803 - International M&A: The Stumbling Block of Personal Information

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Jonathan Fox is currently the deputy chief privacy officer for Sun Microsystems, Inc. located in Menlo Park, California.

Mr. Fox has been involved in privacy and data protection for Sun Microsystems since the creation of it's privacy policy. He assumed responsibility for managing Customer-facing privacy issues and co-founded Sun's privacy council, which he chairs.

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In recent years, expanding globally has become an essential part of the competitive strategy of many US companies. However, growing globally also raises new challenges in the area of corporate compliance. Many key US laws and regulations apply broadly not only to companies established in the United States, but also to the foreign subsidiaries of US companies, to US citizens and permanent residents working abroad and, in some cases, to foreign nationals as well. Of course, US companies operating abroad must also follow the domestic laws and regulations of each country in which they operate. Since even a potential violation can tarnish a company's reputation (and an actual one can bring civil and criminal penalties), multinational companies must develop a clear global corporate compliance strategy. They must also adopt global management strategies to make their strategies work across multiple legal and cultural contexts. Managing global risk with a solid compliance program is becoming even more important in recent years as many US regulators have toughened their stance on enforcement and received additional funding from Congress in the wake of corporate scandals and in the interest of national security. It is also an essential first step for companies with a broader corporate social responsibility mission.

By Marya M. Rose, M. Angella Castille, and Virginia Harper Ho

The Challenges of Global

MPLIANCE in Emerging Markets

Emerging markets, most notably, Brazil, Russia, India, and China (the "BRIC" countries) offer attractive opportunities for US investors. At the same time, establishing and growing a company in these markets requires special vigilance, since these markets can create pitfalls for global corporate compliance. US companies doing business in these key emerging markets (and elsewhere) can meet the challenges of global corporate compliance by making sure their compliance program covers each of the primary areas of US law that have an international reach. Multinationals also need to be familiar with the local laws in each of the BRIC countries that impose similar obligations on foreign investors and the practical compliance challenges of doing business in these emerging markets. With core strategies for developing, implementing, and maintaining a successful global compliance program, global companies can successfully manage the risks of operating in the BRIC countries and lay an important foundation for sustained growth in these dynamic markets.

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A Survey of Global Compliance Obligations for US Companies

Any global compliance program for US companies (and for multinationals operating in the US) must take into account US laws and regulations in a broad range of areas, including anti-bribery laws, export and import regulation, US embargoes and economic sanctions, antitrust law, and accounting and financial reporting regulations. In addition, US companies must ensure that they (and their foreign partners and suppliers) comply with the domestic laws of the countries in which they operate.

Foreign Corrupt Practices Act (FCPA) and Anti-Bribery Laws

Anti-bribery law, particularly the Foreign Corrupt Practices Act (FCPA), is one of the most significant areas a global compliance program can address. Over the past five years, the US Department of Justice (DOJ) has stepped up enforcement actions and imposed stiffer penalties under the FCPA, and recent enforcement actions against major multinationals have ended in settlements topping $10 million in fines, and in some cases, criminal penalties.[1] Additional funding from Congress, appropriated as a direct result of post-September 11th anti-terrorism legislation, has enabled the DOJ to focus more staff and resources on FCPA enforcement initiatives.

The FCPA applies broadly to all companies with securities listed on a US stock exchange (including foreign issuers with American Depository Receipts (ADRs) registered in the US), and to all businesses established in or with a principal place of business in the US and their directors, officers, employees, and agents (both US and foreign nationals), all US citizens and permanent residents, and to "any person" with respect to illegal acts committed in the United States. The FCPA prohibits any effort to make payments or gifts "corruptly" to any officer or employee of a foreign government or agency in order to "obtain or retain" business, regardless of whether the payments originate in the US or abroad. The FCPA's definition of "public official" sweeps in political candidates, party officials, representatives of state-owned enterprises, or public international organizations. The International Anti-Bribery Act, which implemented the Organization for Economic Cooperation and Development's (OECD) anti-bribery convention as part of US law, also makes conduct intended to secure an improper advantage from foreign officials a violation of US securities law.

Although the FCPA does not apply directly to a US company's foreign affiliates, actions by foreign affiliates or agents (such as a sales representative or distributor) can create liability under the FCPA if the actions were authorized, condoned, or ratified by the entity that is covered by the FCPA. For example, Schnitzer Steel Industries and its Korean subsidiary were recently targeted by the Securities and Exchange Commission (SEC) and the DOJ (and ultimately paid multi-million dollar penalties in 2006) because of the Korean subsidiary's violation of antibribery and recordkeeping and reporting requirements under the FCPA.[2] Failure to investigate a potential FCPA violation or to document that the transaction was unauthorized can create direct liability for the US party. The affiliate or agent's actions may also be a violation if any facilitation of the transaction occurred in the United States.

Not all payments to foreign officials are barred by the FCPA. Illegal payments or benefits are those made with an

intent to influence an official to abuse his or her position.

In addition, the FCPA includes an exception for "grease" or "facilitating" payments to an official to get them to take "routine governmental action" in areas where the official does not have any discretion to act. This could include, for example, small payments to an official to obtain a required permit for the business (larger payments are less likely to fall within the exception). The FCPA also includes an affirmative defense if the payment was legal under the written laws of the foreign country, or was a reasonable expense related to promoting, signing, or performing a contract with the foreign government. Relying on foreign law is not often much help, though, since as we will see below, most countries (and all of the BRIC countries) have some form of antibribery law on the books. In practice, whether a proposed payment is permitted may not be so clear and a careful case-by-case analysis will be necessary. An option that might be appropriate is to present a proposed transaction to the DOJ for an FCPA opinion; if the DOJ approves the transaction, it will be presumed to comply with the FCPA. Violations of the FCPA can result in heavy criminal fines for companies, and violators may be banned from government contracting and required to disgorge their profits. Individuals can also face jail time or other criminal and civil penalties.

In order to prevent "off the books" transactions, the FCPA also has accounting and record-keeping rules that require US and foreign companies listed on US securities exchanges (i.e., "US issuers") and their officers, directors, and employees to maintain internal accounting controls and to make sure that all transactions (not just "material" ones) are recorded accurately, completely, and in a way that is not misleading. These rules also apply to US issuers abroad, and, unlike the FCPA's antibribery rules, they cover majority-controlled subsidiaries of a US issuer as well. US securities laws intersect with the FCPA accounting and record-keeping rules and raise the stakes for falsifying records and failure to implement effective disclosure procedures and internal reporting controls. Enforcement actions and civil penalties under the "books and records" and internal controls rules of the FCPA are handled by the SEC and have also increased in recent years along with enforcement of the anti-bribery rules.[5]

A number of international conventions, as well as the laws of many other nations, also target bribery and other forms of corruption. These include the OECD's Convention on Combating Bribery of Foreign Public Officials in Business Transactions (the OECD Convention). The United Nations Convention Against Corruption, which requires its 140 signatories to enact laws criminalizing bribes of domestic and foreign officials. The Organization of American States' Inter-American Convention Against Corruption (the OAS Convention), ratified by the United States, Brazil, and over 30 other countries, also prohibits both giving and receiving bribes to or by public officials. The European Union has adopted conventions to deal with corruption of public officials that apply to its member nations. Multilateral lending agencies, including the World Bank, the Asian Development Bank, and the Inter-American Development Bank, have also instituted lending policies that allow for oversight of the books of contractors or consultants on a funded project and prohibit bribery of public officials, fraud, and similar practices.

International Antibribery Conventions

International Conventions	BRIC Signatories	URL
European Union Criminal Law Convention on Corruption, Jan. 27, 1999, ETS No. 173	Russia (signed January 1999, ratified Oct., 2006)	*http://conventions.coe.int/Treaty/EN/Treaties/Html/173.htm*
European Union Civil Law Convention on Corrruption, Nov. 4, 1999, ETS No. 174	No BRIC countries are signatories	*http://conventions.coe.int/Treaty/EN/Treaties/Html/174.htm*
OECD Convention on Combating Bribery of Foreign Officials in International Business Transactions, OECD Doc. DAFFE/IME/BR(97)20, effective Feb. 15, 1999, reprinted in 37 I.L.M. 1 (1998)	Brazil (ratified August 2000)	*www.oecd.org/department/0,2688,en_2649_34859_1_1_1_1_1,00.html*
OAS Inter-American Convention Against Corruption, OAS Doc. B-58, March 29, 2006, reprinted in 35 I.L.M. 724 (1996)	Brazil (signed March 1996, ratified July 2002)	*www.oas.org/juridico/english/Treaties/b-58.html*
United Nations Convention Against Corruption, U.N. Doc. A/58/422	Brazil (signed December 2003, ratified June 2005); Russia (signed December 2003, ratified May 2006); India (signed December, 2005); China (signed September, 2003; ratified January 2006)	*www.unodc.org/unodc/crime_convention_corruption.html*
United Nations Convention Against Transnational Organized Crime	Brazil (signed December 2000, ratified January 2004); Russia (signed December 2000, ratified May 2004); India (signed December 2002, not ratified); China (signed December 2000, ratified September, 2003)	*www.unodc.org/unodc/en/crime_cicp_convention.html*

Export and Import Regulations, Embargoes, and Economic Sanctions

Another minefield to address in a global compliance program is import and export regulations. On the import side, companies must be sure that if they are serving as the importer of record, the products comply with product-specific import restrictions and are accurately marked with their country of origin. Product classification that is consistent with the US Harmonized Tarriff Schedule and US Customs' interpretive guidance is the key to compliance. Many companies rely on classifications made by freight forwarders without realizing that the ultimate responsibility for proper classification of products and duty rates lies with the importer of record. Failure to use reasonable care in determining classification and value of goods and frequent negligent mistakes can expose the company to audits by US Customs, as well as criminal prosecution. Closely related to the issue of appropriate product classification is determination of the product's value. Customs must confirm that the importer has assessed the proper duty rate against the price paid or payable. The determination of price on which the duty is based is a frequent area of fraud by importers, with respect to both US and foreign import duties. Attempts to evade import duties are also the cause of bribery of foreign customs officials, which can translate into an FCPA violation. Some jurisdictions are known for paying their customs officials inadequately, so those officials feel justified in demanding bribes to supplement what is perceived as a meager salary. Country of origin determines whether the products are subject to tariffs, duties, or antidumping orders, and whether the shipments qualify for duty drawbacks and other preferential terms under the North American Free Trade Agreement and other free trade agreements. Restricted imports, improper documentation, or failure to accurately mark imported products can result in seizure by customs authorities, additional duties, or other penalties.

Customs must confirm that the importer has assessed the **proper** duty rate **against** the price **paid** or payable.

