Sentinel

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ReedSmith

A SUMMER OF SANCTIONS: WORLD LEADERS RESPOND TO IRANIAN OBSTINACY

The global unease surrounding Iran's development of nuclear capabilities has reached the tipping point. Tehran continues to assert that its nuclear development is intended purely for medical and energy-related purposes, while simultaneously expelling International Atomic Energy Agency inspectors from the country. The apparent subterfuge surrounding Iran's nuclear intentions has forced global leaders into action. In recent months, the United Nations, the United States, and the European Union have aligned to denounce Tehran's continued nuclear development, moving beyond diplomatic efforts to the imposition of resolutions and sanctions directed at Iran.

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The new UN Resolution is a call for countries to closely monitor and cease specific interactions with Iran, but does not specifically address transactions that individuals and the business sector transact with Iran. However, both the U.S. and EU sanction regimes do specifically limit the permissible activity of the private business sector in relation to Iran. It remains unclear at this point what the practical impact upon the international business community will be, as many elements of both the U.S. and EU sanction regimes must be implemented by regulations that have yet to be released. Likewise, unless and until UN member nations enforce the UN security resolution, it remains unclear how the measure will impact Iran and those countries that choose to do business with Iran. Nevertheless, companies should plan now to ensure that their compliance programs are in line with the various sanction regimes.

UN Sanctions

The first major action of the summer in the global sanction regime against Iran came in the form of United Nations Security Council Resolution 1929. This Resolution affirms that the United Nations member countries expect Iran to comply with its international nuclear obligations. Resolution 1929 received broad support from the UN community, with 12 countries voting in favor of the Resolution, Lebanon abstaining, and only Brazil and Turkey voting against, likely because of their nuclear trading with Iran.

To ensure support for Resolution 1929, and wide latitude for its enforcement, the terms of the Resolution are intentionally broad. The language in Resolution 1929 likewise foreshadows the use of broad language in both the U.S. and EU sanctions regimes. However, while the Resolution's terms are broad, they do impose substantial challenges for Iran, as well as those UN nations seeking to do business with Iran. While Resolution 1929 is not directly applicable to private persons and businesses, the manner in which member states enforce the Resolution may have a significant impact upon the operations of the business sector, primarily in three categories of transactions.

1. Prohibitions Against the Development of Iran's Weapons Capability

- Iran is prohibited from engaging in nuclear activities abroad, including uranium mining and the production or use of nuclear materials.
- UN nations are prohibited from engaging in the sale or transfer to Iran of eight categories of weapons.* This prohibition also precludes the provision of technical training or financial assistance related to such weapons.
- Nations are called on to take all necessary measures to prevent the transfer of technology or assistance to Iran in relation to ballistic missiles capable of carrying nuclear weapons, and Iran is prohibited from undertaking activity related to ballistic missiles.

2. Prohibitions Imposed Upon the Shipping Industry

- Nations are called on to examine all cargo in their jurisdictions that is suspected of including prohibited cargo destined to, or returning from, Iran.
- In addition to inspections in port, Resolution 1929 calls for inspection at sea if there is information to support reasonable grounds that a vessel is carrying prohibited items either to or from Iran.
- Resolution 1929 also relieves nations of the obligation to provide bunkering services, such as the provision of fuel and water, to Iranian vessels suspected of transporting prohibited materials.
- States are requested to contact the UN Security Counsel Committee regarding certain activity by the Islamic Republic of Iran Shipping Lines, including the transferring of vessels, and the renaming or re-registering of vessels.

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3. Prohibitions Imposed Upon the Financial Sector

- The Resolution calls on member nations to prohibit the establishment of Iranian banks within their territories, and to prohibit the establishment of their own financial institutions within Iran, if such establishment may contribute to Iran's proliferation.
- The Resolution adds entities as well as individuals to the list of persons whose assets are to be frozen.
- The Resolution calls for member nations to be vigilant when conducting business with Iranian entities in order to prevent contributing to Iran's nuclear proliferation.

