Corporate Counsel's International Adviser

BUSINESS LAWS, INC.
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Issue No. 240
May 1, 2005

Letter from the Editor

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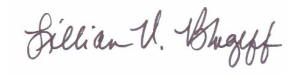
Dear Subscribers:

Transparency International, the global, nongovernmental organization dedicated to anticorruption, released its 2005 *Global Corruption Report* on March 16, 2005, focusing on corruption in the construction sector.

Transparency International publishes the results of an annual survey of business professionals that measures their perceptions regarding the corruption level of doing business in various countries around the world. The latest report notes that the cost of corruption in the construction sector is $300 billion annually. The organization is simultaneously launching an initiative to prevent corruption on such projects, which is discussed in the Updates section of this newsletter. For more information, see <www.transparency.org>.

Very truly yours,



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THE NEW DYNAMICS OF FCPA INTERNAL INVESTIGATIONS: OFTEN NOT A PRIVATE AFFAIR*

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I. Introduction

Even prior to the current spate of U.S. corporate accounting and fraud scandals, Foreign Corrupt Practices Act (FCPA) internal investigations were increasing in their frequency, scope, and seriousness. While sharing many of the issues common to all types of corporate internal investigations, FCPA investigations are particularly complex and challenging. The issues associated with such investigations, especially the issue of voluntary disclosure, have been fraught with internal debate and even angst.

Enron and its brethren have now produced the Sarbanes-Oxley Act of 2002, new SEC rules, new New York Stock Exchange rules, and other changes in corporate governance. These developments, while not FCPA-driven, are already having a significant impact on FCPA internal investigations, and particularly those conducted by companies with publicly traded stock. This impact is being seen in a variety of contexts, including the ongoing operations of multinational companies and, most strikingly, in the context of corporate mergers and acquisitions (M&A). The impact is enhanced by the SEC's emphasis on real-time enforcement and the greater predilection of corporate boards of directors in recent years toward voluntary disclosure of potential or actual FCPA violations. One might even question whether the term "internal investigation" has become somewhat of a misnomer in the FCPA context, given the tendency in recent years for such investigations to be used as an adjunct to law enforcement. The old model of an internal investigation as a truly internal matter, which companies pursued in the exercise of corporate responsibility, struggles to survive in an era when enforcement officials expect transparency, disrespect privilege, and feel free to substitute their judgment on remediation for the judgment of those entrusted with management oversight. Moreover, concerns regarding successor liability have recently led to extreme steps to avoid such liability in the M&A context.

The first part of this article will discuss recent FCPA cases in which internal investigations have been in-

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volved and demonstrate some of the trends, of concern to many thoughtful observers, that threaten the truly internal investigation. The second part will review some of the distinguishing features of FCPA internal investigations. The final part will discuss some of the implications of Sarbanes-Oxley and other recent developments for such investigations, and assess whether the trends reflected in recent enforcement actions are likely to continue.

II. Recent FCPA Enforcement Actions Involving Internal Investigations

A. The M&A Context

Nowhere is the new dynamic of FCPA internal investigations more striking than in the M&A context. M&A are generally associated with due diligence, not internal investigations; however, as recent cases demonstrate, that line can be very blurry. What is begun as due diligence may quickly become an internal investigation if the due diligence uncovers evidence of potential FCPA violations. The internal investigation in this instance may bear little resemblance to the traditional concept of an internal investigation. It may be conducted as a joint or parallel exercise of an acquiror and its target, often with ongoing reporting to enforcement authorities. Decisions regarding scope, discipline, and remediation are not exercises in judgment of the entity whose activities are the focus of the investigation, but may be taken by third parties with very different perspectives and goals, such as avoiding successor liability. The acquiror's judgment about what is necessary and appropriate may be very different from the target's. Even within an acquirer or acquiree organization, different parties — shareholders, management, the board of directors — may make different judgments, depending on their perception of enforcement risks and potential transactional benefits. The investigations become a focus of press reports.

Consider the following illustrations from recent cases.

1. ABB

ABB, a foreign issuer, proposed to sell two of its subsidiaries — ABB Vetco Gray, Inc., a U.S. company, and ABB Vetco Gray UK, Ltd. — to an investment consortium. In October 2003, a preliminary agreement with respect to the transaction was entered into. In the course of due diligence, evidence surfaced with respect to possible improper payments by the two subsidiaries in the course of their business activities overseas. The Opinion Procedure Release issued by the Department of Justice (DOJ) in July 2004 describes what transpired between the acquirors (referred to as the Requestors) and ABB in the following terms:

> Previously, after the Requestors and ABB had executed a Preliminary Agreement dated October 16, 2003, relating to the acquisition of the OGP Upstream Business, they agreed to mutually conduct an FCPA compliance review — through separately engaged counsel — of the OGP Upstream Business for the prior five-year period. ABB and the Requestors separately engaged forensic auditors to assist in the review and analysis of financial information, and ABB provided the Requestors with access to witnesses and records related to its OGP Upstream Business.
>
> Requestors have represented that the review of OGP Upstream Business involved more than 115 lawyers and over 44,700 man-hours. Requestors conducted a manual review of over 1,600 boxes of printed e-mails and other documents, CD-ROMs, and hard drives of electronic records, amounting to more than 4 million pages. Over 165 interviews of current and former employees and agents of the OGP Upstream Business were conducted. In addition, the forensic accountants visited 21 countries, assigning more than 100 staff members to review and analyze hundreds of thousands of transactions. Counsel for the Requestors also produced 22 analytical reports of OGP Upstream Business operations, with supporting evidence. All documents and witness interview memoranda were provided to the Department and the SEC as they were produced.

This "compliance review," clearly a massive investigation by another name conducted with apparent contemporaneous and full transparency to enforcement authorities, resulted in the DOJ's bringing of a criminal enforcement action against the two subsidiaries for alleged violation of the antibribery provisions of the FCPA, and the SEC's initiation of proceedings against the parent

company for alleged violations of the books and records and internal control provisions of the FCPA. The proceedings were settled with the subsidiaries' agreement to pay an aggregate fine of $10.8 million, and the parent's agreement to pay a civil fine of the same amount (offset against the criminal fine) and to disgorge profits from the transactions at issue of $5.9 million. *United States v. ABB Vetco Gray, Inc.* and *ABB Vetco Gray UK, Ltd.,* No. 04-CV-279-01 (S.D. Tex. July 2004); and *SEC v. ABB,* No. 1:04CV1141[RBW] (D.D.C. July 2004). *See also* SEC Accounting and Auditing Enforcement Rel. No. 2049 (July 6, 2004).

The acquirors also sought an opinion from the DOJ under its Opinion Review Procedure that they would not be prosecuted for proceeding with the transaction. Opinion Procedure Release 02-04 of July 12, 2004, summarizes the favorable opinion the acquirors received and the conditions attached thereto. These conditions included continued cooperation with U.S. and foreign authorities with regard to any further investigation of these matters, disclosure of any future violations discovered with respect to the acquirees, and the institution of a series of compliance measures with respect to the acquirees.