Export controls, enforced by the Department of Commerce and the State Department's Directorate of Defense Trade Controls (the DDTC), apply broadly even beyond the borders of the United States and have been the focus of tougher enforcement as part of US national security policy. Whether a transaction is permitted, requires a license, or is prohibited depends on what is being exported, who and where the recipient(s) of the exported product or technology are, and who the exporting party is. Violations can result in a range of criminal, civil, and administrative penalties. The United States currently maintains embargoes and economic sanctions programs, enforced by the Treasury Department's Office of Foreign Assets Control (OFAC), against 13 countries, including Iran, Syria, North Korea, and Cuba, and against designated banned entities or individuals. These programs generally prohibit direct or indirect financial and business transactions of any kind between US nationals, permanent residents, or US companies,

and banned individuals or companies or those located in the embargoed countries. Under the Export Administration Regulations (the EAR), administered by the Department of Commerce, US companies and individuals cannot provide technical assistance or support to listed entities or individuals. These controls are intended to prevent assistance to terrorists and those engaged in producing weapons of mass destruction and other dangerous technologies. Anti-boycott laws prohibit US companies from complying with the Arab Leagues' boycott of Israel.

> The **complexity** of US export controls makes it **critical** that US companies know **who** they are **doing business with** at each stage of a transaction and have a **compliance program** that can screen for **"red flags"** at every level of the organization.

Under the Export Administration Regulations (the EAR), administered by the Department of Commerce, exporting or providing technical assistance in connection with certain so-called "dual use" goods that have both military and civilian application may be prohibited or may require a license. The export of US-origin military technology and components is controlled by the DDTC under the Arms Export Control Act (AECA) and its implementing regulations, the International Trade in Arms Regulations (ITAR). A number of these export controls apply to foreign subsidiaries of a US company and to the acts of foreign entities in the United States. For example, the export of US-origin goods or technology, or incorporating US components by *any person* (foreign or US) to any country without a license or exemption, will be a violation of the EAR if the shipment is made to an agent in London, for example, when there is "reason to know" that it will ultimately be shipped to Cuba, a prohibited destination. As if these rules were not already broad enough, under both the EAR and the ITAR, the disclosure or transfer to a foreign national (typically a foreign-born employee) is considered an "export" of the technology. For this reason, special licensing rules will have to be considered before a foreign employee can participate in any project involving controlled technology. And since US export controls also prohibit "US persons" from "facilitating" (broadly defined) prohibited transactions, failure to properly monitor and restrict the actions of a foreign subsidiary or a foreign distributor or agent can create liability for the US company or individual involved. Subsidiaries of US companies may be subject to export restrictions of the country they are established in that may be similar to or conflict with US export controls. The complexity of US export controls makes it critical that US companies know who they are doing business with at each stage of a transaction and have a compliance program that can screen for "red flags" at every level of the organization.

Accounting and Financial Reporting Rules

In addition to the FCPA accounting and record-keeping rules, US securities laws impose corporate governance, disclosure, and reporting obligations on US and foreign companies with securities listed on a US exchange. In some cases, these rules can reach across international borders. For example, Rule 13b2-1 of the Securities Exchange Act of 1934 prohibits any falsification of records (whether "material" or not) by "any person" —under this rule, manipulated or misleading accounting entries on a foreign affiliate's books can violate the rule if the affiliate's financials are consolidated into the US issuer's financials. There could also be a violation if there is any significant deficiency or weakness in the company's internal control over financial reporting that could reasonably have a negative effect on the company's ability to report financial information.

The Sarbanes-Oxley Act of 2002 (SOX) also requires the chief executive officers (CEOs) and chief financial officers (CFOs) of listed companies to certify to the SEC that their company's financial reports are free of any "material" omissions or inaccuracies, that the company's financial statements and periodic reports fairly present the financial condition and results of operations of the company, and that the company has maintained effective disclosure controls and procedures and internal control over financial reporting. Under SOX, the company's CEO and CFO must also certify that *any* fraud involving management or certain key employees has been disclosed to the company's auditors and to the audit committee of the company's board of directors. Certain listed companies must also report annually on the internal control over financial reporting of the company and *all* subsidiaries and give management's assessment of the effectiveness of that control. All off-balance sheet-transactions must be disclosed. To illustrate how securities law and the FCPA can interact, if an FCPA violation was "covered up" by tweaking the books (or hiding the transaction), there might be an antibribery and a "books and records" violation of the FCPA and an obligation under SOX to disclose the fraud to auditors. The FCPA violation is also likely to be viewed as a weakness in the company's internal control over financial reporting.

Although US courts have ruled that some parts of SOX (such as the whistleblower protections) do not apply to foreign subsidiaries, the SEC's interpretative releases make clear that the SOX reporting requirements have some extraterritorial effect, since they apply to foreign issuers and to consolidated (foreign or domestic) subsidiaries.[4] Material liabilities, including any related to a foreign subsidiary's operations or an export controls violation, that have a significant effect on the company's financials must be reported, and any inaccuracy or a failure to report could lead to an SEC investigation of the US issuer, in addition to any underlying liability for the incident itself.

From the standpoint of corporate counsel, another challenging aspect of SOX is the obligation Section 307 of SOX places on the company's lawyers, regardless of whether they are in-house or outside counsel or US or foreign-qualified lawyers, to report material violations of securities laws or breaches of fiduciary duty by their client first to the company's chief legal counsel or CEO and, if an appropriate response is not received, then to the company's audit committee or to the board of directors. These rules may conflict with other countries' laws about attorney-client confidentiality and could require foreign lawyers representing US public companies to report under US law.

Although the extra compliance obligations for public companies under US securities laws are beyond the scope of this article, for public companies, SOX clearly raises the bar (and the costs) for cross-border compliance programs and makes effective tracking of cross-border and foreign transactions, FCPA screening, and standardized accounting procedures essential.

Antitrust Law

As a company's operations expand abroad, a comprehensive compliance program should not only address identifying antitrust clearance issues for major transactions, such as cross-border mergers and acquisitions, but also (and perhaps more importantly) for preventing antitrust violations in the course of "routine" business deals. The primary US antitrust laws are the Sherman Act, the Clayton Act, the Robinson-Patman Act, and the Federal Trade Commission Act. The Sherman Act prohibits monoplization, attempted monopolization, and agreements and understandings that unreasonably restrain trade. The Clayton Act and the Federal Trade Commission Act also prohibit certain anti-competitive behavior such as typing, exclusive dealing and unfair methods of competition or unfair or deceptive trade practices.

Actions taken entirely outside the United States, regardless of the location or nationality of the actors, can result in civil penalties under all these statutes and criminal liability under the Sherman Act. If such actions relate to imports, US antitrust law applies where the conduct has either an actual and intended effect in US domestic markets or a direct, substantial and reasonably foreseeable effect on imports into the US For behavior concerning exports or other non-import matters, US antitrust law applies where there is a direct, substantial and reasonably foreseeable effect on US domestic trade, US imports or the export trade of any person exporting from the US.

Similarly, the Robinson-Patman Act's ban on certain

International Environmental Conventions

Convention	Website
Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, March 22, 1989	*www.basel.int/text/con-e-rev.pdf*
Montreal Protocol on Substances that Deplete the Ozone Layer, January 1, 1989	*http://hq.unep.org/ozone/Montreal-Protocol/Montreal-Protocol2000.shtml*
Rotterdam Convention on the Prior Informed Consent Procedure for Certain Hazardous Chemicals and Pesticides in International Trade, September 10, 1989	*www.pic.int*
Stockholm Convention on Persistent Organic Pollutants, May 22, 2001	*www.pops.int*
Kyoto Protocol to the 1992 United Nations Framework Convention on Climate Change, February 16, 2000	*http://unfccc.int/essential_background/kyoto_protocol/items/1678.php*

discriminatory pricing practices applies to any person engaged in trade either within the United States or with other countries involving products sold in or imported into the US market (exports are not covered).

The Clayton Act also prohibits certain mergers and acquisitions, including cross-border transactions that have the above-described competitive effect on US domestic commerce, US imports, or exports from the US The Hart-Scott-Rodino Antitrust Improvements Act (the HSR Act) requires notice to antitrust authorities for proposed transactions that meet certain size thresholds and a waiting period to allow the government time to analyze the transaction.

Although intra-company transactions are exempt, the HSR Act applies to a broad range of cross-border and foreign transactions, including certain acquisitions of foreign assets or securities by US or foreign persons as well as specified acquisitions by US or foreign persons of US assets and securities. Cross-border transactions often require compliance with multiple foreign antitrust laws as well, including the European Union's antitrust and merger control regime, and competition authorities in the US cooperate actively with their counterparts abroad to screen transactions involving multiple jurisdictions. Foreign competition laws may even apply more strictly to some deals than US antitrust law. Enforcement of US antitrust law is spearheaded by the Federal Trade Commission's Bureau of Competition and the Antitrust Division of the Department of Justice.

Labor and Environmental Laws

Although the extraterritorial effect of US labor and environmental laws is less expansive than some of the other areas of US law reviewed here, these areas create some of the greatest reputational risks for global multinationals. These are also areas in which socially responsible US companies can lead the way in introducing "best practices" wherever they operate.

From a purely legal standpoint, compliance with local labor and environmental law requirements may be more burdensome for foreign affiliates of a US multinational than for their US counterparts. For example, labor regulations in Latin America, as in Europe, often impose higher obligations for US companies than would be the case under US law—except perhaps for US civil rights laws (e.g., equal employment statutes). Rules on the enforceability of non-competes, the privacy rights of employees and third parties, and confidentiality obligations are beyond the scope of this article, but all vary widely internationally and must be taken into consideration. At the same time, bureaucratic regulation of employment matters in many countries is coupled with lax and inconsistent enforcement.

US civil rights laws and certain US wage and hour regulations extend to US citizens working abroad, and rules against workplace discrimination and other prohibited practices should be communicated clearly to foreign managers. Although other US laws do not reach most labor practices by foreign employers, the US Tariff Act of 1930 gets at some of this activity indirectly by prohibiting imports of products produced using prison or child labor, and gives US customs officials the right to seize such merchandise and take action against violators.

> **Compliance** with local labor and **environmental** law requirements may be more **burdensome for foreign** affiliates of a US multinational than for their **US counterparts.**

The most significant environmental requirements that affect US companies when they do business in foreign jurisdictions are the international treaties entered into by the United States in the last 20 years, some of which have been signed by as many as 191 countries. Although the US has not been a signatory to all of the environmental treaties (notably only the US and China have not signed the Kyoto Protocol) a US company must comply with the requirements of international treaties when it is doing business in a signatory country. For example, although the US has not signed the Basel Ban, which prohibits the transborder shipment of hazardous waste, a US company cannot ship hazardous waste to a country that has signed the Basel treaty. This example illustrates the importance to US companies of being knowledgeable about the environmental laws and regulations and treaties for every jurisdiction in which they manufacture, sell products, or ship waste. The same rule of thumb holds true for every other area of environmental compliance. Because law and practice in this area vary widely, a comprehensive global compliance strategy must take these variations into account, and extensive due diligence on the countries where the company maintains operations is essential.