The Comprehensive Iran Sanctions and Accountability Act

Riding the wave of momentum from the UN Resolution, on July 1, 2010, President Obama, with the overwhelming support of the U.S. Congress, signed into law the Comprehensive Iran Sanctions and Accountability Act ("the U.S. Act"). In addition to implementing the UN Resolution, the new U.S. sanction regime greatly expands on the UN Resolution. By far the most aggressive sanction regime against Iran, the goal of the U.S. sanctions, as well as the EU sanctions, is to cripple the Iranian financial sector. Iran has a vast quantity of crude petroleum resources, but

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lacks the means to develop and refine its petroleum. The U.S. and EU sanction regimes strive to prohibit investment in Iran's energy sector, with the expectation that Iran will abandon its weaponized nuclear ambition when it ceases to be an economically viable country.

The U.S. Act seeks to achieve its goal of interfering with Iran's economy and nuclear development by forcing international companies into a mutually exclusive choice: conduct business with the United States, or conduct business with Iran, but not with both. As discussed below, the U.S. Act contains three points. First, the U.S. Act provides for significant increases in both the available sanctions, and the kinds of transactions that will invoke the sanctions. Second, the U.S. Act permits U.S. states and local governments to divest a foreign company of state assets, if the foreign company continues to conduct business with Iran. Third, the U.S. Act seeks to end the diversion of U.S.-origin goods to Iran by working with countries that are often the facilitator of such diversions.

Increases in Sanctions and the Activities to Which They Apply

Increased Energy-Related Sanctions

The U.S. Act calls for the president, absent a waiver, to impose at least three sanctions upon entities who invest in the energy sector of Iran (under the previous sanction regime, only two or more sanctions were to be imposed). The U.S. Act also increases in the number of sanctions to be imposed by the president from six to nine.

While U.S. persons and companies are subject to, and may be sanctioned accordingly for, violating the energy-related sanctions contained within the U.S. Act, the broad language of the U.S. Act also permits the sanctioning by the U.S. government of non-U.S. companies. The ability of the U.S. government to impose sanctions upon a non-U.S. company will depend upon the jurisdiction the United States is able to exert over such a company. However, one purpose of imposing sanctions against non-U.S. companies, even if such sanctions cannot be enforced by the U.S. government, is to draw international attention and apply pressure upon those companies who continue to do business with Iran.

As outlined below, the U.S. Act addresses and sanctions three means of investment in the Iranian energy sector. Within each means of investment, the U.S. Act proscribes sales, leases, and provisions of services that reach a certain financial threshold. However, while the financial value of each sanctioned activity is clear, the U.S. Act uses broad language to define the prohibited action. Specifically, the U.S. Act sanctions actions that will "directly and significantly" impact the Iranian energy sector, without ever defining those terms. It is reasonable to presume that the intent of Congress is for the U.S. Act to be interpreted as broadly as possible.

- **Development of Petroleum Resources** – The U.S. Act calls for the imposition of sanctions upon a person who knowingly makes an investment of at least $20 million, or over a one-year period makes a series of contributions that aggregate to $20 million. The prohibited investments under this section are those that directly and significantly contribute to the enhancement of Iran's ability to develop petroleum resources.
- **Production of Refined Petroleum Products** – The U.S. Act further calls for the imposition of sanctions upon a person who sells, leases, or provides goods, services, technology, information, or support to Iran that could significantly facilitate the maintenance or expansion of Iran's domestic production of refined petroleum products. The U.S. Act makes clear that this definition includes direct and significant assistance with construction, modernization, or repair of petroleum refineries. In order for the provision of goods and services to be sanctioned under this section, such goods and services must have a fair market value of at least $5 million, or during a one-year period, have an aggregate fair market value of $5 million.
- **Export of Refined Petroleum to Iran** – The final energy-related sanction prohibits the knowing sale of refined petroleum products to Iran, or the provision of goods and services that could directly and significantly contribute to the enhancement of Iran's ability to import refined petroleum products. The goods that are sold, leased, or provided must have a fair market value of at least $1 million, or $5 million if done over an aggregate of one year. This section does contain an exception for persons who perform underwriting services or insurance services, on the condition that the president determines the person has exercised due diligence to ensure they do not engage in actions that violate the sanction.

