

Ways To Avoid The Pitfalls Of Expanding Abroad

Law360, New York (December 06, 2013, 1:38 PM ET) -- As U.S. companies seek new markets abroad, they may also encounter new areas of U.S. government regulation and enforcement. In a slow recovery, the benefits of foreign revenues are clear, but international expansion also carries some significant risks. Thus, any company reaching for opportunities abroad should plan carefully to ensure that the risks are properly identified and managed. As counselors to businesses large and small encountering those risks, we offer the following thoughts on high-priority compliance areas that should be considered for companies looking to increase overseas sales, particularly in the aerospace and defense sectors.

Anti-Corruption Compliance

In our experience, most companies are familiar with the U.S. Foreign Corrupt Practices Act (FCPA). The FCPA prohibits bribery of non-U.S. government officials by U.S. companies and persons, issuers on U.S. stock exchanges, or people physically present in the United States, in order to obtain or retain business. Many elements of the offense have been interpreted broadly by the courts, so, for example, a bribe to obtain an unfair advantage by circumventing government licensing or customs procedures are violations of the statute. Similarly, bribes paid to employees of state-owned entities are violations.

As many companies are also aware, enforcement of the law over the past decade has increased, generating large monetary penalties and jail time for corporate officers, investors, and their agents. As has been increasingly reported in the press, the investigation of alleged violations can involve wide-ranging investigations and substantial legal fees even before any penalties are imposed.

Based in part on these developments, in our experience an increasing number of companies have taken a proactive approach by making sure they have good procedures in place. In guidance published in November 2012, the U.S. government provided a few clear guidelines about what the U.S. government is looking for in a compliance program.

The single most important tip is that a company must understand its own anti-corruption risks and take reasonable measures to address those risks. A good anti-corruption program should reflect a thoughtful review and analysis of a company's business activities, including: (1) where it does business; (2) how it engages third parties acting on its behalf; (3) how it will treat hospitality, gifts and entertainment; and (4) how to self-evaluate compliance.

A company expanding abroad should also understand what other anti-bribery laws apply to it. Some, like the U.K. Bribery Act have powerful long-arm jurisdiction provisions. Some, like the Hong Kong Prevention of Bribery Ordinance, prohibit commercial bribery as well as bribes of government officials. Countries like Brazil have recently developed new anti-bribery laws, so it is critical that companies keep track of developments in countries where they operate.

ITAR Brokering and Commission Reporting

Companies that sell defense-related goods or services outside the United States should be aware of requirements under the International Traffic in Arms Regulations to register with the U.S. Department of State's Directorate of Defense Trade Controls as an exporter of such articles or services under the ITAR. In addition, companies that are involved in brokering activities related to defense articles or services on behalf of another company must register with DDTC. Moreover, companies that pay commissions, fees or political contributions abroad may have ITAR reporting and record keeping obligations. Being aware of these requirements in advance can help to facilitate non-U.S. transactions regarding defense articles and services.

The brokering registration requirements came into effect in October 2013. They now apply to: (1) U.S. persons, wherever located; (2) any non-U.S. person located in the United States; or (3) any non-U.S. person that is owned or controlled by a U.S. person. Brokering activities for which registration is required include "any action on behalf of another to facilitate the manufacture, export, permanent import, transfer, reexport, or retransfer of a U.S. or foreign defense article or defense service, regardless of its origin." 22 C.F.R. 129.2(b). There are limited exceptions for administrative services, and for activities performed on behalf of an employer or affiliate.

The ITAR also regulates certain fees or commissions related to sales of defense articles or services valued in excess of \$500,000. Under the provisions, companies that are applicants for DDTC export control licenses or that supply the U.S. Department of Defense with services or articles valued in excess of \$500,000 must report to the DDTC when they seek to provide non-U.S. political contributions of \$5,000 or more, or pay fees or commissions of \$100,000 or more. Reports made under the provision must contain detailed information about the fees and contributions paid, including the recipients of those payments.

To comply with these provisions, companies may need to register and may need to file reports, depending on their specific activities. It is also good practice to understand whether any third parties you may work with overseas are subject to the brokering provisions, and encourage them to register as appropriate.

Export Control Reform

In an effort to increase exports and lower regulatory burdens for certain defense-related goods and services, the Obama administration has undertaken a comprehensive export control reform effort. That effort has resulted in certain new definitions, and many items moving from being controlled under the ITAR to the Export Administration Regulations, administered by the Department of Commerce's Bureau of Industry and Security.

As part of that effort, amendments to several categories under the U.S. Munitions List to the ITAR have already been enacted. Changes to USML Categories VIII (aircraft and associated equipment), XVII (classified defense articles), XIX (gas turbine engines and associated equipment), and XXI (miscellaneous articles) took effect on Oct. 15, 2013.

Final rules have been published for changes to Categories VI (vessels of war and special naval equipment), VII (tanks and military vehicles), XIII (auxiliary military equipment), and XX (submersible vessels, oceanographic and military equipment), which will take effect on Jan. 6, 2014.

In general, companies that make goods in these areas may have less restrictive licensing requirements and greater license exceptions under the new classifications. Some defense articles that are moving to the EAR will still be subject to special EAR-based controls. Companies that have not dealt with the EAR should ensure that they both properly classify their items under the new categories, and understand the new options that may be available to them under the EAR.

STA License Exception

One such option may be the Strategic Trade Authorization, or STA license exception. First published in June 2011, the STA license exception allows shipments to certain countries that are close allies of the United States. While the exception thus provides a major new avenue for exports of many commercial or dual-use items for shipment without a BIS license, it is subject to several requirements. The major requirements are as follows:

1. The exception only may be applied for certain reasons for control. If an item is subject to a reason for control not contained within the STA exception, it cannot be shipped under the exception;
2. Items categorized under certain Export Control Classification Numbers are specifically excluded from shipment under the STA exception;
3. The STA is not available for end-user or end-use based controls, or embargoes;
4. STA has special recordkeeping requirements, including that an exporter must notify the consignee in writing that the shipment is made pursuant to License Exception STA, and the consignee must provide a statement that it is aware the shipment is being made pursuant to STA; and
5. There are special requirements for use of the STA license exception for "600 series" items that were moved onto the EAR from the ITAR as part of export control reform.

On balance, companies that understand and use the STA license exception, particularly those companies that do regular business with governments of close allies to the United States, can obtain an advantage over competitors who do not understand or use the exception.

Conclusion

These laws can be complex, especially where they intersect with one another (as they often do in international business). Companies that understand the law and plan ahead for compliance in concert with foreign expansion will position themselves for long-term success, without the business disruptions and loss of confidence that can arise from U.S. government investigations or enforcement.

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