Global Business Ethics

Despite the broad reach of the laws outlined above, a global compliance program cannot be limited to "the

Selected US Laws with Global Reach

Antibribery	Foreign Corrupt Practices Act (FCPA), 15 USC. §§ 78dd-1 to d-3, 78m	*www.usdoj.gov/criminal/fraud/fcpa.html*
Antitrust	Sherman Antitrust Act, 15 USC. § 1 et seq.	*www.usdoj.gov/atr/foia/divisionmanual/ch2.htm#a1*
	Clayton Act, 15 USC. § 12 et seq., 20 USC. §§ 52-53	*www.usdoj.gov/atr/foia/divisionmanual/ch2.htm#a3*
	Hart-Scott Rodino Antitrust Improvements Act of 1976, 15 USC. § 15 et seq.	*www.ftc.gov/opa/2001/01/hsrreform.shtm*
	Robinson-Patman Act, 15 USC. § 13-13b, 21a	*www4.law.cornell.edu/uscode/html/uscode15/usc_sec_15_00000013----000-.html*
	Federal Trade Commission Act, 15 USC. § 41 et seq.	
Customs/Import Regulations	US Department of Customs Import-Related Laws and Regulations	*http://ia.ita.doc.gov/regs/index.html*
Export Controls	Export Administration Act of 1979, Pub. L. 96-72, 93 Stat. 503, 50 USC. App §§ 2401 et seq.	*www.access.gpo.gov/bis/ear/ear_ data.html*
	Arms Export Control Act, 22 USC. § 2751 et seq.	*http://pmddtc.state.gov/aeca.htm*
	International Trade in Arms Regulations, Trading with the Enemy Act, 50 USC. App. 1 et seq.	*http://pmddtc.state.gov/reference.htm*
	Export Administration Regulations, 15 C.F.R. § 730 et seq.	*www.acces.gpo.gov/bis/ear/ear_data.html*
Securities Laws	Sarbanes Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745	*www.law.uc.edu/CCL/SOact/soact.pdf*
	Securities Act of 1933, 15 USC. § 77a et seq.	*www.sec.gov/divisions/corpfin/33act/index1933.shtml*
	Securities Exchange Act of 1934, 15 USC. § 77b et seq.	*www.sec.gov/divisions/corpfin/34act/index1934.shtml*

letter of the law." For example, suppliers to a US multinational have no legal obligation under any US labor or environmental laws (and may not be acting in violation of any local laws), but the clear message from ongoing media exposés is that a company whose name is on the product is going to be held accountable for the business practices of its global supply chain. International human rights conventions and agreements, such as the Universal Declaration of Human Rights and the International Covenant on Civil and Political Rights, also set a standard for ethical business practices that consumers and international organizations use to measure corporate conduct, even though the legal responsibility of a corporation for a violation is not clearly established under international law. In this context, multinationals with a strong compliance mentality will view legal requirements as a minimum standard, recognizing that their conduct and the conduct of those they do business with abroad affects their reputation around the world. High standards of corporate ethics are also at the core of a broader commitment to corporate social responsibility that can have a wide-ranging impact on the communities where a multinational does business.

Compliance in Emerging Markets: Brazil, Russia, India, and China

US investment in the BRIC countries has grown exponentially in recent years, and having a presence in China and/or India has become the norm in many industries. Although the BRIC countries differ widely in terms of their cultures, political systems, economic strategy, and openness to foreign investment, all have taken steps in recent years to build a better legal framework for global business. For example, Brazil, China, and India have all recently introduced corporate governance reforms. Russia has revised its competition law in the past year and India and China are in the process of doing so. Each of the BRIC countries also has a fairly well developed body of legislation governing business practices, and each has an established and evolving international trade regime that is an integral part of its development strategy. All of the BRIC countries have established export control laws, which comply to varying degrees with international non-proliferation and anti-terrorism regimes. Brazil, Russia, India, and China are also each party to one or more of the international anti-corruption conventions, and each has adopted its own implementing laws to combat bribery and corruption.

However, as many multinationals have found, local law and practice in the BRIC countries is enough to keep conscientious corporate compliance officers awake at night. According to recent global surveys, investors in each of the BRIC countries are concerned about business ethics and poor corporate governance in those markets, with Russia ranking near the bottom and China, India, and Brazil faring somewhat better (in that order).[5] Transparency International's global corruption perception index for 2006 ranked Brazil, China, and India 70th (part of a nine-country tie) out of 163 countries surveyed and Russia ranked 121st (tied with Rwanda, Swaziland, the Phillipines, and five other countries). For global companies, these numbers are symptomatic of the many areas where the business climates in the BRIC countries (each to a different degree) pose challenges to making compliance programs work.

> All of the BRIC countries have **established** export control laws, which **comply** to varying degrees with **international** non-proliferation and anti-terrorism regimes.

Some of the top challenges include:

- inconsistent enforcement of existing laws and regulations;
- lack of independence of the judiciary;
- lack of transparency in regulatory enforcement and in the legal system;
- historical importance of interrelationships between public officials and business interests;
- cultural acceptance of various "nonmarket" business practices, such as gift-giving, bribery, and kickbacks; and
- complex, bureaucratic, or inconsistent business regulations.

Despite these risks, many investors still see the BRIC countries as attractive destinations with high growth potential. For companies headed to (or already in) the BRIC countries, an important first step is to identify and understand the risks and then to find an approach that meets the compliance standards for the company but also responds to each country's unique context. The top compliance risks in one country will not be the same in the others, so in-depth research on each new market is an essential element of any compliance strategy.

Brazil

Brazil has been opening its market to foreign investment by reducing trade barriers since the mid-1990s, and its stock exchange has now begun to compete effectively against US capital markets for regional and international listings. Since 2000, Brazil's security regulators have introduced tiered listing requirements, including the stringent "Novo Mercado" listing rules, that impose higher corporate governance standards for listed companies.[6] As these developments suggest, Brazil boasts a sophisticated financial sector and in general, a more developed legal and economic infrastructure than the other three BRIC countries.

However, keeping on top of compliance under Brazilian regulations is one of the main challenges for US-based multinationals, since the country's regulatory environment is complex and bureaucratic. Labor laws are very strict and are fairly onerous for foreign investors doing business in Brazil. Employee federations, established in each state, play a key role in labor relations and labor unions can be active and aggressive. Compliance with Brazil's tax laws is also burdensome, since regulations are opaque and filing obligations complex. For investors contemplating acquiring a Brazilian company, hidden tax liabilities should be a key focus of due diligence given the lack of transparency in the tax law. Environmental standards may also be higher than the equivalent US regulations, although enforcement is inconsistent and lax in many respects. For example, the Brazilian Environmental Crimes Law, passed in 1998, strengthens enforcement mechanisms, provides for increased administrative penalties, and imposes criminal liability on corporations for environmental violations; CEOs can face administrative and civil penalties for decisions that harm the environment and criminal penalties, including jail time, if the actions were done with criminal intent.

Brazil's competition law is also enforced aggressively, as compared to many Latin American countries. It prohibits conduct that harms competition, dominates the market, increases profits arbitrarily or abuses dominant market position in Brazil. It also includes a merger notification system that requires mandatory post-merger notification based on whether the transaction will result in a controlling market share and on the market dominance (based on annual revenues) of any party to the transaction. The law permits regulators to undo the deal or spin-off portions of the business if they find a violation of the competition law. Having local professionals and personnel to aid in working through these areas is critical, and particularly so if a dispute arises, since Brazil's legal system is procedurally complex and difficult to navigate.

From a US law standpoint, US companies need to be vigilant in monitoring FCPA compliance in Brazil. Although Brazil has ratified four major international conventions aimed at corruption since 2000 (see International Antibribery Conventions sidebar), analysts and investors still give Brazil poor marks for the level of public corruption in the country, which can also affect the judiciary.[7] As in the other BRIC countries, two primary factors behind the problem are a business climate characterized by extensive regulatory control and broad discretion for regulatory authorities.

Russia

Since the early days of *perestroika,* Russia's reforms have progressed in fits and starts, and its attractiveness to foreign investment has trended up or down accordingly. Russia has enacted a basic investment code and is attempting to streamline its tariff system and trade regulations as part of its bid to join the WTO. A voluntary corporate governance code has been adopted based on the OECD corporate governance guidelines to encourage transparent and ethical business practices. Russia is also attempting to bring its competition law more in line with international practice, with a new Antimonopoly Law, introduced in 2006, that covers transactions between Russian or foreign parties with respect to shares or assets that have competitive effects in Russia. The new law amends earlier prohibitions on price fixing, horizontal and vertical market allocation, abuse of a dominant market position, and other anticompetitive practices, and raises the monetary thresholds for the existing pre-merger notification system to reduce the need for review of smaller transactions. Russia's tax code and related regulations provides a reliable framework for local and foreign companies. However, enforcement of tax and customs implementing regulations remains weak.

Despite these changes, doing business in Russia poses perhaps the most serious compliance challenges for US multinationals of all the BRIC countries. Some observers report that the level of graft throughout the economy is increasing to crippling levels.[8] Lack of enforcement of existing legislation, and the relational networks among officials of various levels that date back to the Soviet era, are part of the backdrop to these trends. One fundamental challenge is the complexity of Russia's top-down administrative bureaucracy. In Russia, there is also a high (and more direct) level of government intervention in the private sector. For example, the Yukos deal, where Russia's biggest oil producer was forced into bankruptcy and its assets auctioned off in a tax evasion case, was widely criticized as retaliation for its CEO's opposition to the Putin administration. The government's willingness to challenge business deals for political reasons raises broad concerns about the rule of law and transparency in the economy.

The Russian Criminal Code prohibits gifts, payments,

and bribes made to public officials in return for a benefit, and the Civil Service Law prohibits officials from accepting gifts or payments in connection with their duties. However, Russia's anti-corruption legislation does not impose any liability for making such payments, and in general, the legislation is a recent innovation. Due to ongoing state intervention in the workings of the courts and judicial corruption, Russia's current legal infrastructure is ill-equipped to improve the transparency of Russian business, and laws against corruption are poorly enforced. Anti-corruption initiatives of the Putin administration have also been criticized by global watchdog organizations, such as Transparency International, as too limited or even as intended to achieve political goals.[9]

At a practical level, foreign investors in Russia are less likely than in China, India, and Brazil to find partners and personnel that are fluent in English and familiar with the rules that US companies must operate under. For example, in negotiating a potential joint venture partnership, Cummins' representatives found it necessary to educate their partner regarding required FCPA and export control compliance issues. The deal moved forward only after the partners' US counsel confirmed to them that compliance with these laws was critical. In most cases, sustained effort will be needed to build basic awareness of US compliance goals.