Modification to Banking Regulations

In addition to sanctioning those entities that facilitate the growth of Iran's energy sector, the U.S. Act addresses those persons and entities who participate in Iran's banking industry. The banking section of the Act (section 104) addresses the activities of foreign financial institutions ("FFI") and domestic financial institutions ("DFI"), and lists requirements for financial institutions that maintain accounts for FFIs.

Precisely which financial institutions are covered by these regulations is unknown at this time, as the Act defines neither FFIs nor DFIs. Rather, the Secretary of the Treasury is instructed to prescribe regulations within 90 days of enactment that will include definitions of FFI and DFI.

- **Foreign Financial Institutions** – The U.S. Act urges the president to use his authority to directly impose sanctions on the Central Bank of Iran, and other Iranian financial institutions engaged in proliferation activities or activities that support "terrorist groups."

  Whether or not the president chooses to impose sanctions, the legislation requires the Treasury Department (within 90 days) to impose regulations on FFIs engaged in certain activities. Specifically, the Secretary of the Treasury is required to create regulations to either prohibit, or impose strict conditions upon, opening or maintaining a correspondent account or a payable-through account in the United States by an FFI if such an FFI engages in any of a number of listed activities. The activities that will trigger imposition of the prohibition or condition include:

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  - FFI facilitating the efforts of the government of Iran (including efforts of Iran's Revolutionary Guard Corps or its agents) to acquire or develop weapons of mass destruction or their delivery systems
  - FFI facilitating the efforts of the government of Iran to provide support for organizations designated as foreign terrorists, or to support acts of terrorism
  - FFI facilitating the activities of a person subject to UN Security Counsel financial sanctions
  - FFI facilitating a significant transaction for: Iran's revolutionary Guard Corps, or agents, who are sanctioned under U.S. law; or a financial institution whose property is likewise blocked under U.S. law

- **Domestic Financial Institutions** – The Act calls for the Secretary of the Treasury to prescribe regulations that prohibit any person owned or controlled by a DFI from knowingly engaging in a transaction with, or engaging in a transaction that benefits, Iran's Revolutionary Guard Corps. This prohibition also includes agents or affiliates of Iran's Revolutionary Guard Corps whose property or interests are blocked by the International Emergency Economic Powers Act.

- **Requirements for Financial Institutions Maintaining Accounts for Foreign Financial Institutions** – Domestic financial institutions that maintain either correspondent accounts or payable-through accounts within the United States for FFIs will be subject to heightened regulations. The precise regulations are not known at this time, as they are to be created by the Secretary of the Treasury; however, they will require DFIs to engage in one or more of the following:

  - Perform an audit of activities governed by the Act that may be carried out by the FFI
  - Report to the Treasury on transactions or other financial services provided with respect to governed activity
  - Certify, to the best knowledge of the DFI, that the FFI is not knowingly engaging in any such activity
  - Establish due diligence policies, procedures, and controls reasonably designed to detect whether the Secretary of the Treasury has found the FFI to knowingly engage in any such activity

Contracting with the U.S. Government

To ensure that no U.S. government funds are being sent to Iran, or to entities that transact business with Iran, the U.S. Act creates a heightened certification requirement for government contractors. Within 90 days of enactment of the U.S. Act, the Federal Acquisition Regulation "shall be revised to require a certification from each person that is a prospective contractor that the person, and any person owned or controlled by the person, does not engage in any activity for which sanctions may be imposed."

State Authorization of Divestment

Title II of the U.S. Act is a break from the federal sanction policy. This section authorizes U.S. state and local governments to enforce their own sanction-like activity against foreign companies that invest in the energy sector of Iran. Provided the state or local government complies with certain due process requirements, it is permitted to do one of two things. First, the government body has the option to divest from specified persons, with the support of the United States government, the assets of the state or local government. Assets included here are public monies, such as any pension, retirement, annuity, endowment fund, or similar instrument, which is controlled by the state or local government. Second, the government body is permitted to prohibit investment of assets in persons investing in the energy sector of Iran. Investment assets include a commitment or contribution of assets, a loan or other extension of credit, and the entry into or renewal of a contract for goods or services.