In many respects, the trajectory of the ABB matter followed that of the Cardinal Health/Syncor transaction in 2002, which resulted in the criminal prosecution of the Taiwanese subsidiary of Syncor and its agreement to pay a fine of $1 million for one violation of the FCPA. *United States v. Syncor Taiwan, Inc.,* Cr. No. 02-1244 (C.D. Cal. Dec. 2002). *See also In the Matter of Syncor Int'l Corp.,* SEC Admin. Proc. File No. 3-10969 (Dec. 10, 2002); SEC Accounting and Auditing Enforcement Rel. No. 1687 (Dec. 10, 2002). There again, the "internal" investigation that was conducted with respect to the activities of Syncor affiliates, principally in Taiwan but later extending to other foreign operations as well, was driven by the acquiror. Although Opinion Procedure Release 2003-01 (issued Jan. 12, 2003) does not mention Cardinal Health by name, it is widely believed to be the requestor in that case.

2. Lockheed/Titan

The FCPA issues in this transaction also arose from FCPA due diligence. In the fall of 2003, the parties announced their intention to proceed with an acquisition. From the beginning, the transaction was closely followed in the press. Due diligence subsequently uncovered indications of possible improper payments by Titan, and investigations were instituted by both parties to the transaction. U.S. enforcement authorities were notified of the matter, and the companies pledged to provide full cooperation, including providing them with the results of their internal investigation. In the spring of 2004, Lockheed announced it was lowering the acquisition price for Titan. The deadline for closing the deal was twice extended. When a late June 2004 deadline set by Lockheed for resolution of the government investigations of Titan was not met, Lockheed abandoned the transaction. All of this was reported in the press as it occurred. *See, e.g., Los Angeles Times,* Mar. 23, 2004, at C2; CBS.MarketWatch.com (June 26, 2004); Titan 8-K filings (June 29, 2004 & Aug. 4, 2004).

3. Teleglobe/ITXC

This case involves a somewhat different fact pattern, in that the evidence of potential FCPA violations did not surface until after completion of the acquisition of IXTC by Teleglobe, a foreign issuer, in May 2004. The company's 10-Q filed on October 15, 2004, relates the following sequence of events:

> On August 16, 2004, Teleglobe announced that after the merger with ITXC was consummated, as part of its normal ongoing review of ITXC's operations in connection with the post-merger integration of the Company and ITXC, the Company had identified and was investigating potential instances of noncompliance with the United States Foreign Corrupt Practices Act (FCPA) relating to ITXC's operations in certain African countries. The Company voluntarily notified the Securities and Exchange Commission (the SEC) and the U.S. Department of Justice (the DOJ) of the matter. The Company's Audit Committee subsequently engaged an outside law firm, Debevoise & Plimpton LLP (Debevoise), to investigate the FCPA-related matters. As a result of the investigation, the following individuals are no longer employed by the Company: the Company's Vice President, Sales-Wireless, formerly the Executive Vice President, Global Sales for ITXC; the Company's Regional Buyer for

Africa, formerly ITXC's Regional Director for Africa; and Theodore M. Weitz, the Company's Executive Vice President and General Counsel, formerly Vice President, General Counsel and Secretary of ITXC prior to its merger with Teleglobe.

The 10-Q also noted in the same discussion (of Legal Proceedings) that an executive summary of the results of the investigation was provided to the company's audit committee and external auditors. From the fact that the financial statements included in the 10-Q were unaudited, it may be inferred that the pendency of the FCPA issues had caused the auditors to decline to sign off on the company's financial statements. The investigation thus may have served another purpose of satisfying corporate auditors. Indeed, auditors have in recent years become another significant player in the dynamic of internal investigations.

In each of these contexts, the FCPA investigation or investigations was carried out within the context of the issues already having been disclosed to enforcement officials. Whether these were voluntary disclosures, or disclosures that were considered to be legally necessary due to the materiality of the FCPA issues discovered in relation to the acquisition, is not clear. What is clear is that the investigation or investigations took place effectively under the supervision of enforcement officials. In the *ABB* case, instead of the internal investigators digesting the information they gathered and preparing a report, the Opinion Procedure Release reports that documents and witness interview memoranda were furnished to the enforcement agencies contemporaneously with their production. In effect, the internal investigators acted as an adjunct of the enforcement agencies. Even this extraordinary level of cooperation, however, did not insulate either the subsidiaries or the parent from a very substantial fine.

B. Other Contexts

Outside of the M&A context, the picture from recent enforcement actions reflects a somewhat different dynamic. The *BJ Services* case, an antibribery, books and records, and internal controls case involving Argentina settled by the SEC this year with a cease and desist order, illustrates this point. The Consent Decree entered into between the company and the SEC reveals the following as regards the company's internal investigation:

1. Internal Investigation and Discovery of Other Payments

11. In June 2002, while investigating seemingly unrelated financial issues in Argentina, BJ Services senior management learned that violations of the Foreign Corrupt Practices Act might have occurred in Argentina. At the direction of the board of directors, a full internal investigation ensued. The investigation provided details of the payments noted above. The internal investigation also uncovered an aggregate of 151,406 pesos in additional undocumented or improperly characterized payments made by BJSA [BJ Services, S.A.] during the period from January 1998 through April 2002, the largest of which was 10,994 pesos, with a few in the 3,000 to 7,400 pesos range, and the remainder under 3,000 pesos. Most of the payments were to the third-party customs agent for unspecified customs charges and contained no supporting documentation. [Footnote omitted.]

2. Cooperation and Remedial Actions by BJ Services's Management

12. Upon discovery of the aforementioned payments, BJ Services began an internal investigation of such payments and their accounting, engaged outside counsel in both the U.S. and Argentina and disclosed the matters to its outside auditors and its full board of directors. Upon completion of BJ Services' internal investigation, BJ Services voluntarily and promptly approached the Commission's staff, notified the staff of the results of the investigation, and cooperated with the staff's investigation, including declining to assert its attorney-client privilege with respect to communications during the relevant time period.

13. Upon completion of BJ Services' internal investigation, BJ Services also undertook certain remedial actions. In particular, the company: arranged for proper classification of the equipment associated with the January 2001 payment to Argentine customs; revised the accounting treatment of the

subject payments and included the appropriate supporting documentation in the accounting records; replaced the management of the Latin American Region; approved the expansion of its existing corporate internal audit department and placed an additional audit manager in the Latin American Region reporting directly to BJ Services, director of internal audit; retained an additional independent auditor to conduct a forensic audit of its books and records in Argentina; and adopted an improved and expanded Foreign Corrupt Practices Act education and prevention program introduced in all of its regions worldwide.

Securities Exchange Act of 1934, Rel. No. 43940 (Mar. 10, 2004), Accounting and Auditing Enforcement Rel. No. 1972 (Mar. 10, 2004), Admin. Proc. File No. 3-11427.