India

With aggressive development goals, a large English-speaking population, and industrial hubs attracting a growing stream of foreign investment, India is well on its way to becoming the second Asian economic powerhouse, after China. India has recently focused on reforming its capital markets and financial sector, and has encouraged foreign investment in new fields, such as insurance, telecom, and real estate. In 2005, India's securities regulator, the Securities and Exchange Board of India (SEBI), adopted changes to its standard listing agreement (as Clause 49) that require independent directors to strengthen earlier corporate governance requirements for listed companies. India is also in the process of finalizing regulations needed to implement its antitrust law, the Competition Act of 2002.

As in the other BRIC countries, however, a major obstacle to staying compliant with local law is that India's business regulatory environment is burdensome and bureaucratic at both national and state levels. Competition between central, state, and municipal agencies adds further complexity. India's tariff and tax systems are particularly difficult to navigate, in part because of the lack of consistent implementation. For example, India's value added tax (VAT), which sought to introduce uniform tax rates for each category of goods and services, was not introduced concurrently by all states within India. The fact that the tax has not been implemented nationwide means that the cost of goods and services in certain parts of India will be higher as a result of the VAT.

> India has recently **focused** on reforming its **capital markets** and **financial sector**, and has encouraged foreign **investment** in new fields, such as insurance, telecom and real estate.

India's labor and employment laws have been periodically revised since their introduction in the 1940s, but have not kept pace with the demands of the growing economy. Current labor laws emphasize job security and can restrict worker mobility and limit management's ability to respond to changing economic conditions. Labor-management tensions can run high, and as in China, government notification and approval is required for many workforce reductions. Foreign investors must also comply with a series of environmental laws enacted in India over the past 30 years to curb rising pollution levels across the country. The Environmental Protection Act of 1986 also requires regulatory clearance for large-scale or environmentally hazardous foreign investment projects. However, because enforcement is largely decentralized and under individual State Pollution Control Boards (SPCBs), environmental standards and compliance can vary widely.

Government authorities in India have broad discretionary powers and play a considerable role in a system with a high degree of state involvement. India also has a large public sector that is dominant in many industries—as of 2004, the Indian government owned 240 enterprises, in addition to the businesses owned by state governments.[10]

India's Prevention of Corruption Act of 1988 (POCA) targets bribery and other corrupt practices by public officials. India's Code of Criminal Procedure also imposes criminal penalties on public officials who demand bribes. This law extends to officials of state-owned enterprises, universities, and other institutions that receive government aid. In the past five years, India has introduced measures, including the Right to Information Act of 2005, to improve enforcement of the POCA and increase the government's transparency and public accountability. However, as in Russia, these laws do not target improper payments (only their receipt), and India does not yet have in place targeted legislation to combat fraud and illicit payments in the private sector. Doing "business as usual" in India or going along with partners who do, can create real risks for US companies, although many Indian companies are familiar with US company's expectations. The prevalence of such practices also creates practical challenges for US companies in getting infrastructure projects, logistics issues, and permitting handled promptly, which can affect their overall competitiveness in the Indian market.

China

In less than three decades, China has established a legal framework to support what is now a regional and global economic powerhouse. This framework includes a full panoply of laws regulating foreign trade and investment, and the conduct of business in nearly every industry sector. In 2006 and 2007, China's amendments to its basic corporate law took effect and it enacted major new corporate tax, and bankruptcy legislation, in addition to a new basic property law. China is also in the process of drafting a comprehensive antitrust law, which may bring clarity to China's evolving competition law framework. Current rules requires pre-merger regulatory notice and review of domestic transactions and some offshore transactions, depending on the parties' market share in the industry in China and the anticipated effect of the transaction on market concentration. China has also enacted a number of regulations governing insurance, banking, and investment services over the past few years as part of a gradual opening of these industries to foreign investment.

Although new regulations are an important first step for China's legal and economic development, the sheer volume of regulations does little to simplify the cumbersome bureaucratic administrative structures that carried over from the pre-reform era. Compliance with Chinese regulations is also somewhat of an art; regulations can be vague or at odds with other laws, enforcement agencies may have overlapping or even competing enforcement mandates, and there is a widely recognized divide between national policy goals and implementation at the local level. These challenges are particularly obvious with respect to China's labor laws, which take a protective stance toward workers and restrict terminations and layoffs, but which are also poorly enforced. Environmental regulation is another area where problems with the legislation itself and the conflicting incentives of national and local-level enforcers result in uneven and unclear standards in practice. Another challenge to compliance efforts is that despite over a decade of reforms geared toward privatizing the state sector, the government continues to play a dual role as both regulator and market participant in many areas of the Chinese economy.

Like the other BRIC countries, China's business context creates many opportunities for improper gifts and payments to be made, and China consistently scores high on global corruption indices. China maintains a high degree of state control over private business, in part through multi-layered regulatory approval requirements. State-owned, formerly state-owned, and quasi-privatized state enterprises are also active players in many industries, and most hospitals, schools, and civil associations are state entities in China. Connections with officialdom continue to be important to business success. Another real difficulty for compliance-minded US companies, is that culturally, gifts are an important part of cementing business relationships, and business-related entertainment done cheaply can offend. Knowing where to draw the line is important and there are not always clear "right" answers.

At the same time, China's Criminal Law, commercial antibribery rules, the PRC Anti-Unfair Competition Law, and the new Anti-Money Laundering Law, which took effect on January 1, 2007, together prohibit accepting and paying bribes and address other forms of corruption. Almost all major central government ministries and ministry-level departments and agencies have also issued their own anti-corruption, anti-bribery guidelines. Most importantly, the Chinese Communist Party (the CCP) has disciplinary rules against party officials accepting bribes, and a central unit charged with maintaining Party "discipline." Since the CCP is still the dominant force across society and many corporate officers are party members (particularly in current or former state enterprises), these rules carry real force. In 2006 alone, the CCP reportedly brought disciplinary action against over 97,000 Party cadres for graft.[11] China has also signed onto several of the main international anti-corruption conventions in recent years and is in the process of drafting a comprehensive Anti-Bribery Law (see International Anti-bribery Conventions sidebar). However, given the inconsistent enforcement of existing legislation, US companies are well advised to be on their guard.

Investors should also take care to carefully screen and monitor any Chinese party they deal with on transactions that fall under US export controls. China's porous borders and lack of transparency in enforcement of its own export controls can lead to unauthorized re-exports from China to what may well be a prohibited destination or end user under US law.

The operations of many US multinationals in China have been recognized as meeting or exceeding local PRC requirements, and of setting an example of good corporate ethics. As homegrown Chinese companies become more competitive and the Chinese market matures, however, strong compliance with Chinese law is even more important—the new climate is already making enforcement authorities more willing to make investors toe the line on everything from customs compliance and tax filings, to employee social welfare payments and wage obligations. Cummins has found that a key to many of the compliance dilemmas China poses is to focus on building relationships with local business partners, agents, and suppliers; a good rule of thumb for all the BRIC countries.

Compliance Strategies for a Global Marketplace—An Ounce of Prevention…

As the first two sections of this article suggest, a global compliance program must take into account the "nitty gritty" of US laws and regulations, but will also have to be "translated" into the unique business culture of each country where the company has operations. The program will also have to deal with compliance risks in a wide range of relationships, ranging from global sourcing contracts to sales to joint ventures to US-side hiring and staffing practices. And it has to work. Despite these challenges, there are some general guidelines many multinationals have found helpful in building a successful compliance program in emerging markets and beyond.

There are several basic elements that make up a global compliance program. While dealing with compliance problems is a key element, the basic focus is on creating policies and procedures that prevent noncompliance in the first place—as the saying goes, "an ounce of prevention worth a pound (or several million) of cure."

Risk Assessment and Calculations of the Cost

An early step in setting up or reworking a global compliance program is to know the top risk areas for the company, and to understand how these risks break down across different countries or affiliates. Local conditions will vary widely. One helpful tool is the *OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones*, developed by the OECD (see Antibribery, Antitrust, and International Agreements sidebar).

It is also important to accurately set (and update) a budget for the compliance program. Compliance is not a place to cut corners. It is also important to recognize that US companies' compliance obligations can make them less attractive to potential business partners than foreign competitors who don't need to impose these kind of restrictions. Cummins' approach has been to set its standards for quality and service at or above its competition, knowing that for some potential partners, its way of doing business will be a tough pill to swallow.

Creating a (Counter?) Culture of Compliance

A central goal (and one of the greatest challenges) for a multinational compliance program is to create a culture of ethical business practice that transcends national boundaries and yet responds to local business cultures. The following are some tips on how to build a compliance-oriented culture:

- Build the "Tone at the Top:" Since in the initial stages, this is likely to be a counter-cultural movement—for both the US offices and foreign affiliates—establishing the "tone at the top" is key.
  - The board of directors must be educated about its responsibilities of compliance program oversight and compliance reporting.
  - Senior management, from the CEO on down, needs to lead the way.
  - Corporate counsel can educate senior management to assure that they reinforce the compliance message.
- Send the Message Loud and Clear
  - Integrating affiliates into the process early helps the compliance plan respond to differences in business cultures (i.e., "safety" may look different from one culture to another).
  - Putting policies into the local language and vetting them with local personnel for cultural issues and gaps improves communication.
  - Clear and consistent communication at all levels means management compliance training is a first priority.
  - The corporate culture in a joint venture affiliate needs to be set by both partners to the joint venture, but the US partner needs to make sure compliance is a core commitment.
  - Company intranets are an easy way to make sure everyone has access to company policies.