This provision is significant because of the scope of "persons" subject to divestment. This section makes no distinction between U.S. and foreign persons. For purposes of this section, the "person" who is subject to divesture of assets, or prohibition of investment, is "a natural person, corporation, company, business association, partnership, society, trust, or any other nongovernmental entity, organization, or group; any governmental entity or instrumentality of a government, including a multilateral development institution...; and any successor, subunit, parent entity, or subsidiary of, or any entity under common ownership or control with, any entity described [in this definition]."

By including parent companies and subsidiaries in the definition of person, this law requires international companies that transact business with U.S. states to monitor, and potentially terminate, the activities of their subsidiaries, and parent companies, or else be subject to divestment of state assets, including ineligibility for state and local contracting.

Efforts to Curb Diversion of Goods, Services and Technology to Iran

The final effort of the U.S. government to impede the development of Iran's economy and pressure Iran to comply with its international obligations is an attempt to cease diversion of U.S. goods to Iran, in part through the use of international pressure. Title III of the U.S. Act requires the Director of National Intelligence to submit to the executive branch a report identifying countries that allow the diversion of goods through their own territory and into Iran. The diverted goods that trigger the reporting include: U.S. origin goods; goods that would make a material contribution to Iran's development of weapons (including nuclear, chemical, and biological, as well as their delivery methods); goods that support international terrorism; and goods that are prohibited from export to Iran by virtue of a UN Security Council resolution.

In order to curtail diversion to Iran, the U.S. Act imposes an additional licensing requirement for export to countries that permit diversion. If the president determines that a country does allow substantial diversion of goods, services, or technology, then the president shall designate that country as a Destination of Diversion Concern. Once a country is identified as a Destination of Diversion Concern, the president shall impose a license requirement for export of goods,

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services or technology to that country, under either the Export Administration Regulations or the International Traffic in Arms Regulations (whichever is applicable). These license requirements are subject to a presumption of denial.

EU Sanctions

In the same month that the U.S. Act became law, the European Union took two steps to join the global collation standing in opposition to Iran. The European Union's stance, while not as draconian as the U.S. Act, does impose severe sanctions upon Member States, as well as individuals and companies.

The EU regime exists in two parts: the Council Decision of July 26, 2010 ("EU Sanctions"), and Regulation (EU) No. 668/2010. Like their counterpart in the United States, the EU Sanctions require formal implementing regulations, which are expected in the latter part of 2010. At this point, the only entities that are required to comply with the Council Decision are the governments of the Member States. However, Regulation (EU) No. 668/2010 is immediately enforceable without any subsequent legislation. In a similar fashion to the U.S. Act, the EU Sanctions seek to disrupt the financial sector of Iran. In order to accomplish this disruption, the EU Sanctions target the fledgling petroleum industry, the financial sector, and the shipping industry, and freezing the assets of specific Iranian persons and entities.

Energy Sector

The EU Sanctions contain a prohibition upon the sale, supply, or transfer of both equipment and technology that is related to the petroleum and natural gas industries of Iran. The prohibition applies to sales, directly or indirectly, to Iran, an Iranian, or an Iranian-owned enterprise that is engaged in refining, liquefied natural gas, exploration, or production.

In addition to the prohibition of the raw goods and technology, the EU Sanctions likewise prohibit the provision of technical assistance and financing related to the Iranian energy sector. While this act is stringent, it does contain two provisions that may lessen the burned on companies. In order to violate the energy sector provision, the prohibited activity must be engaged in either knowingly or intentionally. In addition, these prohibitions are without prejudice to the execution of an obligation relating to the execution of a contract that pre-dates the EU Sanctions.

Financial Impact

A policy of strict financial controls is imposed by virtue of the EU Sanctions. Member States must engage in heightened monitoring of activities with financial institutions that do business with Iranian banks, as well as the activities of local branches of Iranian banks. The establishment of new Iranian bank branches within Member States is prohibited, and financial institutions within Member States are prohibited from opening accounts within Iran. Further, the EU Sanctions call for notification to the Member State if funds in excess of €10,000 are being transferred either to or from Iran. Should a transfer exceed €40,000, prior notification and authorization from the member state is required.