The process in the *BJ Services* case, and the result, bear some similarity to that followed in the *Baker Hughes* case, where the company, following an internal investigation, disclosed the investigation results to enforcement officials, provided cooperation extending to the partial waiver of privilege, and undertook extensive remedial actions which, one may infer from the outcome of enforcement proceedings, were considered to be adequate by enforcement officials. *In the Matter of Baker Hughes Inc.,* SEC Admin. Proc. File No. 3-10572 (Sept. 12, 2001). Although penalties were not imposed, the disclosure left both companies with an SEC Consent Decree. Should subsequent violations of the FCPA occur, this would likely have the result of substantially increasing the penalties to which they would be subject.

Having reviewed some recent cases, let us step back and discuss FCPA internal investigations more generally, as well as the legal changes that have prompted the move away from truly internal investigations.

III. FCPA Internal Investigations

Distinguishing Features of FCPA Internal Investigations

Much has been written about internal corporate investigations, and this article, therefore, will not attempt to provide a blueprint for the conduct of such investigations in general. FCPA internal investigations are in many respects just another species of internal investigations. They share issues, tools and skills, characteristics, and pressures including time pressures common to many types of internal investigations. They may involve ongoing as well as past practices, where immediate action to "stop the bleeding" may be necessary when the practices are discovered. They may put significant commercial assets or activity at risk, or arise in a business context where quick decisions must be made. They require careful strategizing and planning, including decisions regarding scope and privilege. They can raise issues of corporate politics and personal agendas, and put careers at stake.

At the same time, there are a number of aspects of FCPA internal investigations that are unusual. They reflect the core character of the FCPA as a law that is transnational, extraterritorial, and focused on foreign government official action. They also reflect the focus of — especially for publicly traded companies and, particularly, in the wake of Sarbanes-Oxley — accounting and internal control issues. They are unusually complex, both factually and legally. Moreover, the fact-specific nature of FCPA issues, especially on the antibribery side, makes it critical to focus on "soft" issues of knowledge and intent. Finally, they can raise a number of significant collateral issues, including security, public relations, private and governmental enforcement risks, and others. These aspects make FCPA internal investigations particularly challenging and sensitive.

Below is a more detailed discussion of the questions that often need to be addressed in an FCPA internal investigation.

1. Whether to Investigate

A threshold question when an allegation of corrupt practices surfaces is whether it is sufficiently credible to merit investigation. Although all allegations must be taken seriously, the potential for abuse in this area must also be recognized. One must carefully consider the source of the allegation of corruption and the potential motives underlying the allegation, as well as the possibility of misunderstanding or confusion. In the FCPA context, it is not uncommon for allegations of corruption to be used as an offensive weapon, for example, to gain

an advantage in procurement, or to deter an acquisition. Even if the motives of the person alleging corruption are not pure, and even if their hands may not be clean, however, if they have credible evidence of possible corruption, it may be necessary to investigate, if only as a defensive matter. How to accomplish this, for example, in the context of an ongoing procurement if the company does not want to simply abandon the business opportunity unless or until it becomes clearer that there is in fact a problem, can be challenging.

2. Launching the Investigation

Deciding whom to inform, deciding who the client is (especially where multiple entities within a corporate group are implicated), taking steps to preserve privilege (assuming a decision has been made to preserve privilege to the extent possible), preserving documents, deciding on an initial scope, forming the team to investigate, and stopping any activities that could give rise to ongoing violations are all typical launch steps in the FCPA as well as the general investigative context. Attachment A contains a checklist of launch-related issues. In general terms, the FCPA context is no different. However, in practice, these issues are considerably more complex because of the likely wider reach, including into foreign jurisdictions, of the FCPA investigation. As that reach extends, the extent to which command and control structures exist to readily implement initial decisions is often reduced, posing challenges for the investigation. Moreover, the wider the scope, the more difficult it will be to know at the outset whether key team members are people who are free of any possible implication or can be trusted. Every aspect of the investigation, from communications to logistics, will be more complex than the typical investigation. For issuers, it will be critical to give attention to books and records and internal control/compliance issues as well as the bribery issues. Although criminal risks may be greater as to the latter, the former represent the Achilles heel of FCPA liability, and can in some circumstances carry criminal responsibility as well.

3. Foreign Subsidiaries and Affiliates

In recent years, as the examples in § I show, the majority of FCPA cases have involved business operations carried out by foreign subsidiaries or affiliates. An investigation will, therefore, typically encompass not only the parent company, but will implicate foreign subsidiaries or affiliates as well. Even where these entities are wholly owned or controlled by the parent company, the conduct of an investigation with respect to a foreign subsidiary can involve significant challenges. Where the entity is not owned or controlled, but is merely an affiliate, those challenges increase exponentially. Key issues, at the launch of the investigation and as it progresses, such as securing documents, require greater coordination and involve greater challenges and should not be assumed to be automatic even with subsidiaries. Parent/subsidiary issues must be examined, both from an accounting/control standpoint and from the standpoint of knowledge/authorization of the payments or transactions at issue. This requires an understanding of the corporate structure, reporting lines (including intermediate reporting persons or shareholding entities), and careful attention to the identity of actors. The differing jurisdictional reach of the antibribery and books and records provisions with respect to foreign persons also becomes an important factor. Issues (such as third-party relationships) must sometimes be reviewed across a company's foreign operations, especially once a problem has been discovered in one foreign operation. If a company has far-flung foreign operations, this can become a massive undertaking, although it may be possible to target representative jurisdictions.

4. The Demand Side

Even if no foreign subsidiaries or affiliates are involved, an FCPA investigation will invariably involve consideration of the action of foreign persons. Even though the FCPA focuses on the "supply side" of bribery of foreign officials and other categories of public persons, bribery is an activity that inevitably has two sides. However, the "demand side" of the bribery equation is always represented, but rarely accessible to the investigator. Thus, absent a foreign government proceeding against the foreign official, the investigators will be operating with limited information as to the demand side.

5. Intermediaries and Other Third Parties

Another category of third parties often involved where more information may be available than with respect to the implicated officials, are third parties with whom the company has a business relationship, for example,

non-U.S. partners, agents, representatives, consultants, or contractors. The degree of control over these persons will likely vary from some to none. This will affect access to relevant information and persons. Decisions must also be made as to the extent to which the investigation must encompass such persons who would typically be outside the scope of available privilege. If the conclusions of the investigation suggest undue risk from an association with the foreign person, such that termination or changes to the relationship are warranted, the key question will become the extent to which the contractual relationship permits such actions. More often than not, contractual rights come up short against the unforeseen facts of such situations, putting the company in the situation where the recommendations of counsel to reduce FCPA risks may create commercial risks from a breach of contract.

6. Privilege

Traditionally, the maintenance of privilege has been a key consideration in internal investigations, including FCPA internal investigations. The recent insistence of enforcement authorities on a waiver of privilege at least as to certain issues (in *BJ Services,* for example, as described above, the waiver related to communications during "the relevant time period") has limited the extent to which complete maintenance of privilege is a realistic expectation today. Against that backdrop, it must be emphasized that protecting privilege in the FCPA context, given its transnational character, is an even more challenging endeavor than in the general white collar context. Foreign jurisdictions may not follow the United States in the extent to which privileges are recognized, so that interviews that could be privileged if conducted on U.S. soil may not be privileged when conducted on foreign soil. As other countries' anticorruption efforts grow, these differences could become significant. Nonetheless, most companies opt to preserve privileges, since only if privileges are preserved from the outset, can the possibility of limited waivers be retained.