Writing (or Rewriting) a Corporate Code of Conduct

It may seem that corporate codes are everywhere—industries, international organizations, and human rights organizations have developed guidelines for ethical business practices. Many of these can be useful starting points for developing a tailor-made code of conduct. In any case, a corporate code of conduct is a key statement of a company's approach to doing business and should

Antibribery, Antitrust, and International Agreements

Antibribery	
IMF Code of good practices on transparency in money and financial policies	*www.imf.org/external/np/mae/mft/index.htm*
Inter-American Convention Against Corruption	*www.oecd.org/department/0,2688,en_2649_34859_1_1_1_1_1,00.html*
OECD Risk Awareness Tool for Multinational Enterprises in Weak Governance Zones	*www.oecd.org/dataoecd/26/21/36885821.pdf*
Transparency International	*www.transparency.org*
United Nations Convention Against Corruption	*www.unodc.org/unodc/crime_convention_corruption.html*
United Nations Convention Against Transnational Organized Crime	*www.unodc.org/unodc/en/crime_cicp_convention.html*
US Department of State/Corruption Links	*www.state.gov/e/eeb/cba/gc/rlnks/*
World Bank Anti-Corruption Guidelines - FCPA	*http://siteresources.worldbank.org/projects/resources/40940-1173795340221/revisedPMNDfinaluserguideline031607.pdf*
103 Leading the Effort Against Corrupt Practices in the Global Arena	*www.acc.com/resource/v8150*
Leading the Effort Against Corrupt Practices in the Global Arena	*www.acc.com/resource/v7858*
Antitrust	
DOJ Antitrust Enforcement Guidelines for International Operations (April 1995)	*www.usdoj.gov/atr/public/guidelines/internat.htm*
European Commission Antitrust Legislation	*http://ec.europa.eu/comm/competition/antitrust/legislation/legislation.html*
FTC's Antitrust Guidelines for Collaborations among Competitors (April 2000)	*www.ftc.gov/os/2000/04/ftcdojguidelines.pdf*
Russian Antitrust Legislation (Federal Antimonopoly Service of the Russian Federation)	*www.fas.gov.ru/english/legislation/index.shtml*
International Agreements	
International Standards and Agreements	*www.acc.com/resource/v6073*

clearly lay out its expectations of those it does business with. The code of conduct may go by many names, and there may in fact be multiple codes: one directed at the company's employees, another for its management, and another for its suppliers and other third parties. Of course, codes of conduct are works in progress and should be reviewed regularly to make sure they are comprehensive and also understandable.

> If the company has already established **internal codes of ethics**, the code of conduct for the company's business partners should be **consistent** with those existing policies.

US securities laws already require public companies to have a corporate code of conduct, as well as a code of ethics for senior financial officers, and many companies apply such codes to all senior company executives. If the company has already established internal codes of ethics, the code of conduct for the company's business partners should be consistent with those existing policies. Typically, a code of conduct will at least cover the company's legal and ethical rules in the areas discussed above. It is also advisable to discuss policies addressing insider trading, trade secrets, proper use of the company name and intellectual property, confidentiality, and workplace practices. Companies subject to US securities regulation must also ensure that their code of conduct covers conflicts of interest, includes a general compliance with laws obligation, and stresses full, fair, accurate, timely, and understandable disclosure. If the code of conduct is the primary (or only) business ethics guideline third parties will receive, the code should have some degree of detail on what the various regulations require so that expectations are clear. Finally, the code should reference any appropriate industry-specific standards and clearly spell out the company's policies toward reporting and handling noncompliance. Compliance with the code of conduct should be a condition of employment for company employees and a contractual obligation for the company's suppliers, agents, and other business partners. The code should be translated in the local language of the region where a foreign subsidiary is located.

Written Policies—Period

It should go without saying, but one of the first steps in creating compliance policies is to write them down. Enforcement actions under the FCPA, export control laws, securities laws, and most other major US regulations, makes clear that a company will have very little to say in its own defense without written policies showing an intent to comply with the law. Policies should address each of the areas in this article, and they should be provided to all employees in all the company's facilities in the local language. It is also important to hear from foreign affiliates on the issues they encounter in their business relationships so that policies that do not work well in certain contexts can be revised, or issues common across several locations can be addressed in a coordinated way if necessary.

Standard Contract Terms

All contracts entered into by the company with sales representatives, distributors, agents, as well as joint venture agreements, purchase agreements for a cross-border merger or acquisition, and similar major transaction documents, should include compliance language. Depending on the type of agreement, these could include some or all of the following:

- limits on the term of contracts to two years or less; no-fault termination on 60 days' notice;
- remedies for breach:
  - o termination rights for breach of the corporate code of conduct,
  - o immediate termination rights for actual or suspected FCPA or export control violations (this may be tough to get),
  - o put/call rights to buy out or sell out to a joint venture partner if a critical breach occurs, or
  - o indemnification;
- consent required to subcontract or assign;
- audit rights for books and records, internal accounting controls requirements;
- commitments to participate in the company's ethics training;
- reps and warranties and/or covenants:
  - o no beneficial interest by a government authority,
  - o books and records "accurately and fairly reflect in reasonable detail the transactions and dispositions of assets,"
  - o governmental approvals and permits were not obtained in violation of FCPA,
  - o compliance with US and local law (note, it might not be enough to covenant to "not violate," since a foreign party might not be legally required to comply), and
  - o no (or covenant to notify of) changes in status of contracting parties and their directors, officers, employees and agents;
- specific clauses on the FCPA and export controls that spell out the prohibitions and the books and records standards; and
- for a seller, obtaining required licensing as a pre-condition of contract validity or obligation to perform.

Compliance Procedures

1. Getting the Right Team: Oversight and Reporting Structures

Since the compliance program will need to be implemented company-wide, a compliance team should be put in place at every level of the company. Leadership from all core departments of the business, including human resources, information technology, purchasing, engineering, and sales should provide input and coordinate their efforts to initiate and carry out the compliance plan. Within each department, clear reporting structures should be set up so that every employee knows who to go to with compliance-related questions or concerns, and these should be put into organization charts and flow charts that will clearly demonstrate the reporting and oversight chain. Senior management, coordinating with legal counsel, should have direct oversight for the compliance program and this role is often assigned to a senior manager who is the designated ethics or compliance officer.

Corporate counsel clearly plays a key role in spearheading and monitoring compliance initiatives. US-based and local counsel in country will need to work together to set materiality thresholds for reporting purposes, track and monitor pending litigation, conduct training sessions, provide issue-specific guidance to business-unit personnel, and advise management. Local counsel, whether in-house or outside, should be familiar with US law, local law, and the company's operations so that they can handle basic questions and identify issues for US-based in-house counsel. Cummins has found that its local counsel provide an essential resource for personnel based abroad to get sound advice from a business standpoint. Because of overlapping laws and regulations, having counsel familiar with both US and local law at the ground level is critical to success.

2. User-Friendly Standard Practices

It's also important to translate compliance policies into user-friendly standard practices that tie into the company's reporting mechanisms and trigger legal counsel review when necessary. For example, in the area of FCPA compliance, Cummins requires its employees to apply for authorization for corporate jet flights on forms that have a box to fill in the purpose of the flight and indicate if government officials will be on board. If any public officials (including representatives state-owned partners) will be traveling, the request is sent to corporate counsel for review to be sure the flight is proper under the FCPA.

3. Front-end Due Diligence

Thorough front-end due diligence is perhaps one of the most critical compliance procedures a company can put in place. Background checks based on multiple sources should be done on all potential suppliers, agents, joint venture partners, and new hires. Many companies use investigative services for this purpose, particularly for screening foreign contracting parties. Since the company will have the least amount of control over independent suppliers, the initial quality screening evaluation of a supplier from a technical standpoint should be supplemented with a look at FCPA and other key legal compliance issues such as:

- Do they have any direct or indirect ownership or affiliation with a foreign government? Do they have relatives who are public officials or work for a state-affiliated company?
- How well does their experience match what they are expected to do?
- Are they proposing market terms and market rates for their services?
- Is there any evidence of "shady" financial dealings?
- Do they have in place standard practices to handle import/export and other industry-specific compliance issues?

Face to face meetings are also key to get a "feel" for whether the person or the company of interest understands how your company does business and can work within those limits. Making compliance part of the initial negotiations with key business partners will make it clear to all involved if the potential partner shares a commitment to ethical business practices or not.

4. Monitoring and Revamping

Fortunately or unfortunately, a compliance program is not done once it's put in place. It is critical that the company establishes a system of regular site visits of all suppliers, consultants, and joint venture partners and audits of their payments and other business records, to the extent the company has a contractual right to do so. External audits should also be conducted so that there is independent evidence of problems and successes. These visits can reinforce the company's commitment to its corporate code. Regular visits by US management to foreign affiliates, and visits by manag-

ers abroad to the US offices, can not only facilitate coordination and compliance monitoring, but can also build a stronger global *esprit de corps*. Processes should also be in place globally to pick up changes, particularly for company personnel.

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Sample Forms and Policies

- *Action Plan for Creating a Secure and Smart Border* (2005). *www.acc.com/resource/v5478*
- *Data Protection Policy* (2007). Learn to inform employees of the principles under which company processes personal information received from countries belonging to the European Union. This policy complies with the US Department of Commerce safe harbor framework. *www.acc.com/resource/v8332*
- *Due Diligence Checklist* (2005). *www.acc.com/resource/v7032*
- *Information Management and Document Retention Policy* (2007). Excerpted from a 2007 ACCE CCU program material, this policy provides the principles and framework for the implementation of an efficient information management system including a policy for indexing, filing, retaining, and routine disposing of documents. *www.acc.com/resource/v8418*
- *Receipt, Retention, and Treatment of Complaints* (2006). This sample policy was provided by a multinational company to comply with French law regarding anonymous tip reporting hotlines. *www.acc.com/resource/v7208*
- *Recordkeeping Requirements, Financial Services Authority, United Kingdom* (2006). *www.acc.com/resource/v8005*

For example, will the company be notified when a business partner becomes a public official or has a family member who does? Written policies and procedures and "standard" contract terms should also be reviewed regularly and updated as necessary. There is very little that cannot be improved.

5. Dealing with Potential Violations: Investigations, Whistleblowing, and Voluntary Disclosure

A global compliance program must have clear procedures for handling potential violations. Although a "zero tolerance" policy for violations is the best policy, procedures must be in place to allow for confidential disclosure and prevent any retaliation against whistleblowers. Although this may not be legally required in other countries where affiliates are located, it is the best way to make sure potential violations are uncovered and dealt with quickly.

Whenever a violation or potential violation is uncovered, management and corporate counsel must respond quickly and thoroughly and get a clear understanding of action steps to be taken. In order to give in-house counsel the benefit of an independent perspective (and a neutral sounding-board), outside counsel should be charged with analyzing the situation and advising whether a self-disclosure should be made to the relevant governmental agencies. If an investigation should result, all personnel must clearly understand the importance of cooperating with the foreign or US investigation. US enforcement agencies are likely to deal more leniently with companies that are proactive in dealing with a potential problem—hiring external auditors, reworking (or adopting) compliance plans, or making self-disclosures. Putting some of these steps into a formal pre-crisis plan may make it easier to deal with issues quickly.

Sound Corporate Governance

Although corporate governance is a topic far beyond the scope of this article, good corporate governance practices can go a long way toward preventing a compliance breach and limiting the potential liability if one occurs. This could include establishing an independent board, conducting external audits, hiring a dedicated ethics officer, establishing corporate governance guidelines for the company's board of directors and management, and making sure management of foreign affiliates values corporate compliance. For example, when Cummins negotiates with a foreign joint venture partner, it typically requests that Cummins employees hold certain key positions in the joint venture such as controller, and that Cummins personnel rotate with the partner's appointee as General Manager. As in India, China, and Brazil, corporate governance mechanisms for independent board oversight may also apply under local law.

