CHAPTER 14

Foreign Operations and Investments

The purpose of the acquisition review of the target company's (Company) export and foreign activities is to determine the extent to which the Company's operations and investments comply with U.S. laws and regulations and to identify steps required to confirm that the Company is in compliance with foreign laws.

The U.S. laws and regulations applicable to domestic companies with foreign operations and investments relate primarily to (1) exporting and reexporting U.S.-origin commodities and technical data; (2) conducting business with U.S.-embargoed countries; (3) participating in boycotts prohibited by U.S. law; (4) engaging in business activities involving payments to foreign government officials; and (5) engaging in business combinations that violate U.S. antitrust laws. Local foreign counsel generally must be consulted regarding compliance with applicable foreign laws and regulations, and a list of issues that would normally be considered by purchaser's counsel is set forth below.

LEGAL BACKGROUND

U.S. Export Controls

A. Export Administration Act

The Export Administration Act (50 U.S.C. ß 2401) regulates the export of commodities and technical data from the United States and their reexport to third countries. The law is intended to prevent the transfer of technologies that could enhance the military potential of other countries, to halt the proliferation of nuclear and chemical weapons and the depletion of scarce resources, and to advance U.S. foreign policy.

The Department of Commerce, Bureau of Export Administration (BXA) is charged with enforcement of the act. BXA classifies commodities and technical data by level of technology, product type, and destination. Depending on these classifications, an export or reexport may be permissible only with specific license authorization or prohibited altogether. A U.S. exporter may be liable for violation of the statute if it exports or attempts to export with "knowledge" or "reason to know" that the statute has not been complied with.

B. Arms Export Control Act

The Arms Export Control Act (22 U.S.C. ß 2778) prohibits the export of defense articles and services that add to the military potential of other countries and terrorist groups. The prohibited items are specifically identified on the U.S. Munitions List set forth in the International Traffic and Arms Regulations (ITAR) administered by the U.S. Department of State, Office of Defense Trade Controls (formerly the Office of Munitions Control). The ITAR controls are of particular concern to companies engaged in sales of military and defense-related equipment. The law may also prohibit the export of any commodity or product if it has substantial

military applicability or has been modified for military purposes (e.g., over-the-counter software with encryption features).

C. Other Export Control Laws

While the Departments of Commerce and State have primary responsibility for regulating exports, there are other federal agencies whose regulations may affect the operations of the Company. These include the Department of Justice, which administers the Controlled Toxic Substances Import and Export Act (exports of pharmaceutical drugs), and the Department of Energy, which administers the Atomic Energy Act (exports of nuclear-related products), the Federal Power Act (exports of electricity), and the Natural Gas Act (exports of natural gas).

U.S. Embargoed Countries

Under authority of the International Emergency Economic Powers Act (50 U.S.C. ß 1201) and other federal statutes, the president has imposed trade controls on countries that present a threat to U.S. national security or foreign policy. The Office of Foreign Assets Control of the Department of Treasury (OFAC) has primary authority for promulgating and administering regulations implementing these embargoes. OFAC regulations typically prohibit a wide range of business activities, such as imports from the embargoed country (e.g., Iran) and dealings in property in which the embargoed country has an interest (e.g., Iraq).

Foreign Corrupt Practices Act

The Foreign Corrupt Practices Act (15 U.S.C. ßß 78dd.1, 78dd.2, and 78m(b)) prohibits certain payments to foreign government officials for the purpose of influencing regulatory actions. Prohibited activities include bribing foreign officials and maintaining inadequate internal accounting procedures that could shield illegal payments. The bribery provisions comprehend any payments or gifts made to government officials, employees, or candidates for the purpose of obtaining or retaining business in a foreign country. The accounting provisions require any U.S. company subject to U.S. securities laws to maintain detailed records of its foreign operation's business transactions.

This statute is enforced by the Department of Justice and the Securities and Exchange Commission. Culpability under the act requires "knowledge" on the part of the violator, which includes conscious disregard of known circumstances. The act should be treated with great care and is of particular importance to companies that regularly engage foreign agents. An important exception to the antibribery rule permits "facilitating payments" to government employees for routine governmental actions (e.g., obtaining permits, providing telephone or electric service). Additionally, an affirmative defense exists for payments that are lawful under a foreign country's written laws or expenditures associated with product demonstration.

Antiboycott

The Export Administration Act's antiboycott provisions (50 U.S.C.App. 2401 (Section 8 of the act)) prohibit participation by U.S. companies in "secondary" or "tertiary" boycotts of other countries (e.g., the Arab boycott of Israel). This law is administered by the Department of Commerce, Office of Antiboycott Compliance. Prohibited activities include discriminatory conduct based on sex, religion, race, or national origin; refusal to do business with a boycotted person, entity, or country; furnishing to a foreign government or customer information about one's business relationships or affiliations with charitable organizations or a person's race, religion or national origin; and implementing letters of credit containing prohibited conditions (15 C.F.R. 769).

This law is of special concern to companies doing business in the Middle East. Culpability exists if a company or person engages in the prohibited activities and is shown to have intended to support a boycott. The Department of Commerce shares enforcement jurisdiction with the Department of Justice, which prosecutes criminal violations, and the Department of Treasury, Internal Revenue Service, which imposes certain reporting requirements on U.S. taxpayers.