7. Need for Foreign Evidence-Gathering

Even if only U.S. persons are within the scope of the investigation, the transnational character of the FCPA means that the investigative process will almost certainly involve foreign evidence-gathering. Any such effort will require dealing with language and cultural differences that may affect the substance and reliability of the allegations, access to evidence, and the quality of evidence; geographic differences that may affect the cost and feasibility of evidence-gathering in person and require resorting to long distance methods of gathering information, with the challenges those methods create; time differences that can affect scheduling and other logistical issues; and local law issues as discussed below. Some key evidence (for example, bank account information of third parties) will likely not be available to the internal investigator because of privacy or secrecy limitations.

8. Local and Third-Country Law Issues

Besides the local law dimension of the privilege issue identified above, local law will invariably have a significant presence in FCPA investigations, even more than it does in FCPA counseling. Local law may affect whether and how witnesses may be interviewed, what documents may be provided and removed from the country, disclosure issues, and the analysis of whether an FCPA violation as well as local law violations have occurred. Local law may also create rights and remedies capable of being invoked by those under investigation in legal proceedings, for example, breach of contract suits, libel suits, or others./1/ To anticipate and address these types of issues, it will generally be necessary to associate local counsel in an FCPA investigation. If the matter is the subject of criminal proceedings or investigation in the foreign country, the local law issues become even more significant. Moreover, with other countries, adoption of transnational bribery laws pursuant to the Organization for Economic Cooperation and Development and other international anticorruption conventions, the possibility that a given transaction will implicate third-country antibribery laws as well as local law becomes very real (for example, because an intermediate subsidiary is located there).

9. The Local Political, Business, and Security Situation

Successful FCPA investigations require more than just a focus on legal issues. Investigators must develop an understanding of the local political, business, cultural, and security situation both at the time the conduct under investigation occurred and currently, as it may be

relevant to local remediation and disclosure issues. Investigating an FCPA issue in Indonesia is different from doing so in Russia, China, Saudi Arabia, Nigeria, or Mexico. The presence of elements of organized crime in some countries creates a potential for physical violence that must be taken into account in planning an investigation. And, even if there is no organized crime elements in play, security issues must be considered. Cultural issues come into play in evaluating witnesses and documentation and in planning and executing strategy.

10. Accounting Issues

In many cases, the issues in FCPA investigations will require the involvement of forensic accounting expertise within the team. This may not be the case where the investigation focuses on a fairly discrete set of issues or transactions; however, where the investigation involves a series of transactions over time, the need to do financial analysis of payments or other types of accounting issues, such expertise may be necessary. Retention of forensic accountants should be done in a way that is consistent with the company's privilege goals. They should not function independently, but as a part of the team.

11. Public Relations

The reputational risks associated with FCPA violations, and antibribery violations more generally, create a potential for press interest should they become aware of the issue. This interest may be exploited by whistleblowers or third parties, or may arise simply due to leaks within the company or elsewhere. The company conducting the investigation will often need to have at the ready a public relations plan and other plans to respond to press reports. This will include the possibility that reports of issues in one country will spread to another country, raising concerns there to which the company will need to respond.

12. Local Proceedings

Although "stopping the bleeding" (halting activities that may create a risk of ongoing violations) is typically a first priority when an investigation is initiated, the investigation may arise in the conduct of ongoing activities, for example, a competitive bidding process or regulatory actions that cannot be unilaterally frozen by the company simply because it has initiated an investigation. If the violation is only alleged, there will likely be strong business pressures not to jeopardize a business opportunity or to otherwise potentially adversely affect the company's business unless and until the investigation has clarified what has occurred. These can be among the most difficult issues for counsel to address.

13. Direction and Consultation

In § IV.A. below, we discuss who is most likely to direct today's FCPA internal corporate investigation. In many ways, this has come full circle from the FCPA's origins in the SEC's voluntary disclosure program of the mid-70s. Today, however, the number of players in an FCPA internal investigation has multiplied. In an M&A context, as we have seen, if a potential FCPA issue is identified in the target company, the acquirer will play a significant and possibly even driving role in the FCPA investigation. The company's external auditors, disclosure counsel, and enforcement officials, will also often play a role. This proliferation of players implies a considerably more complex process of reporting and consultation than was the case in recent decades.

14. Making Adjustments while Preserving the Integrity and Credibility of the Process

Once an FCPA investigation is launched, new issues will surface, such as whether the investigation needs to be extended to additional foreign operations or types of relationships, and what type of report to prepare. In addition, many of the issues addressed initially will likely need to be revisited as knowledge and circumstances evolve. New witnesses may be identified; witnesses may require reinterviewing as additional information emerges; and timing factors may change. Some aspects, however, will be irrevocably fixed (or freedom of action or ability to remediate significantly limited) by decisions made early in the process — privilege and document retention issues being the most obvious of these. Some issues encountered may implicate the integrity and credibility of the investigation. These areas going to integrity, credibility, or irrevocable choices can be the most agonizing. Counsel must constantly grapple with how to balance legitimate resource constraints against the need for a process that can later be defended as thorough and balanced. Prioritization, reprioritization, and adjustment become con-

stant features of the process. Surprises are not unusual. Conflicts or differences in judgment may arise between the investigators and the client regarding scope, priorities, focus, or interim steps to be taken. Especially in the wake of Sarbanes-Oxley, as discussed more fully in § IV. below, these issues have become complex and potentially charged.

15. Disclosure Issues

Disclosure issues have tended to generate great debate during the course of most FCPA internal investigations. The FCPA does not mandate disclosure, but other statutes, U.S. or foreign, may require it. In the United States, such a requirement can come from the general securities laws, International Traffic in Arms Regulations commission disclosure requirements, Office of Foreign Assets Control blocking notification requirements, boycott requests, or tax filings, among others. Accounting standards may also come into play in a way that effectively mandates disclosure. Local law may mandate it. And even if there are no legal requirements to disclose, it is clear that the DOJ and SEC encourage voluntary disclosure (although they have not quantified specific benefits that flow from such disclosure). The risk of an involuntary disclosure due to a press report, a whistleblower, internal or external to the company, or referral from another country's authorities or the World Bank cannot be overlooked; it is an increasing risk in today's climate of greater sensitivity to corruption issues. In a truly voluntary disclosure situation, the impact of a disclosure should also be taken into account: the likely government response, including the scope of a government investigation, penalty risks, and the risk of collateral sanctions and other proceedings; the impact of the government's likely insistence on at least some waiver of privileges; the resources required to defend the investigation, both out-of-pocket and management time; the public relations and business consequences in the United States and abroad; etc. Although the FCPA has been held by courts not to establish a private right of action, companies should anticipate that creative plaintiffs will find theories of civil liability to pursue. Recently adopted anticorruption treaties will only fuel this trend, as well as making it more likely that an asset acquired as a result of corrupt conduct will be put at risk. Faced with the lack of a clear benefit and this expanding list of risks, companies historically have tended to be reluctant to make voluntary disclosure. As shown by the cases discussed in § II., in recent years, corporate boards of directors and audit committees have often opted for disclosure, even when not mandated by law, believing that it is the course of action expected by enforcement officials. This trend, it should be emphasized, is not universal and companies even today do make different judgments about the relative costs and benefits of disclosure. Moreover, results such as the one in *ABB,* where significant penalties were imposed in the face of what was termed "extraordinary" cooperation by the disclosing entities, not to mention a massive investigative effort, underscore both the risks and lack of defined benefit in making disclosures. If disclosure is required as a matter of law, then there may be no choice. If not, one must question whether, even as to the issue of successor liability, a concern of most acquirors, it is not obvious that significant protection against such liability could not be obtained by a purely internal effort.