Global Training

Corporate counsel should take the lead in establishing training at each level of the company, starting with senior management and the Board of Directors. For example, Cummins has implemented an online compliance training program including modules focused on the FCPA and export controls, two key areas for its personnel in emerging markets. The training and related policies are translated into the local language. Cummins also has an in-person training program to train key employees at a more detailed level. Training for suppliers and other contractors is harder to implement, but can be a key part of enforcing a supplier code of conduct. Trainings can be offered during regular site visits to minimize disruption to the supplier.

The first goal of training is to build awareness, which will almost inevitably bring to light "standard" practices that need to change. Corporate counsel can triage these issues and begin responding to potential compliance breaches. A second-stage training can focus on implementing new "standard" practices going forward. Training programs will need to be repeated periodically (ideally annually or semiannually) so that new personnel are up to speed.

Measuring Program Effectiveness

Once a program is in place, there should be mechanisms in place to measure its effectiveness, such as:

- Compliance surveys;
- Internal and external compliance audits;
- Standard financial audits and other accounting controls; and
- Incorporating compliance/ethics objectives into global goal-setting.

Closing Thoughts

Clearly, putting in place a successful global compliance strategy, especially in emerging markets, is not for the faint of heart. Yet despite its costs, a solid strategy can be an excellent tool to build a common corporate culture, improve communication within the organization, and limit risk exposure at the same time. And since the BRIC countries are in fact "emerging, " the ongoing evolution of their legal system, economy and society will most likely keep things interesting for a long time to come.

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Notes

1. Remarks of Asst. Attorney General Alice S. Fisher, U.S. DOJ at the American Bar Association's National Institute on the Foreign Corrupt Practices Act, Oct. 16, 2006, *available at www.usdoj.gov/criminal/fraud/docs/reports/speech/2006/10-16-06AAGF-CPASpeech.pdf* (discussing the Statoil and Schnitzer Steel Industries settlements).
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3. Stephen Taub, "Recent FCPA Actions Show Feds' New Attention," *Compliance Week*, Jan. 2007, pp. 18-70, at p. 18.
4. For example, *Carnero v. Boston Scientific Corp.*, 433 F.3d 1 (1st Cir. 2006); Release Nos. 33-8124, 34-46427, Certification of Disclosure in Companies' Quarterly and Annual Reports; Release Nos. 33-8176, 34-47226, Conditions for Use of Non-GAAP Financial Measures; Release Nos. 33-8177, 34-47235, Disclosure Required by Sections 406 and 407 of the Sarbanes-Oxley Act of 2002; Release Nos. 33-8180, 34-47241, Retention of Records Relevant to Audits and Reviews; Release Nos. 33-8182, 34-47264, Disclosure in Management's Discussion and Analysis about Off-Balance Sheet Arrangements and Aggregate Contractual Obligations; and Release Nos. 33-8238, 34-47986, Management's Report on Internal Control over Financial Reporting and Certification of Disclosure in Exchange Act Periodic Reports.
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International M&A: The Stumbling Block of Personal Information

Jonathan Fox, Sun Microsystems
Peter Lefkowitz, Oracle Corp.
Peter McLaughlin, Foley & Lardner LLP
Amy Yates, Hewitt Associates

Association of Corporate Counsel
October 31, 2007

Remind me why I'm here

1. Your deal might not close.
2. Compliance land mines.
3. Material price and risk changes.
4. Negative publicity.
5. European Works Council issues.

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Risk Assessment & Compliance

- There are different reasons companies acquire companies
  - Customer base/Market share
  - Product
  - Technology/Intellectual property
  - Employees
  - Other
- This won't change your compliance obligations, but it will let you know where to focus and your approach
- It starts before due diligence
  - Understand the business purpose of the acquisition
  - Understand the integration approach
  - Focus on the 20% that will get you 80%

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Acquisition Project Plan

- Deal Announced ➔ Deal Closed
  - Form team
  - Plan
  - Offer/Welcome letter/package
  - Data Transfer Agreements
  - Timeline of data transfers
  - Avoid the clean room
  - Track other team's plans (especially HR, IT, Marketing)

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Acquisition Due Diligence

- Specifics to seek out
  - Complaints/Sanctions
  - Data Transfer Instruments
  - DB Registrations
- Offer letter/Consent/Notice templates
- Hindrances to employee/customer data transfer
- Vendor agreements and management policies
- Security polices
- How central is PI to the transaction?

Sale Due Diligence

Will this be a share or asset transaction?

How well can you segregate employee and customer data?

What PI goes into the Deal Room and When?

What do your policies say about sharing PI?

Introduction to Bigco

Bigco is a large multi-national conglomerate based in the United States, with over 50,000 employees in 80 countries.

- BigMarket – marketing list rental and bonded warehouse services;
- BigInformation -- outsourced payroll management; and
- BigServer – outsourced data center and server operations and related hardware.
- Safe Harbor certified for employee and business data, and it has good relations with its European works' councils.

7

Bigco's Strategic Plan

Bigco has decided to hone operations to take advantage of the booming outsourcing market in Europe. The Board has directed senior management to look into strategic acquisitions for BigInformation and BigServer, using funds from the sale of BigMarket. The Board has indicated that it wants to move quickly, closing deals and integrating the remaining operations into its business within 6 months.

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Initial Questions re Bigco

- •Are there privacy commitments that BigMarket will have to address to become divestiture ready?
- •Is their anything in BigMarket's privacy commitments that would affect a sale?
- •Are all three companies under the same employee and customer policies?
- •What are the basic data flows for BigCo?
- •How are systems set-up?
- •Is EU data transferred beyond US?

Target 1: PayU

- •Payroll services to universities in the U.K., Ireland and continental Europe
  - expanded into providing financial advisory services to employees of its university customers.
- •All of its operations teams and employees are in the EU
  - it operates a subsidiary in each EU Member State where local processing activities are required to support its services.
- •The investment bank's economic analysis shows that Bigco could add as much as ten points to its net margin by consolidating operations at BigInformation's facilities in Bangalore, India, while concurrently trimming EU operations by 30%.

PayU Due Diligence - I

What is the overall business strategy behind the prompting the acquisition?

What does PayU's policy state about onward transfers?

What is the PayU's relationship with work council?

What is PayU's standard customer and vendor privacy language?

What is the integration strategy?

What notices have employees and customers been provided about privacy?

PayU Due Diligence - II

In due diligence, Bigco learns

•PayU’s form contracts say “we assure you that we comply with all applicable European Union and Member State laws concerning the treatment of your data and that your data is totally and completely secure with us.”

•PayU is not Safe Harbor certified and has not signed “model contracts” for the international transfer of customer data.

•They outsource some of their own payroll and financial services processing activities to a company in China, whose contract says only that they will “maintain appropriate security for the data and environments.”

PayU Due Diligence - III

- PayU has an internal privacy policy, which says “we will share your data with third parties only when required by law or for the operation of PayU.”
- They have an active pan-European workers’ council.

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Target 2: SecureCorp

The second target, SecureCorp, is a US firm that focuses on providing secure data center facilities to military contractors and credit card processors. SecureCorp is well known for its proprietary intrusion detection software. The company is privately owned by the founders, a small group of very successful sales people.

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SecureCorp Due Diligence - I

- Where is SecureCorp located and What are it's policies?
- Does it provide managed services or just hosting facilities?
- Does it manage data centers for military differently than other customers?
- What are the data flows?
- What is SecureCorp's standard privacy contract language?
- What is the integration strategy?
- What notices have employees and customers been provided about privacy?

15

SecureCorp Due Diligence - II

- SecureCorp has a large workforce in France, and the investment bankers are concerned that the deal will be too expensive if Bigco acquires all of the employees.
- To provide assurances about expenses, SecureCorp has offered to provide all of its employment contracts and employment files (current salary, bonus and any ownership granted; employment reviews; record of all leaves/requests).

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SecureCorp – No Go

Bigco decides not to acquire SecureCorp. When asked, Bigco's management explains that they were concerned about keeping key staff members. In particular, one of the four founders has MS and Bigco's medical consultant is concerned he won't be able to work full time next year.

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Sale of BigMarket

- The investment bank also has found a potential buyer for BigMarket.
- MarketCraze is interested in buying the company for cash and, pending due diligence, has indicated that it is willing to offer significantly more than the investment bankers had projected.
- MarketCraze has been in the news a lot lately for its troubled relations with the FTC and European regulators.

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BigMarket Pre-Sale Issues

- In due diligence, BigMarket's data (including personal information) will be sent to the US, India, France, and Brazil.
- What steps does Bigco need to take before providing any information to MarketCraze?
  - confidentiality agreement with terms re: security, limited access, indemnity for loss/breach/misuse? single point of control over disclosures, particularly for employment and financial data; how should the flow of PII be phased?
- What assurances should they seek about their data?
- What questions should they ask about MarketCraze, its business?
  - Do they have any continuing liability if they sell to a company that has a proven track record of problems handling and limiting uses of data appropriately?

19

Integration - I

- Policy
  - What is the acquired entities privacy policy?
  - How does it differ from your company's?
  - Does it offer more or less protections or uses of personal data?
- International
  - Are there trans-border data flows to address?
  - Are work councils active?
- Outsourcing/Vendor Status
  - What processes and tools have been outsourced?
  - Under what contractual terms and controls?

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Integration - II

- Privacy Impact Assessments
  - Who, what, when, where, why and how was the data collected?
  - Who, what, when, where, why and how is the data used?
  - What are the controls and process for systems that contain PII that will be left intact?
- Training
  - Who uses, accesses, or manages systems that contain PII (or receive reports from such systems)?
  - What training in your company's privacy policy and practices will be required?

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CANADIAN LAWYERS

Canadian Public Mergers and Acquisitions: Trends and FAQs

2006 and 2007 have been banner years for mergers and acquisitions activity in Canada. Record capital raising and investment by private equity funds, higher costs associated with maintaining public issuer status, high commodity prices, and changes in Canadian tax laws governing income trusts have all contributed to the non-stop flow of deal activity. We felt there was no better time to answer some frequently asked questions on Canadian M&A and discuss the trends we're watching in 2007.

Blake, Cassels & Graydon LLP

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1 Who regulates trading in securities in Canada?

Trading in securities, including in M&A transactions, is regulated in Canada by securities laws enacted by each of the provinces and territories of Canada. Each provincial or territorial securities act creates and empowers a provincial or territorial securities commission to enforce such laws. Canada's provincial and territorial securities commissions have enacted a number of multilateral and national rules to try to harmonize the application of securities laws across the country. A draft national rule governing take-over bids has been published but not yet adopted.

2 We're considering investing in a Canadian public issuer. At what stage would we have to publicly disclose our investment?