Antitrust

An acquisition may implicate U.S. antitrust laws by reason of the Company's foreign operations in two ways: (a) the combination of the purchaser's and the Company's activities in certain lines of business of U.S. foreign commerce may result in a prohibited degree of concentration; and (b) the foreign commerce activities of the Company itself, generally in concert with foreign trading partners, have anticompetitive results for U.S. businesses. Although this book does not address the analysis or resolution of issues relating to the legality of the acquisition under U.S. antitrust laws, Chapter 13 refers to issues that should be considered with respect to anticompetitive practices of the Company in foreign commerce.

ISSUES TO BE CONSIDERED

U.S. Regulatory Exposure

A. Export Controls

___ 1. Is the Company or any division significantly engaged in export activities?

___ 2. What types of products or technical data does the Company export?

___ 3. Do any of the exported products have military applicability?

___ 4. Does the Company have a formal export compliance program?

___ a. Company policy manual

___ b. Decision-making structure or organization

___ c. Personnel charged with compliance responsibility

___ 5. Are any of the export destinations (e.g., constituents of the former Soviet Union, China) restricted by U.S. export controls?

___ 6. Does the Company currently export pursuant to any federal export licenses, and are the Company's activities in compliance with these export licenses?

B. Embargoes
___ 1. Does the Company conduct business in any embargoed country?
___ 2. Does the Company conduct business indirectly with any embargoed country?
___ a. Via third parties
___ b. Via resale of the Company's products
___ c. With any known diverters

C. Foreign Corrupt Practices
___ 1. Does the Company conduct business overseas through foreign agents?
___ 2. What are the customary practices for agents' commissions in the foreign countries in which the Company engages such agents?
___ 3. What do local laws provide concerning commissions?
___ 4. Does the Company keep accurate accounting records for foreign activities?
___ a. Are there any unusual payments/gifts to bank accounts, unidentified corporate entities, or relatives of government officials?
___ b. Does the Company circulate annually an FCPA questionnaire?

D. Boycott
___ 1. Does the Company conduct business with any boycotting countries?
___ 2. Do the records of such business indicate that the Company has engaged in any of the prohibited activities?
___ a. Discriminatory conduct
___ b. Refusal to do business with a boycotted entity or country
___ c. Furnishing prohibited information on boycott questionnaires

The Company's Compliance with Foreign Laws and the Post-Acquisition Effect on the Purchaser of the Company's Foreign Activities

A. Form in Which the Company's Foreign Operations Are Conducted
___ 1. What registration/permission procedures are required to conduct business in the host country?
___ a. If registration is necessary, what requirements must be met?
___ (1) National level
___ (2) Local level
___ b. May registration be refused even if formal requirements are met?
___ c. Is registration revocable for any reason?
___ d. Are there any limitations on the rights of an offshore company?
___ 2. What legal forms may a business entity take in the host country?
___ a. Corporation
___ b. Partnership (limited/general)

___ c. Limited liability company
___ 3. What are the provisions of local law regarding limited liability?
___ 4. Does local law authorize foreign partners/owners to enter into transactions with the controlled entity?

B. Ownership Interests
___ 1. Are there any local legal restrictions on a U.S. company's percentage of ownership?
___ 2. Will the consummation of the acquisition have any adverse effect on the activities of the Company in the foreign country or require any consent of a foreign government?
___ 3. Does local law allow civil or criminal liability pass-through to owners?
___ 4. Is there any restriction on the type of currency in which an investment may be made?
___ 5. Are there any rules governing the timing of investment capital contributions?
___ 6. What laws govern the ability of a U.S. corporation or a U.S.-controlled entity to acquire ownership of or rights to land and/or natural resources?
___ 7. Is assignment of equity permitted?
___ a. Required consents
___ b. Rights of first refusal

C. Security/Property Rights
___ 1. Who may own the rights to property contributed by the parent U.S. company or developed in the foreign country?
___ a. How can it legally be protected?
___ 2. Has the Company or its controlled foreign entity complied with local law in the protection of all property rights?
___ 3. What are the limitations, if any, on creditors' rights?
___ 4. What are the political risks?
___ a. Expropriation
___ b. Rapidly changing legal regime
___ c. Currency devaluation
___ 5. Is political risk insurance available?
___ 6. Is there a fair and effective dispute resolution process?
___ a. When dealing with government-owned entities
___ b. When dealing with private entities
___ c. Are arbitration agreements enforceable?

D. Management and Governance
___ 1. Do local laws require the establishment of any particular governing bodies (board of directors, executive committee, etc.), and if so, does the law specify the division of responsibilities among them?
___ 2. Are there limitations on the nationality of any managers (e.g., a

requirement that the board chairman be a national of the host country)?
___ 3. Does the local law grant nonowners (e.g., employees) the right to elect members of the governing body?
___ 4. Are there any formal requirements under local law covering meetings of governing bodies, publication of annual reports, and other governance matters?
___ 5. Are the Company's foreign entities in compliance with local law relating to governance?

E. Taxation
___ 1. Is the Company (or its controlled foreign entity) in compliance with local taxation rules?
___ a. Filings required by host country
___ b. Special rules on transactions with affiliates
___ c. Is disclosure of the Company's worldwide results of operations required?
___ 2. Is there any tax withholding on dividend payments?
___ 3. Are there any unusual taxes on business activities or services?

F. Labor Laws
___ 1. Are there unusual employee work rules, health and safety requirements, employee termination rights, or retirement benefits?
___ 2. What are the liabilities of an offshore parent company with respect to labor law compliance?