16. Discipline and Remediation Issues

Regardless of whether a mandatory or voluntary disclosure is made, an FCPA investigation puts disciplinary and remediation issues squarely on the table. The investigation needs to address both the specific individuals and relationships implicated in the investigation as well as the company's compliance program more generally:

— ***Discipline.*** If the investigation finds violations, the questions that drive discipline and remediation are various. How serious are the violations? Who committed the violations and with what state of mind? Are those persons still with the company? Are they persons who would be viewed as carrying significant compliance responsibilities or exercising "gatekeeping" roles such that their participation would be viewed with great concern by enforcement officials? In light of those factors, what sanctions should be taken against them and when? Are there any legal constraints, for example, under local law or contract, with respect to disciplinary action that could affect either the range of available sanctions or the process that must be followed? What are the likely consequences of any sanctions on such persons (*e.g.,* wrongful termination lawsuits, press disclosures,

etc.)? What should be done with persons who have not cooperated with the investigation or have been determined to pose undue risks going forward? Are there contractual relationships that need to be terminated or restructured? Do the contracts give the company the right to do what it would like to do from an FCPA perspective? Are there practices that need to be stopped in the foreign operation? All of these are, obviously, highly specific to the factual findings of the investigation.

— ***Remediation More Generally.*** The principal focus of more general remediation efforts will be on the company's compliance program, although internal control systems may also be implicated. Does the company have a compliance program? Does it include all of the policies and procedures that the investigation has shown to be necessary? Are there adequate resources, financial and otherwise, devoted to the program? Has there been adequate training? What is the capacity of the internal audit function with respect to the detection of FCPA issues? Does the company have the right compliance structure for its operations? Should a decision not be made to disclose violations voluntarily, thorough compliance and remediation is important and arguably even more important than if a decision is made to disclose. This is because, should the violations later come to light involuntarily, the company will be under great pressure to demonstrate that it has engaged in effective self-policing.

This brings us to the next major topic of this article, the impact of recent accounting and corporate fraud scandals on FCPA internal investigations.

IV. The Impact of Corporate Governance Reforms on FCPA Internal Investigations

Enron and other corporate fraud and accounting scandals of the early twenty-first century have produced the Sarbanes-Oxley Act of 2002/2/ and other reforms in corporate governance. These reforms are akin to what the USA PATRIOT Act has done to the rules for waging the war on terrorism. They are far-reaching and will have significant implications, some of which are already manifest, for FCPA self-policing, including the conduct of FCPA internal investigations by public companies.

A full review of Sarbanes-Oxley and other corporate governance reforms in recent months are beyond the scope of this brief article. Rather, this section will simply highlight some of the corporate governance changes that may have the greatest impact on FCPA internal investigations.

A. Who Is the Client? Past as Prologue

One already manifest impact of Sarbanes-Oxley and other reforms designed to strengthen supervision of management by the board of directors, and, particularly, by the audit committee, is that audit committees are more often engaging FCPA counsel directly, instead of relying on counsel selected by management. This represents a return to the earliest days of the FCPA as described earlier. Section 301 of Sarbanes-Oxley encourages this, by explicitly giving audit committees the authority to engage outside auditors and to cause the issuer to pay the costs of that engagement (Sarbanes-Oxley, § 301, amending § 10A of the Securities Exchange Act of 1934, 15 U.S.C. § 78f). This can lead to multiple and even (although rarely) competing investigations, if management also engages its own counsel to do an investigation, or it may lead to the investigation being centralized under the audit committee's counsel, especially given the cost implications and other complications of multiple concurrent investigations. Alternatively, it may result in the audit committee's counsel playing more of a reviewing than a direct investigating role. All variations are possible, but whatever variation prevails in a particular case, it is almost a certainty that there will be more, not less, outside counsel at the investigating table, and that some of them will be directly responsible to the audit committee.

B. Selection of the Investigator

Recent corporate governance reforms also will create pressures for more independent investigations. Although there are a few companies that maintain an internal investigative staff function, this is costly, and will likely mean more recourse to outside investigative resources that are perceived to be independent. The SEC's § 21(a) Report of October 2001/3/ flags as one of the factors it

will consider in determining an enforcement response is who did the investigation. The report does not use the word "independence," but the questions it raises suggest that the SEC will focus on whether internal or external resources were used, and, if external, whether they had done prior work for the company, among other factors. Sarbanes-Oxley does not articulate standards for an investigator's independence, but by focusing on auditor independence in Title II, and by emphasizing the need for independence on audit committees in § 301, it effectively suggests the need for independence of audit committee advisers.

Independence may not be the only factor to consider, however, in selecting an external investigator. If the FCPA issues implicate senior management for whom a law firm has worked in the past, or a transaction in which the firm has served as counsel, then it would be difficult for that firm, as much integrity as it might have, to be perceived as independent. (And perception may be as important as reality in defending the credibility of an internal investigation.) Or if the investigation implicates the advice of a law firm, that firm obviously could not credibly investigate the allegations. On the other hand, if those elements are not present, then it may not be a problem to have a firm involved that has done prior work for the company. Indeed, in some cases it may be a benefit, for example, where an understanding of the corporate structure, operations, or culture is key and time is of the essence. Completely new counsel may also be less attuned to subtleties that could affect either their factual undertaking or their ability to convince management or the board of the soundness of their advice. The ability to draw on past experience, and the confidence and trust that can be built in a relationship over time, can also be a victim of a pure independence model. The specialized expertise required for FCPA investigations should also be taken into account.

This discussion suggests that, rather than a hard-and-fast rule regarding independence, a case-by-case approach may need to be followed. More than in the past, however, the ability to demonstrate a significant element of independence will be critical in FCPA internal investigations going forward.