There are two regimes that require the public disclosure of a holding in a Canadian public issuer – insider reporting and early warning reporting. Upon acquiring or obtaining control or direction over 10 per cent or more of the voting securities of a Canadian public issuer, the acquirer becomes an "insider" of that issuer and any trading in securities of that issuer while above the 10 per cent threshold must be disclosed using Canada's sedi.ca Web site. Under the early warning regime, the acquisition of, or ability to exercise control or direction over, 10 per cent or more of the voting or equity securities of a Canadian public issuer must be promptly disclosed via press release and regulatory filing. Subsequent acquisitions or dispositions while above the 10 per cent threshold of two per cent or more of voting or equity securities must also be disclosed.

3 We're considering increasing our stake in a Canadian public issuer. At what stage would we have to make a public take-over bid for all of the issuer's securities?

Subject to reliance on an available exemption, any acquisition of, or obtaining control or direction over, voting or equity securities that would result in the acquirer holding 20 per cent or more of the voting or equity securities of any class of a Canadian public issuer will constitute a take-over bid and require that an offer be made to all securityholders of the class on the same terms and conditions.

4 What can we do to avoid triggering the take-over bid requirements?

Exemption from the take-over bid rules is available in certain circumstances. One of the most commonly used exemptions is the "private agreement" exemption, under which purchases may be made by way of private agreements with five or fewer vendors without complying with the take-over bid rules (which would otherwise require an offer be made to all security-holders of the class). Canadian laws exempt such purchases only if the purchase price (including brokerage fees and com-missions) does not exceed 115 per cent of the market price of the securities.

5 If we approach a Canadian public issuer about a possible M&A transaction, what type of public disclosure obligations would the issuer have?

Canadian public issuers are required to promptly disclose any "material changes" in their affairs, being any changes in their business, operations or capital that would reasonably be expected to have a significant effect on the market price or value of any of their securities. This includes a decision by the board to implement a change or by senior management if they believe that approval of the board is probable. Preliminary discussions and conditional proposals where material terms have not been agreed are not generally viewed as disclosable. However, any determination of the existence of a material change is highly fact specific and needs to be carefully considered in the context of a specific transaction.

6 Should we expect the target board to insist on an auction?

There is no requirement under Canadian law for a board of a target company to hold an auction before entering into an agreement for the sale of the company, and it is common for a target to enter into such agreements without an auction. In other cases, a target board will determine that an auction or more limited market check before entering into an M&A transaction is in the best interests of the corporation and will proceed on that basis.

7 How are Canadian public issuers typically acquired?

A public M&A transaction in Canada is typically effected by way of a take-over bid, amalgamation or plan of arrangement. Take-over bids may be made with or without the agreement of the target and may be completed in as few as 35 days following the mailing of a take-over bid circular to target shareholders. Amalgamations and plans of arrangement generally require the agreement of the target company and approval at a meeting of the target's shareholders, which will typically be held 45 to 90 days after an acquisition agreement is entered into.

8 What type of securities regulatory oversight is involved in a Canadian take-over bid?

Canadian securities legislation contains detailed procedural and substansive requirements applicable to take-over bids. These include a requirement for an offeror to mail a take-over bid circular setting out the terms and conditions of the offer to the target, its board, auditors and subject securityholders. The take-over bid must also be filed with the securities commissions, but is not subject to any pre-clearance review.

9 What kind of disclosure must be made in a Canadian take-over bid circular?

The circular must set out prescribed information about the offer and the parties, including securityholdings and past dealings by the bidder and related parties in securities of the target. If the target company has Quebec securityholders, which will often be the case, then unless a *de minimis* exemption applies, the circular must also be prepared in the French language and mailed to Quebec holders.

The consideration offered may be either cash or securities (or a combination of cash and securities). Where the purchase price consists of securities of the offeror, the circular must contain extensive disclosure regarding the offeror's business and financial results.

The directors of the target issuer must deliver their own circular to securityholders in response to the bid.

10 We acquired a large block of securities just before we decided to make a take-over bid for the remaining securities. What issues should we be aware of?

Offerors must be wary of Canadian "pre-bid integration rules", designed to ensure that all of the target's securityholders are treated equally in the context of a take-over bid. The rules "integrate" pre-bid purchases (other than those made over a stock exchange) by requiring that consideration offered under the formal bid be at least equal in form and amount to the consideration paid in any such purchases made within the previous 90 days.

11 What conditions are permitted in a Canadian take-over bid?

Other than a financing condition, which is not permitted, Canadian take-over bids can be highly conditional. Bids are commonly subject to a number of conditions, including attaining a minimum level of acceptance, frequently 66-2/3 per cent of securities of the class subject to the offer (the threshold for approval of certain fundamental corporate transactions in most jurisdictions) or 90 per cent (the level which generally gives the purchaser the right to acquire the balance of the securities of the class outstanding): receipt of regulatory approvals; and there having been no material adverse change in the business of the target.

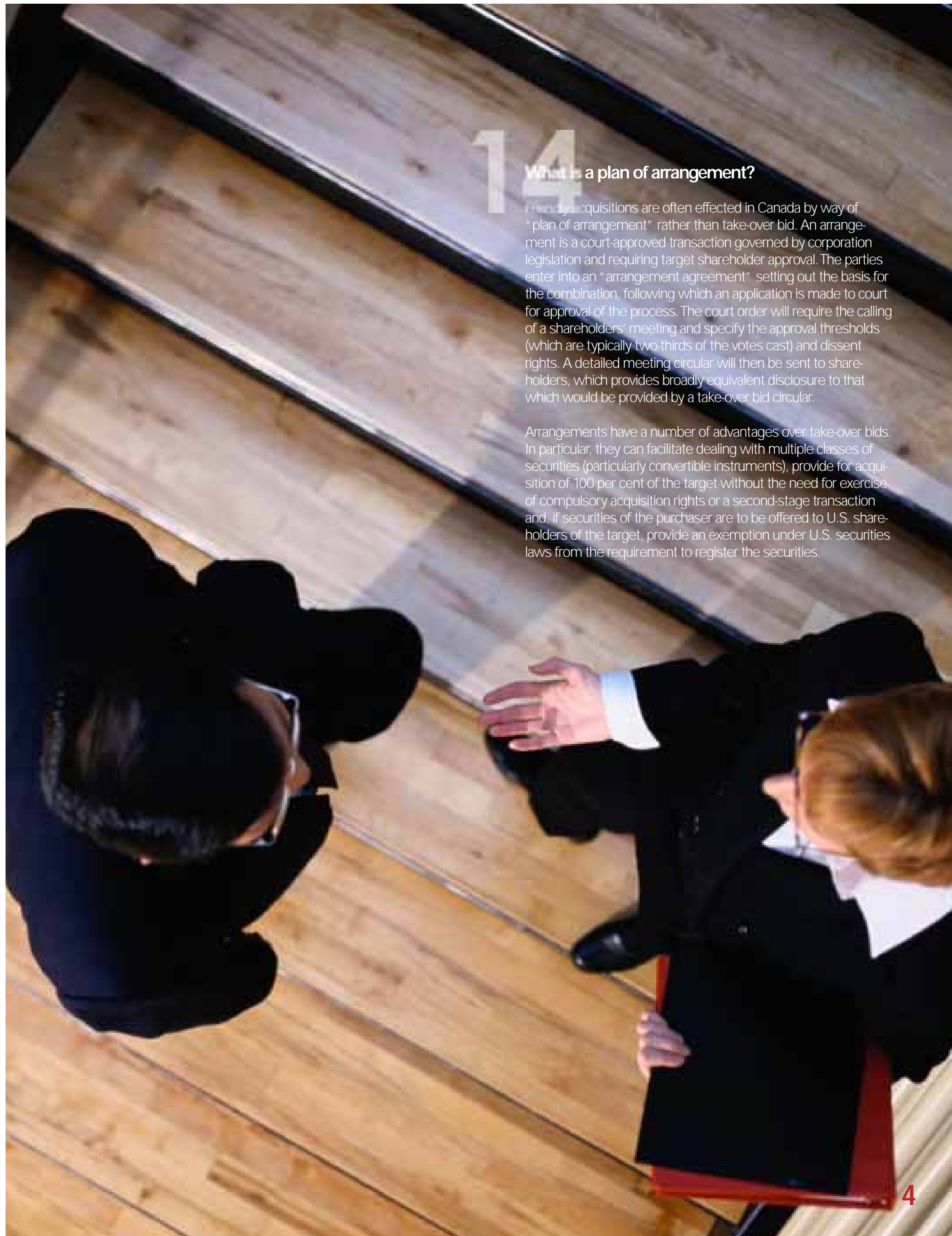
12 We're concerned that a significant securityholder may not tender to our bid. Can we offer any inducements to tender?

Canadian securities laws provide that all holders of a target's securities must be offered identical consideration in a take-over bid and prohibit an offeror from entering into a separate agreement that has the effect of providing to one securityholder greater consideration for its securities than that offered to the other securityholders. In a recent Canadian case, steps taken to accommodate a large securityholder's tax-planning objectives and a litigation release relating to disputes over the bid provided to certain securityholders were both found to be collateral benefits by the Ontario Securities Commission.

13 Can we be assured of acquiring the public minority following a take-over bid?

In the corporate context, an offeror that acquires 90 per cent of the shares of a class, excluding shares held by the offeror at the time of the bid, has a right of compulsory acquisition to purchase the remaining shares of the class at the offer price or, if the shareholder objects, at a court-determined "fair value". Similar provisions typically exist in the declarations of trust governing Canadian income trusts.

There are other ways minority securityholders can be bought out following a take-over bid, such as an amalgamation, arrangement or consolidation, which results in minority shareholders receiving cash for their target securities. Canadian securities and corporate laws provide protection for minority securityholders in these circumstances, but if an offeror acquires 66-2/3 per cent of the securities under a bid, it will generally be able to acquire the minority's securities of the same class pursuant to such a "second step" transaction.



14 What is a plan of arrangement?

[illegible] acquisitions are often effected in Canada by way of "plan of arrangement" rather than take-over bid. An arrangement is a court-approved transaction governed by corporation legislation and requiring target shareholder approval. The parties enter into an "arrangement agreement" setting out the basis for the combination, following which an application is made to court for approval of the process. The court order will require the calling of a shareholders' meeting and specify the approval thresholds (which are typically two-thirds of the votes cast) and dissent rights. A detailed meeting circular will then be sent to shareholders, which provides broadly equivalent disclosure to that which would be provided by a take-over bid circular.

Arrangements have a number of advantages over take-over bids. In particular, they can facilitate dealing with multiple classes of securities (particularly convertible instruments), provide for acquisition of 100 per cent of the target without the need for exercise of compulsory acquisition rights or a second-stage transaction and, if securities of the purchaser are to be offered to U.S. shareholders of the target, provide an exemption under U.S. securities laws from the requirement to register the securities.