The banks are not the only entities within the financial sector that must deal with the EU Sanctions. Additional prohibitions include investing in the oil and gas sector, financing or loaning money to the Iranian oil and gas sector, and restrictions on the provision of insurance and re-insurance within Iran.

Prohibited Iranian Nationals

The identification of specified Iranian nationals and Iranian businesses is the element of the European Union sanction regime that became immediately enforceable. Similar to the Specially Designated Nationals list maintained by the United States Department of Treasury, Regulation (EU) No. 668/2010 requires member nations of the EU to freeze the assets of designated individuals. The Regulation immediately imposed this restriction on in excess of 40 Iranian individuals and 50 Iranian businesses.

Shipping

The new EU Sanctions imposed upon the shipping industry are similar to those that are called for by the UN Resolution 1929. Upon reasonable belief that a shipment within a Member State contains cargo that is prohibited by the EU Sanction, the Resolution authorizes the Member State to inspect such cargo, provided it complies with international law. An additional impact on the shipping industry results from the fact that Iran's national shipping line ("IRISL"), along with many of its subsidiaries, has been placed on the EU prohibited list. Further, the EU Sanctions call for Member States to communicate about any activity or transfer undertaken by either the IRISL, or by Iran Air's cargo division to evade the sanctions.

Conclusion

As evidenced by the 2010 summer of sanctions, the international community is taking steps to combat Iran's refusal to comply with its international nuclear non-proliferation obligation. While formal regulations are needed to implement the various sanction regimes, the international business community should take note that enforcement is on the near horizon. Companies engaged in international shipping, energy, banking, and other international transactions should, prior to the release of the implementing regulations, review and update their compliance policies.

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* The prohibited categories of weapons are: battle tanks, armored combat vehicles, large-caliber artillery systems, combat aircraft, attack helicopters, warships, missiles, or missile systems, and any part related to a weapon in any category.

NEW DEPARTMENT OF JUSTICE GUIDANCE SEEKS TO BOLSTER CONFIDENCE IN THE USE OF INDEPENDENT MONITORS

It is a foregone conclusion that the resolution of corporate regulatory violations through deferred-prosecution and non-prosecution agreements is here to stay. Now the government is taking steps ensure that the custodians of those agreements—independent monitors ("IMs")—are not just a verifying, but a verifiable quantity in the context of these alternatives to prosecution. As a supplement to guidance issued in 2008, on May 25, 2010, the acting deputy attorney general of the Department of Justice ("DOJ"), Gary Grindler, issued a memorandum (the "Grindler Memorandum") offering recommendations on how DOJ may resolve disputes that arise between IMs and the corporations they are contracted to monitor. Including this new instruction, DOJ has now issued a total of 10 principles to guide the structure and implementation of the corporate-IM relationship, in an effort to bring more order and legitimacy to the overall process.

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Recognizing that DOJ is never a party to the agreement negotiated between a monitored corporation and an IM, the Grindler Memorandum recommends that any such agreement specify the appropriate extent of DOJ's involvement in resolving disputes that arise between the parties. The Grindler Memorandum also observes that the extent of DOJ's involvement in potential dispute resolution will depend largely on the extent of the IM's role and responsibility vis-à-vis the monitored corporation, but notes that DOJ should never actually arbitrate contractual disputes between an IM and a corporation. Finally, the Grindler Memorandum offers two sample provisions related to dispute resolution, which may be included in the agreement between a monitored corporation and an IM. One provision requires at least annual meetings between the corporation and DOJ representatives, to discuss the progress of the monitorship, its scope, costs, and other issues. The other provision allows a monitored corporation to propose, in writing, an alternative course of action to one recommended by its IM, if the corporation believes the IM's recommendation is "unduly burdensome, impractical, unduly expensive, or otherwise inadvisable." The provision also notes that any such dispute over an IM's recommendation should promptly be raised with DOJ, and that DOJ may take into account the recommendation and the corporation's reasons for not adopting it when assessing the corporation's overall compliance with the terms of its deferred-prosecution or non-prosecution agreement.