C. The Duty to "Rat"

A third important area to consider is the duty § 307 of Sarbanes-Oxley imposes on lawyers representing public companies. This section requires the SEC to impose standards of conduct requiring such attorneys to report evidence of a material violation of securities law or a material breach of fiduciary duty or similar violation by a company or any agent thereof first to the chief legal counsel or the CEO and, if they do not respond, including with appropriate remedial action, to go up the chain and report the matter to the audit committee of the board. In contrast to the rules imposed on auditors under the Private Securities Litigation Reform Act of 1995,/4/ Sarbanes-Oxley, and its implementing rules, does not require the lawyer to make further disclosure to the SEC.

Some have said that this provision merely codifies many states' existing rules of professional responsibility. While perhaps that is so, if the rules are found to apply in this context, they will likely give a potentially potent new weapon to outside counsel representing clients in FCPA internal investigations. The specific reference in Sarbanes-Oxley to remediation concerns underscores this point.

But while § 307 may be viewed as a weapon in the hands of outside counsel, thoughtful counsel will also take this provision as a serious burden. Going up the chain if one has been retained by senior management is no trivial matter; it could well rupture the relationship, probably irrevocably. And even if the investigator has no prior relationship, it starts a process that could significantly increase the likelihood of disclosure.

D. Compliance and Disclosure Issues

Sarbanes-Oxley increases management responsibility for internal controls, including establishing new certification requirements, requires the inclusion of management assessments of internal controls in annual reports, and establishes new criminal liabilities for knowing or willful false certifications. *See* §§ 302, 404, and 906. It also requires the establishment of codes of ethics for senior financial officers. *See* § 406. These obligations have sharpened, and will continue to sharpen, management's focus on internal controls, and may also have the collateral effect of increasing management's attention to the company's FCPA compliance program. Moreover, findings of internal investigations may affect the ability of management to make the certifications required by §§ 302 and 906 and other new corporate governance

measures, creating situations where disclosure will now be necessary where it might not have been before.

At the same time, the board of directors retains compliance program responsibilities under the *Caremark* decision. Moreover, in the current climate, boards and audit committees may be more inclined to opt for voluntary disclosure in today's environment than had been the case in the past.

The corporate governance reforms of Sarbanes-Oxley may, thus, have the effect, when added to preexisting obligations, of better aligning the obligations and interests of management and the board with respect to compliance and disclosure, and of tipping the balance in favor of disclosure in more cases. Without these legal changes, the pro-disclosure impact of Enron and other cases would likely have faded, as memories of the scandals became more distant. The new rules create the possibility of a long-term drift toward greater voluntary or prudential disclosure.

Nothing in the new rules changes the obligations of the SEC or DOJ in responding to a disclosure, however. Disclosers will still be taking their chances as to the enforcement action that will await them at the end of the process.

E. Other

There are many other provisions of Sarbanes-Oxley that are relevant to FCPA internal investigations, including the obstruction of justice provisions of §§ 802 and 1102 of the Act, the requirements for auditors to retain work papers in § 802, and the whistleblower protection provisions of § 806.

In the post-Enron world, companies must take special care not to engage in conduct that would suggest obstruction of justice by destroying documents or otherwise. This is as true in the FCPA context as it is in other corporate compliance contexts. In the FCPA context, however, the challenges in avoiding obstructions risks are more acute due to the FCPA's transnational character. Implementing document preservation orders in remote foreign subsidiaries may be a considerably greater challenge than doing so in the United States. Investigators may encounter cultural attitudes toward cooperation and openness that are deeply ingrained and make the task of preserving evidence and uncovering the facts much more difficult. In many countries, for instance, reporting adverse information on one's superiors is not culturally acceptable. Special attention will, therefore, have to be given to risk management in this arena.

V. Conclusion

This article has focused on the unusual aspects of FCPA internal investigations, how recent far-reaching changes in corporate governance are affecting the already challenging world of FCPA internal investigations, and how enforcement attitudes as well as acquirors fearing successor liability are affecting the dynamics of FCPA internal investigations. Although recent years have made the true internal investigation something of a threatened species, one must wonder to what extent the trend toward increased voluntary disclosure will be sustainable. Certain changed factors in the FCPA's operating environment undoubtedly make it more likely than it was in the past that corrupt conduct will come to light. On the other hand, the multiplication of enforcement and liability risks, and the absence of clear benefits resulting from disclosure, make the voluntary disclosure decision even more difficult than it has been historically. Whether or not there is disclosure, FCPA internal investigations need to be structured and managed for credibility, independence, and effectiveness.

ENDNOTES

/1/ In one recent matter in which we have been involved, for instance, a third party whose conduct had raised FCPA issues, causing the client to suspend payments to it, brought proceedings in the local jurisdiction to have the company's local subsidiary wound up for nonpayment of debts. Although the company had a contractual basis for withholding payments given the issues that had arisen, under local law, these proceedings were entirely independent of the parties' contractual rights and obligations.

/2/ Pub. L. No. 107-204, 107th Cong., 2d. Sess., July 30, 2002, 116 Stat. 745 (hereinafter Sarbanes-Oxley).

/3/ Report of Investigation Pursuant to § 21(a) of the Securities Exchange Act of 1934 and Commission Statement on the Relationship of Cooperation on Agency Enforcement Decisions, Securities Exchange Act of 1934, Rel. No. 44969, Accounting and Auditing Enforcement, Rel. No. 1470 (Oct. 23, 2001).

/4/ Pub. L. No. 104-67, § 301, adding § 10A to the Securities Exchange Act of 1934.

ATTACHMENT A

Checklist of Issues to Be Considered in Launching an FCPA Internal Investigation

— Are the allegations of FCPA violations credible or questionable? For example, is the source a credible one? Do the allegations need to be tested, and if so, how, before a decision to conduct a full investigation can be taken?

— Are there ongoing activities that need to be halted/ frozen pending any investigation to minimize the risk of further violations?

— What steps need to be taken to preserve documents and where?

— Who should conduct the investigation? Inside counsel? Outside counsel? Regular outside counsel or special outside counsel, to provide an additional layer of independence? What is necessary for FCPA outside counsel to be considered independent?

— To whom should the investigators report? Management? The audit committee of the board (for publicly traded companies and those private companies that have them)? The full board? Some combination of these?

— Who is the client? Is there a need for representation of multiple persons? Should there be joint or separate counsel? If joint, on what terms?

— What legal department are necessary to support, direct, and coordinate with outside counsel?

— What other resources need to be involved, internally or externally? Audit, forensic accounting, local counsel, security personnel, public relations, other (*e.g.,* translators)?

— Who should ***not*** be involved (for example, because they are potentially implicated)?

— What should the scope of the review be, in temporal, geographic, or other terms?

— Where foreign operations are involved, what is the U.S. parent's degree of control over that operation?

— To what extent should the investigation be structured to maintain privileges (attorney-client and work product); to what extent has the ability to do so been compromised by prior nonprivileged disclosures?

— Are there imminent risks of third-party disclosure (*e.g.,* whistleblowing) that will affect timing and strategy?

— Where is the documentary evidence and how can it best be gathered? To what extent has evidence been lost, destroyed, or compromised already? Are there imminent document destruction dates?

— What is the extent to which electronic communications, especially e-mail, may be involved, and how does the accessibility of that information differ from the paper documents?