15 Does Canada have antitrust legislation?

Canada's antitrust law is set out in the *Competition Act* (Canada), which is federal legislation of general application. The *Competition Act* is administered and enforced by the Commissioner of Competition, who is supported by the Competition Bureau.

There are two parts of the *Competition Act* that apply to M&A transactions: the pre-merger notification provisions in Part IX; and the substantive merger review provisions in Part VIII. All transactions are subject to the latter, while only those transactions that exceed certain thresholds are subject to the former. It is a criminal offence to complete a transaction that is subject to pre-merger notification unless either the statutory waiting period has expired or has been waived or terminated early, or the transaction has been exempted from the obligation to file a notification.

Only those transactions that exceed the following three threshold tests (the latter threshold test applies only to the acquisition of voting shares of a corporation or voting interests of a non-corporate entity) are subject to pre-merger notification:

- **Size of the parties test:** The parties to the transaction, together with their affiliates, have assets in Canada, or gross revenues from sales in, from or into Canada, that exceed CAD 400 million; and
- **Size of the transaction test:** The value of the assets in Canada, or gross revenues from sales in or from Canada, of the target and its affiliates exceed CAD 50 million (CAD 70 million for the continuing corporation in the case of an amalgamation); and, where applicable,
- **Equity interest test:** The acquisition of more than 20 per cent of the voting shares of a public corporation or 35 per cent of the voting shares of a private corporation or voting interests of a non-corporate entity, and where this 20/35 per cent threshold has been exceeded but the acquirer holds less than 50 per cent of the voting shares or voting interests of a corporate or non-corporate entity, the acquisition of more than 50 per cent of the voting shares or voting interests.

The waiting period is either 14 days where the parties elect to file a short-form notification or 42 days where the parties elect to file a long-form notification. While the parties can elect the type of notification to file, where they choose a short-form notification, the Commissioner of Competition can issue a demand that they file a long-form notification at any time prior to the expiration of the 14-day period, whereupon the longer waiting period begins only after both parties have submitted their long-form notification. There is a special provision that may apply to an unsolicited offer for a corporation that is designed to prevent a target from holding up the start of the waiting period. While the parties to a notifiable merger are free to complete their transaction following the termination of the statutory waiting period, subject to the Commissioner of Competition successfully applying to the Competition Tribunal for injunctive relief, the Commissioner's review can, and often does, take longer than the statutory waiting period. The Commissioner of Competition can challenge a merger transaction at any time within three years following its substantial completion.

16 If the transaction is subject to *Competition Act* review, what test must be met for the deal to be approved?

The test applicable to a merger transaction is whether it will, or is likely to, substantially prevent or lessen competition. The analysis takes place in the context of a relevant "market", which is defined on the basis of product and geographic dimensions. The *Competition Act* provides that the factors relevant to assessing the competitive impact of a merger include the extent of foreign competition, whether the business being purchased has failed or is likely to fail, the extent to which acceptable substitutes are available, barriers to entry, whether effective competition would remain, whether a vigorous and effective competitor would be removed, the nature of change and innovation in a relevant market, and any other factor relevant to competition. The *Competition Act* contains an express efficiency defence, which is unique to Canada.

17 Does Canada have rules restricting foreign investment?

The *Investment Canada Act* applies to every establishment or acquisition of control of a Canadian business by a non-Canadian. An acquisition of more than 50 per cent of the voting interests of a corporate or non-corporate entity is deemed to be an acquisition of control: the acquisition of between one-third and one-half of the voting shares of a corporation creates a rebuttable presumption that control has been acquired.

In the case of a direct acquisition of a Canadian business by an investor that qualifies as a "WTO (World Trade Organization) investor," or a direct acquisition of a Canadian business that is controlled by a WTO investor who is not a Canadian, it is subject to a requirement to submit an application of review where the book value of the Canadian business is CAD 281 million or more (this amount increases annually). An indirect acquisition of a Canadian business (i.e., the acquisition of a Canadian business through the acquisition of the voting interests of an entity outside of Canada) by a WTO investor is not reviewable.

A lower threshold applies to the acquisition of a Canadian business that is engaged in certain "sensitive" sectors of the Canadian economy, which are defined to be: a cultural business; the provision of either a transportation or financial service; or uranium production and ownership of a uranium producing property in Canada. In particular, in the case of a direct acquisition, it is reviewable where the book value of the assets of the Canadian business is CAD 5 million or more; while in the case of an indirect acquisition, it is reviewable where (a) the value of the Canadian assets is less than or equal to 50 per cent of the value of all of the assets acquired in the transaction and the value of the Canadian assets is CAD 50 million or more, or (b) the value of the Canadian assets is greater than 50 per cent of the value of all of the assets acquired in the transaction and the value of the Canadian assets is CAD 5 million or more. The acquisition of control of a Canadian business may also be reviewable, regardless of the value of the transaction, if it falls within a prescribed business activity related to Canada's cultural heritage or national identity (i.e., publishing, film, video, music and broadcasting). A reviewable transaction may not be completed unless the investment has been reviewed and determined to be of "net benefit to Canada". The initial waiting period is up to 45 days, which can be extended unilaterally by a further 30 days and thereafter only with the consent of the investor. It is common for the responsible minister to require written undertakings in order to arrive at his net benefit to Canada determination.

Where a transaction that is covered under the *Investment Canada Act* is not subject to a requirement to file a pre-closing application for review, it is subject to a requirement to file a notification within 30 days following its completion.

In addition to the *Investment Canada Act*, other federal statutes regulate and restrict foreign investment in specialized industries and sectors, such as telecommunications, broadcasting, newspapers and financial institutions.

18 Once a deal has been negotiated, what deal protection measures are commonly used in Canada?

Canadian deal protection provisions are very similar to those found in U.S. transactions and include the following:

- **No shop:** Buyers typically negotiate a "no shop" clause under which the target board is prohibited from soliciting or encouraging competing bids from other buyers. The no shop clause will usually provide the board of the target with a "fiduciary out" that permits the board to respond to and accept a competing proposal if it constitutes a financially superior proposal.
- **Right to match:** The buyer is frequently granted an opportunity to match any superior proposal.
- **Break fees:** Break fees in Canadian deals generally range between two to four per cent of target equity value. Reverse break fees, pursuant to which a buyer is obligated to pay a fee to the target if the transaction fails for specified reasons, such as failure to obtain regulatory approval, are gaining acceptance in Canada.

So-called "go shop" provisions, pursuant to which a target board is granted a specified period of time in which to actively seek out alternative proposals, have been used in a few instances in Canada, but generally have yet to gain acceptance.

19 What defences are available to Canadian public issuers confronted with unsolicited offers for their securities?

Canadian securities regulators are of the view that unrestricted auctions produce the most desirable results in change of control contests and they frown upon tactics that are likely to deny or severely limit the ability of securityholders to decide for themselves whether to accept an offer. As a result, the securities regulators will not allow a securityholders' rights plan (commonly known as a "poison pill") to permanently block a bid. On application by the bidder, the regulators will typically "cease trade" the rights 45 to 75 days after a bid has been launched. Accordingly, the plan's value is to provide the target's board time to seek out other bidders in an effort to maximize securityholder value.

While there is no prohibition against staggered boards in Canada, corporate statutes permit the removal of directors at any time upon a majority vote of shareholders. Accordingly, staggered boards are of limited utility.

20 What trends and factors are prominent in Canadian M&A in 2007?

- **Income trust M&A:** A major factor affecting M&A activity in Canada in 2007 has been changes to tax laws affecting income trusts. With over 175 income trusts in Canada having an aggregate capitalization of more than CAD 175 billion, income trusts, a type of publicly held flow-through vehicle, are a significant part of the Canadian capital markets. On October 31, 2006, Canada's Minister of Finance announced significant changes to the taxation of publicly traded income trusts and partnerships that will effectively eliminate the tax advantages such structures currently have over traditional public companies. As a result of these changes, income trusts will start paying the equivalent of full corporate tax in 2011.

  As a result of the loss of favourable tax treatment and corresponding decline in market value, income trusts have become very attractive targets for acquisition by U.S. private equity funds and strategic buyers.

- **Increased role of private equity:** Private equity plays a leading role in Canadian M&A. Although many private equity funds active in the Canadian market are Canadian, we see significant involvement from U.S. funds looking for investment opportunities in what they perceive to be a slightly less saturated market. With typically steady cash flows, income trusts are ideal candidates for private-equity-backed leveraged buyouts.

- **Focus on Alberta:** While we expect oil and gas projects to continue to generate significant direct investment in production and upgrading facilities, we also expect there will be spin-offs in related sectors, such as pipelines, which will lead to M&A activity. With the recent changes to the taxation of income trusts, we expect to see significant acquisitions of existing energy trusts by domestic and foreign acquirers.

- **Shareholder activism will continue:** Hedge funds have become active in influencing corporate policy, engaging in proxy battles and even initiating take-over bids in an effort to put issuers in play. Activist hedge funds often acquire large positions in issuers undertaking fundamental change transactions to establish a blocking position. We expect to see many potential acquirers negotiating simultaneously with both the board of the target and its key security-holders going forward.

- **Contentious Environment:** An increasingly contentious deal environment has lead to a wealth of new Canadian legal guidance on issues such as the enforceability of standstill agreements, the utility of shareholders rights plans, the timing of disclosure obligations and the scope of the oppression remedy. We expect the battles, and resultant judicial and administrative decision making, to continue.

- **Participation by BRIC entities:** Continuing globalization and strength in commodity prices has resulted in increased involvement of companies from emerging economies such as Brazil, Russia, India and China in Canadian M&A.

- **Continuing discussion on government intervention:** The federal government is considering possible amendments to the *Investment Canada Act* to introduce a review on grounds of national security or the addition of a national interest standard. In December 2006, the Department of Finance issued a policy paper that suggested increased scrutiny should be given to an acquisition of control of a Canadian business by a state-owned entity.

- **Liberalization of foreign ownership regimes:** 2007/08 may see anticipated new rules addressing foreign ownership restrictions on certain protected industries, such as telecommunications. Recently, the Organization for Economic Co-operation and Development (OECD) released a study urging the Canadian government to scrap ownership restrictions in the telecommunications and transport sectors. The OECD reported that Canada's restrictions are among the strictest in its 30-member organization.

ABOUT BLAKES

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- *IFLR1000: The Guide to the World's Leading Financial Law Firms - 2007 Edition*
- *PLC Which Lawyer? Yearbook 2007*
- *The 2007 Lexpert/American Lawyer Guide to the Leading 500 Lawyers in Canada*
- *PLC Cross-border Mergers and Acquisitions Handbook 2007/08*
- Law Business Research's *The International Who's Who of Business Lawyers 2007*
- *The Canadian Legal Lexpert Directory 2007*

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