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ROUND 2: ENCRYPTION CONTROLS STREAMLINING

The U.S. Department of Commerce, Bureau of Industry and Security ("BIS") published "streamlining" changes to the encryption controls on June 25, 2010. These changes follow the fairly significant changes to the encryption controls effective in October 2008. The 2008 changes were announced as the "simplification" changes and in part restructured the core license exceptions, relaxed some prior notice and review requirements, and removed review and reporting requirements for "ancillary" cryptography. Despite these simplifications, the restrictions were often seen as cumbersome and complicated.

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The 2010 changes maintain the core structure of the regulations and license exceptions, but introduce the following key revisions:

- Decontrol items using cryptography only for a primary function that is not computing, communications, networking, or information security. This is a step beyond the "ancillary" cryptography 2008 change and means that commodities meeting the definition (articulated fully in Note 4 to Category 5, Part 2) are no longer controlled by Category 5, Part 2 at all.
- Introduce the company encryption registration and annual self-classification report for certain less sensitive encryption items, allowing export without a 30-day review wait period. Many products classified before June 25, 2010, will be grandfathered under the reporting requirements and not require self-reporting.
- Amend the requirements within license exception ENC to require far fewer classification requests (previously also called encryption reviews). This change in part means that manufacturers and exporters are responsible for self-classifying products, so the benefit of being able to export without waiting for a classification determination or 30-day wait is paired with an increased obligation to perform accurate classifications.

The changes provide clear benefits to many exporters, particularly those whose products have been decontrolled from Category 5, Part 2. At the same time, the changes do not significantly ease the burdens or simplify the analysis for exporters whose products meet or are close to meeting the standards in § 740.17(b)(2) (*e.g.*, networking equipment). The changes also do not address many industry concerns regarding the treatment of publicly available software, open cryptographic interface ("OCI"), and mass market items. BIS has promised to consider more changes to address those concerns—prepare for Round 3!

New Department of Justice Guidance Seeks to Bolster Confidence in the Use of Independent Monitors—continued from page 6

This latter provision actually rehashes one of the nine principles articulated in DOJ's previous guidance on corporate-IM relations, the so-called "Morford Memorandum," issued in March 2008 by then-acting deputy attorney general Craig Morford. The Morford Memorandum, which was meant solely to provide internal guidance to DOJ attorneys, addresses the selection, independence, and monitoring and reporting duties of IMs, as well as the ideal duration of a corporate-IM agreement. The only "mandatory" provision in the Morford Memorandum requires that the DOJ deputy attorney general review and approve any IM appointment before a monitorship is established, but the provisions in the Morford Memorandum have been formally and informally referenced and followed since their release.

While the Grindler Memorandum is also meant to serve only as internal DOJ guidance, and not to create any rights or obligations on the part of any agency or corporation, it is likely to be as heavily applied and referenced as its predecessor. Before DOJ released any of this guidance, and even since the issuance of the Morford Memorandum, the selection, scope of powers, and costs of IMs has been the subject of hearings on Capitol Hill and of Government Accountability Office ("GAO") studies and reports. Indeed, in November 2009, GAO recommended that DOJ better communicate its ability to assist corporations in resolving disputes with their IMs, since DOJ has a direct interest in the proper and efficient performance of IM duties. The Grindler Memorandum directly references GAO's findings and further notes that "providing clarity as to the Department's role should help instill public confidence in the use of monitors, including the Department's mindfulness of the costs of a monitor and their impact on a corporation's operations, as well as the accountability of monitors in performing their duties." Given this context, the principle in the Grindler Memorandum seems most directly designed to quell public and corporate concerns about the costs and impartiality of IMs. Only time will tell whether DOJ's guidance meets this goal, but with the number of deferred-prosecution and non-prosecution agreements steadily growing, it should not take long.