— Where are relevant witnesses? To what extent are they under the company's control? To what extent are they accessible? Who are the priority witnesses to interview?

— What should the sequencing of document-gathering and review and witness interviews be?

— Are there immediate disclosure obligations? To whom and of what? Under U.S. local law? Local law? To lenders? To other third parties?

— What areas need to be addressed as a matter of priority, either because of the possibility of continuing violations, changes in circumstances, deadlines, possible third-party issues, or the like?

— What factual background is necessary to effectively pursue the investigation? For example, what needs to be known about corporate structure, lines of reporting, the business activity at issue, the country or countries at issue? ■

CHANGES TO CANADIAN IMMIGRATION LAW — WHAT EMPLOYERS AND EMPLOYEES NEED TO KNOW*

*Benjamin A. Kranc***

As some readers may be aware, Canada's new Immigration and Refugee Protection Act (IRPA) came into effect in June 2002. The law was created in a way so as to give great power to change "rules" without the need for a legislative amendment; many changes can be implemented by simply changing the regulations.

There are, of course, many issues that we wish to bring to the attention of readers as IRPA evolves, but this article will apprise readers of some changes to the regulations that came into effect in August 2004, which can have a great impact on Canadian employers and foreign workers.

Some of the more salient changes affecting work permits may be summarized as follows:

Previously, all but Americans who were applying for HRSDC (Human Resources and Skills Development Canada — previously HRDC) confirmed work permits were required to apply at a visa post. Now, persons from visa-exempt countries may apply for work permits that have HRSDC confirmation at a port of entry.

In the test for HRSDC confirmation, generally necessary for work permit issuance (subject to various exemptions), one of the elements to be considered has changed from the "economic impact on the labour market" to the "impact on the labour market." The exact ramification is as yet untested, but this may create at least a psychological restriction on broader arguments of benefits to Canada of bringing in a foreign worker.

It is no longer a requirement for a work permit application that the applicant be admissible to Canada (*i.e.,* no criminal record, etc.). This may seem an unusual provision; however, it must be viewed in the context of the overall scheme. It is still true that someone inadmissible to Canada may not be admitted and as such may effectively be denied a work permit. However, in addition to inadmissibility provisions generally, the regulations had provided for some specific characteristics that were required of work permit applicants, including non-inadmissibility. The difference now is that it is recognized that if the inadmissibility is overcome through the issuance of a Temporary Resident Permit (TRP) then the general inadmissibility is resolved and a work permit can be issued. Otherwise, a TRP would have been essentially ineffective in getting someone a work permit in Canada.

The test for the appropriateness of the wages being paid to a prospective worker, from HRSDC's point of view, has been changed from "sufficient to attract Canadians" to "the prevailing wage." This could have a negative impact on smaller companies, who, though offering legitimate wages (which would attract a Canadian) may not be offering the same wages as large national or multinational organizations. It would seem that the bar in this regard has been set much higher. Prevailing wage information is available at <lmi-imt. HRSDC-drhc.gc.ca>.

The new regulations provide that someone working legally in Canada without a work permit pursuant to IRPR § 186 (*e.g.,* journalists, clergy, and a number of other exemptions), may now apply for a work permit inside Canada (*i.e.,* for a matter requiring a work permit, assuming the requirements are, of course, met) immediately. Previously, there was a three-month waiting period. Note that this does not apply to business visitors.

These reflect important changes in the processing of work permit applications and related matters and should be noted by those affected. ■

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UPDATES*

ANTICORRUPTION

Transparency International Releases 2005 Global Corruption Report Focusing on Construction Sector

Transparency International (TI) released its 2005 *Global Corruption Report* on March 16, 2005, with the report focusing on corruption in the construction sector. The cost of corruption in the construction sector is over $300 billion a year, with the report citing case studies of large-scale infrastructure projects that have been rife with corruption, including bribes paid to secure contracts for the Lesotho Highlands Water Project, among others.

Simultaneously with the publication of the 2005 report, TI is launching an international initiative aimed at preventing corruption on construction projects. In support of the initiative, TI produced a series of reports and business tools including the following:

— three separate risk assessments and action plans including one for project owners and developers in the private or public sector; one for banks, export credit agencies, guarantors, and insurers; and one for construction and engineering companies and consulting engineering firms;
— a report that gives detailed examples of corrupt practices on construction projects;
— reports on how the use of integrity pacts and independent assessments can reduce potential corruption; and
— model construction integrity pacts and codes of conduct.

TI is planning on using the tools to lobby governments, public and private sector project owners, multilateral development banks, commercial banks, insurers, and construction and engineering firms, among others, to take action to prevent corruption on construction projects. For more information, including a copy of the TI report, see <www.transparency.org> or <www.globalcorruptionreport.org>.

GRAY MARKET GOODS

Trademarked Goods That Differ Materially from Authentic Goods Subject to Injunction

Trademarked goods that may be sold under a sell-off agreement are materially different from goods sold in the trademark owners' stores, making them gray market goods and subject to a injunction preventing such sale, a district court held. *Abercrombie & Fitch v. Fashion Shops of Kentucky, Inc.,* No. 1:05cv29 (S.D. Ohio Feb. 16, 2005).

In the case, Abercrombie & Fitch brought suit against Fashion Shops of Kentucky, a discount retailer, seeking to enjoin sales of its clothing which Abercrombie claimed were counterfeit or not genuine. In September 2004, an Abercrombie employee learned that Fashion Shop was selling Abercrombie merchandise in a store in Louisville, Kentucky. He visited several Fashion Shop stores in October and determined that 50 percent of the merchandise was counterfeit. Although the remaining merchandise appeared to be genuine, it was determined that the merchandise was most likely that which should not have been offered for sale in the United States. Rather, the merchandise was most likely of the type that had been produced by a manufacturer for Abercrombie & Fitch, but which had been rejected by the company for quality reasons. This merchandise was able to be sold by the manufacturer, pursuant to a sell-off agreement, but the merchandise was not to be sold in the United States, and was supposed to have its brand name on all interior labels "blacklined" or cut through prior to being sold. These would, thus, be gray market goods or goods that would be sold in the United States without the consent of the U.S. trademark holder. *See KMart Corp. v. Cartier, Inc.,* 486 U.S. 281 (1988).

* *Lillian V. Blageff, an associate editor at Business Laws, Inc. and a member of the Ohio Bar, is the author of these Updates.*

The court cited the decision in *Société des Produits Nestle, S.A. v. Helvetia, Inc.,* 982 F.2d 633 (1st Cir. 1992), where it was held that the scope of protection for gray market goods turns on the degree of difference between the product authorized for the domestic market and the allegedly infringing product. That court noted how the unauthorized importation and sale of materially different merchandise creates confusion on the part of consumers and impairs the local trademark holder's goodwill. It further explained that there is no set way to determine when a difference becomes material, but that the threshold should be kept low enough to take account of differences that are not obvious enough to make it clear to the average consumer that the origin of the product differs from his or her expectations.

