless otherwise agreed by the parties, all payments due to [agent, consultant, or company] under the Agreement shall be made by bank wire transfer to the bank account of [agent, consultant, or company] at a designated bank in the country of [place where agent, consultant, or company resides or provides services] or by check made payable to [agent, consultant, or company] for delivery in [place where agent, consultant, or company resides or provides services].

(h) In no event shall the Company be obligated under this Agreement to take any action or omit to take any action that the Company believes in good faith would cause it to be in violation of any laws of [Country] or any U.S. laws, including without limitation the Foreign Corrupt Practices Act.

(i) The Company may terminate this Agreement immediately in the event the Company concludes, in its sole opinion, that [agent, consultant, or company] has failed to meet its obligations hereunder.

Typical Provisions of an Export Control Compliance Program

Concerning export control compliance, the specific provisions of an export compliance program will depend on the particular needs and requirements of the company based on the export restrictions applicable to its products. The general components of an export compliance program are the following:

- The compliance program would detail the specific measures to be undertaken, such as:
    - Ensuring that each item to be exported by the company is properly classified against the CCL
    - Screening of export customers and export orders against prohibited export destinations and denied persons
    - Training procedures to ensure that employees properly implement the policies
    - Procedures for obtaining appropriate export approvals
    - Implementation of a reporting process with respect to possible prohibited transactions

In establishing a company-specific export program, the objective should be to minimize the compliance burden by adapting the compliance obligations to the company's existing sales and export review and approval procedures. In addition, under the BIS regulations, exporters must retain all records in connection with an export for five years. See 15 C.F.R. § 762.6. The record retention system should keep all documentation related to the transaction usually produced in the regular course of business (e.g., purchase order, invoice, shipping documents, including the shipper's export declaration), along with any BIS correspondence such as a classification ruling or export license. For a complete list of records to be retained, see 15 C.F.R. § 762.2.

Due Diligence Related to Anti-Corruption and Export Controls: Key Questions

Similarly, a mergers and acquisitions due diligence involving a target company that does business with foreign governments should thoroughly review compliance issues related to both export control and anti-corruption issues. For example, the typical due diligence related to export controls should include the following questions:

- Does the target manufacture, distribute, or export products, services, or technology that are subject to export restrictions under export control laws and regulations?
- Does the target do business with any individuals or entities on the government's restricted or prohibited parties lists?

- Does the target do business in the Middle East with a country that has recognized the Arab League boycott of Israel?
- Does the target employ non-U.S. citizens, and are they involved in any company activities involving export restricted technology that could raise "deemed exports" violations?
- Does the target have a comprehensive export compliance program in place that has been adopted by the board of directors or senior management to ensure that the company complies with export control laws and regulations and that the export compliance program has been disseminated to appropriate personnel involved in export activities?
- Has the target appointed an individual as being responsible for implementation of the compliance program (the "export compliance officer"), with sufficient authority to permit proper enforcement?
- Does the target ensure that each item to be exported by the company is properly classified under BIS regulations?
- Does the target screen export customers and export orders against prohibited export destinations and denied persons?
- Does the target provide and document training to ensure that employees properly implement the company's compliance policies?
- Does the target have procedures for obtaining appropriate export approvals?
- Does the target have a reporting process with respect to possible prohibited transactions?
- Has the government alleged any export control violations, or has the target made any voluntary or other disclosures of conduct that could be viewed as violations of the export control laws or regulations?

To adequately assess the risk related to anti-corruption issues in a merger or acquisition transaction involving foreign government contracts, the following questions should be addressed:

- Does the target have corporate compliance policies concerning FCPA-related activities?

- Does the target have an established FCPA compliance program, including training, monitoring, and mechanisms for employees to report potential violations and raise questions or concerns?
- Does the target conduct sales to foreign governments or government officials?
- Does the target have contractual relationships with any foreign officials?
- What type of marketing activities does the target engage in for its foreign sales?
- Does the target use commissioned sales agents to assist in marketing to the government or government officials, and if so, does the target have a process for conducting diligence on such agents?
- Does the nature of any other contacts with governments or government officials give rise to potential FCPA violations?
- Have FCPA or related local law questions and concerns been raised in the recent past?
- Does the target conduct internal audits or other reviews to identify any FCPA or related local law issues?
- Do the accounts, books, and records provide sufficient detail to demonstrate FCPA compliance and an adequate system of internal controls?
- Has the government alleged any FCPA violations, or has the target made any voluntary or other disclosures of conduct that could be viewed as violations of the FCPA?

Conclusion

For any company pursuing foreign government contracts, or considering an acquisition involving such contracts, it is essential that rigorous compliance programs are in place, including for both FCPA and export controls. Enforcement activity is on a sharp upward trend, and the high-visibility prosecutions and settlements ensure that any company doing business with foreign governments will be in a high-risk environment for the foreseeable future. In short, the only way to mitigate the risk inherent in doing business with foreign governments is to set the tone at the top with clearly articulated company policies and effective compliance programs for FCPA and export controls.

Richard J. Vacura *is a partner with Morrison & Foerster LLP's Northern Virginia office, where he heads the government contracts group. His government contracts practice is focused on information technology matters, including counseling, litigation, and claims development for international and domestic companies. His counseling experience includes due diligence reviews for domestic and foreign acquisitions, novation and assignment issues, drafting and negotiating teaming and joint venture agreements, technical data and non-disclosure agreements, export control, international anti-corruption, national security, and standard domestic and international solicitations and contract/subcontract terms and conditions. Mr. Vacura has been named a "Leading Lawyer in Government Contracts" in the* Chambers USA: America's Leading Business Lawyers *directory. He also was named a "Top Government Contracts Lawyer" in 2006 by the* Washington Business Journal.

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