THE BRITISH ARE COMING! THE BRITISH ARE COMING! – PREPARING FOR THE LAUNCH OF THE BRIBERY ACT OF 2010

The enactment of the United Kingdom's ("UK") Bribery Act of 2010 ("Bribery Act" or the "Act") is the UK's most significant piece of anti-corruption legislation to date. Similar to the United States' Foreign Corrupt Practice Act ("FCPA"), the UK's Bribery Act seeks to investigate and prosecute corruption perpetuated by both foreign and domestic companies. In particular, the Bribery Act reforms the criminal law of bribery by creating new offenses and penalties that could potentially apply to companies with relatively minor connections to the UK. Because of the expansive nature of the Act, U.S. companies with ties to the UK must become familiar with its strict requirements and comply with its provisions, in addition to those of the FCPA.

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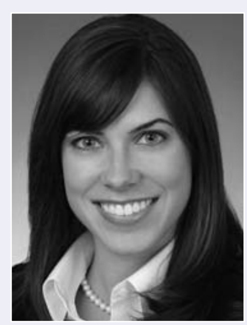
Offenses and Penalties

The Bribery Act, which received Royal Assent on April 8, 2010, replaces the offenses at common law under the Public Bodies Corrupt Practices Act 1889, the Prevention of Corruption Act 1906 and the Prevention of Corruption Act 1916. Unlike the offenses established by these former laws, which are based on an agent/principal relationship, the new bribery offenses under the Act are based on the intent to induce improper conduct.

The Bribery Act creates two types of general offenses.One general offense concerns offering, promising, or giving advantages to another person. The other relates to requesting, agreeing to receive, or accepting an advantage from another person. In addition to these general offenses, the Act establishes a discrete offense associated with bribing a foreign official. The Act also creates a new defense focused on a commercial organization's failure to prevent bribery. This offense imposes strict criminal liability on a company for improper payments made on its behalf.

The Act has established severe penalties for individuals or commercial organizations that commit these offenses. A bribery offense committed by an individual is punishable by fine and/or imprisonment, and the maximum penalty is 10 years' imprison-ment. A commercial organization found guilty of committing such an offense is liable to pay an unlimited fine if the conviction is on indictment. In addition to a fine, a company may also suffer collateral consequences such as potential director disqualifications and debarment from public contracts.



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Extraterritorial Application

The Bribery Act has considerable extraterritorial reach, which exceeds the reach of the FCPA. Because of its expansive scope, any of the new offenses may be prosecuted if committed by a UK national or corporation, or by a person who ordinarily resides in the UK. Naturally, companies with subsidiaries and operations in the UK fall under the jurisdiction of the Act. However, companies with more remote connections to the UK may also be subject to the Bribery Act's jurisdiction. The Act allows UK

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The British Are Coming! The British Are Coming! – Preparing for the Launch of the Bribery Act of 2010—continued from page 7

authorities to prosecute offenses that were committed abroad and unrelated to UK operations.

Implications of the Act on U.S. Companies

Because of its new offenses and its expansive territorial reach, the Bribery Act's impact on U.S. companies with a presence in the UK is far-reaching. U.S. companies now run of the risk of violating both the FCPA and the Act if they engage in activities that constitute an offense under both sets of laws. In order to minimize their risk, U.S. companies must understand the requirements of the Act and implement compliance programs designed to comply with both the FCPA and the Bribery Act.

U.S. companies should place special emphasis on setting up policies and procedures to prevent potential liability for failure to prevent bribery. Under the strict liability provisions of the Act, a company will be guilty of this offense when it fails to prevent an "associated person" from offering, promising, or giving a bribe, and such actions where undertaken by the person while "performing services" for or on behalf of the defendant company. The Act defines an associated person as one who performs services on behalf of the principal. For purposes of the Act, employee actions are considered for or on behalf of the company unless proven otherwise.

A company will not be found guilty of failing to prevent bribery if it can show that "adequate procedures" were put in place to prevent such actions by those associated with the organization. Although the Act does not define "adequate procedures," it does require the Secretary of State to publish guidance about procedures that companies can put in place to prevent bribery on their behalf. However, since no guidance has been published to date, uncertainty exists regarding how to best ensure that procedures already in place will adequately defend a company against claims of failing to prevent bribery.