The district court noted that it is the confusion over the source of the product which is dispositive, not solely the intended market. The district court noted that other circuits had adopted this approach and that this case presented a similar situation — it was possible that some of the merchandise sold in the Fashion Shop stores was merchandise that was subject to the sell-off agreements. That is, it was merchandise that was authorized under Abercrombie's mark for production and sale abroad, but apparently was brought into the United States in violation of this agreement.

In determining whether the difference is material, the court noted that Abercrombie presented evidence that it maintains strict standards of quality and appearance and that the goods authorized for sale under the sell-off agreements did not meet these standards and was materially different. Further, these differences might not be obvious to the average consumer. In addition, the merchandise authorized for sell-off was required to be modified according to Abercrombie's requirements for the interior labels. The court, thus, concluded that Abercrombie had shown a likelihood of success on the merits and granted the injunction.

EXPORT CONTROLS

Department of Commerce Issues Rules Allowing U.S. Companies to Use or Service Goods That Were Exported to Libya

The Department of Commerce published a new rule, to facilitate U.S. companies' participation in the Libyan markets, that would allow U.S. companies to use or service items that may have been originally illegally exported or reexported to Libya by third parties. 70 Fed. Reg. 14387 (Mar. 22, 2005). The rule pertains to so-called installed base items and includes requiring a report to the Bureau of Industry and Security (BIS) for certain activities without requiring a license, as well as those activities that require a license.

Items that are subject to the Export Administration Regulations but are not on the Commerce Control List (CCL), items on the CCL that are now authorized for export and reexport to Libya under a license exception, and items on the CCL that are controlled for national security or antiterrorism reasons only and are not on the Wassenaar Arrangement's Sensitive List or Very Sensitive List will require a report, only, to BIS. For more information, see the *Federal Register.*

Panel Set to Discuss Possible Curbs on Exports of Nanotechnology

A presidential advisory panel has been established to assist policymakers on whether the United States should consider restricting exports of nanotechnology for national security reasons, according to the *International Trade Reporter.* 22 *Int'l Trade Rep.* 290 (BNA) Feb. 24, 2005. The President's Export Council Subcommittee on Export Administration will initiate a study to look at the potential opportunities presented by the development of nanotechnology, as well as the possible implications of such technology on export controls.

SANCTIONS AND EMBARGOES

Treasury Issues New Guidelines on U.S. Payment Policy for Agricultural Exports to Cuba

The Department of the Treasury issued new guidelines to clear up any lingering confusion among U.S. exporters about the payment process they must follow when selling agricultural products to

Cuba, according to a March 16, 2005, press release. Sales of certain agricultural products to Cuba are allowed under the Trade Sanctions Reform and Export Enhancement Act of 2000 (TSRA) as long as they are financed by payment of cash in advance or through financing by a third-country financial institution.

In response to the TSRA, the Office of Foreign Assets Control (OFAC) amended the Cuban Assets Control Regulations (CACR) to make certain changes regarding such financing. With respect to third-country financing, the regulations permit U.S. institutions to confirm or advise such financing. These provisions are included in § 515.533(a)(2) that provide for cash payments, or for financing by a banking institution located in a third country, provided the banking institution is not a designated national, U.S. citizen, U.S. permanent resident alien, or an entity organized under the laws of the United States of any jurisdiction within the United States (including foreign branches). Financing obtained this way may be confirmed or advised by a U.S. banking institution. Financing through letters of credit by a bank in a third country has always been authorized under the TSRA.

In the summer of 2004, OFAC began receiving inquiries from U.S. financial institutions seeking guidance on the question of whether or not the shipment of goods prior to receipt of payment by U.S. exporters was permitted under the CACR. After consultations with various other governmental agencies involved in export transactions, OFAC issued a clarification that "payment of cash in advance" with respect to shipments of agricultural items shipped to Cuba under licenses issued by the Department of Commerce means payment prior to shipment of goods, not prior to delivery of the title in the goods.

A grace period of thirty days was provided with the clarification issued February 24, 2005, in order to allow exporters to complete cash transactions that may have resembled a mechanism more closely resembling documentary collection, where shipment may be made provided cash payment is received prior to delivery of title in the goods. For more information, see 70 Fed. Reg. 9225 (Feb. 25, 2005).

INTELLECTUAL PROPERTY

WIPO Endorses Series of International Patent System Reforms

A committee of international experts meeting at the World Intellectual Property Organization (WIPO) in February 2005 endorsed a series of reforms of the International Patent Classification (IPC) system for classifying patents that would significantly reduce the patent search workload of industry property offices of WIPO Member States, according to a March 1, 2005, press release.

Plans for a new eighth edition of the IPC were also approved, and the new reformed IPC will enter into force on January 1, 2006. The changes have been developed over a period since 1999 and have resulted in the IPC being divided into two levels — a core and advanced — to satisfy the different needs of large and small offices; the creation of an Internet version of the IPC to enhance research and classification; a plan to revise the core level every three years and the advanced level at an accelerated pace to allow for the rapid introduction of changes needed because of technological developments; and access to the worldwide collection of patent documents using the databases of the European Patent Office. Both the Internet version and printed versions of the core level of the eighth edition of the IPC will be available in English and French in June 2005. For more information, see <www.wipo.org>.

UNFAIR COMPETITION

United States Wins WTO Case on Geographical Food Names

A World Trade Organization (WTO) panel agreed with the United States's contention that a European Union (EU) regulation regarding geographical indications (GIs) for geographic food names discriminates against U.S. products and is contrary to WTO rules, according to a U.S. Trade Representative (USTR) March 15, 2005, press release.

GIs indicate the geographic origin of a product where the product has some attribute or reputation associated with that origin, such as

Florida oranges, Vidalia onions, or Idaho potatoes. The WTO Agreement on Trade-Related Aspects of Intellectual Property (TRIPS) provides that GIs may be protected in various ways, but this protection usually takes the form of ensuring that consumers are not misled as to the geographic origin of the good. The EU has a special regulatory regime for geographical indications, separate from its trademark system, which depends to a large degree on government intervention. In contrast, the United States protects GIs through rights provided to private rightholders under the U.S. trademark system.

The United States filed a complaint with the WTO that the EU system discriminated against U.S. GIs and failed to protect U.S. trademarks. With respect to discrimination, the United States claimed the EU system imposed significant barriers to registration and protection for non-EU persons and non-EU products. The United States also claimed that the EU GI regulation did not permit trademark owners to properly enforce their rights because consumers might be confused regarding linguistic variations of GIs. The WTO clarified that the EU regulation could protect GI names only as registered, and not foreign translations or linguistic variations. As an example, U.S. beer maker Anheuser-Busch has asserted that the Czech brewer Budvar cannot use the name BUDWEISER (which is German for the Czech place named Budvar). The USTR had asserted that although there are 600 registered GIs in Europe, none are from non-EU countries. The United States had originally requested dispute consultations with the EU in June 1999, and a WTO panel was requested on August 18, 2003, to resolve the dispute. For more information, see <www.ustr.gov> or <www.wto.org>. ■

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CALENDAR

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