Comparing the Bribery Act with the FCPA

Despite their similarities, the Bribery Act and the FCPA differ significantly in many ways. First, with regard to commercial organizations, the Act does not demand proof of corrupt intent because failure to prevent bribery is a strict liability offense against businesses. Second, the Bribery Act does allow "facilitation payments," such as paying for an official to expedite the performance of a "routine government action." Third, the Act's reach covers recipients of bribes in private transactions, as well as those involving public officials. Because of these differences, complying with the FCPA alone may not be sufficient to avoid violations of the Bribery Act. U.S. companies with UK operations must be aware of the new offenses and the implications they may have on business practices moving forward.

Delayed Implementation of the Act

On July 20, 2010, the UK Ministry of Justice announced plans to delay the implementation of the Bribery Act until April 2011. Along with this announcement, the Ministry also stated that it will launch a short consultation exercise in September 2010 to provide guidance on preemptive procedures designed to prevent bribery from occurring within a company. The results of the exercise will be published in early 2011 to help companies become more familiar with the requirements of the Act before it takes effect.

Conclusion

With the passage of the Bribery Act, the UK is reinforcing its reputation as one of the toughest countries on corruption in the world. The Act's offenses and penalties are stricter than those of the FCPA and its extraterritorial reach is more expansive. For that reason, U.S. companies with connections to the UK must be aware of the subtle differences between the Act and the FCPA, and be prepared to comply with the requirements of both sets of laws.

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The attorneys in Reed Smith's Global Regulatory Enforcement Group advise clients regularly on corruption issues in the United States, Europe, and around the world. The firm's global footprint, and its strong presence in the UK in particular, ensure that Reed Smith clients have access to the best advice possible wherever their businesses are now, or wherever they may be headed in the future.

GOVERNMENT PROCUREMENT IN CHINA*

China's public procurement market, like the rest of its economy, is growing at a remarkable pace. The most current data available indicates that China's purchases through the public procurement process totaled roughly $88 billion in 2008, more than triple the amount in 2003. The size of the procurement market is no doubt larger today and, regardless of the exact figure, that China's public procurement market clearly presents tremendous opportunities for foreign firms in a wide range of industries. By understanding recently released People's Republic of China ("PRC") opinions and legislation, along with China's posture vis-à-vis international agreements governing procurement, foreign firms can form better strategies to access this vast but elusive market.

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Global Regulatory Enforcement

China's Domestic Government Procurement Policies

China's procurement market is governed by the Government Procurement Law ("GPL"). First issued in 2002, the GPL states that PRC government agencies and entities must purchase domestic goods, works, and services, except in rare circumstances when:

- The required items cannot be obtained within China under "reasonable commercial terms," defined as 20 percent more expensive than foreign products
- The items to be procured are for use abroad
- Otherwise provided for by other laws or administrative regulations

Though the GPL provides for a wide variety of avenues to procurement—including open and selective tendering, competitive negotiation, single-source procurement, and request for quotation—few foreign-invested enterprises ("FIEs") have been able to compete successfully in China's public procurement market.

China Defines 'Domestic' Resources Narrowly

Under the GPL, most FIEs have been unable to crack the Chinese procurement market because their goods—though manufactured or assembled in China—have not been considered "domestic" for procurement purposes. Unlike similar legislation in other countries, the GPL does not define the term "domestic," leaving it unclear which items the PRC government considers "domestic" for procurement purposes.

Perhaps in response to calls for greater clarification, in January 2010, the PRC government issued draft implementing regulations for the GPL, which clarified the circumstances under which FIEs may compete for public procurement contracts in China. The implementing regulations define a "domestic" product as one that is "made within China's borders and for which domestic manufacturing costs exceed a certain percentage of the final price." The implementing regulations do not specify a domestic content threshold, but a 1999 PRC Ministry of Finance ("MOF") regulation classifies products with less than 50 percent of their value produced domestically as imports. Furthermore, Article 10 of the implementing regulations defines "domestic projects and services" as those that are provided by Chinese citizens, legal persons, or other organizations. FIEs are considered legal persons under PRC law and should thus be treated as domestic entities for the purpose of public procurement.

Because products that are not "domestic" must be imported into China, analyzing the definition of an "imported" product may help determine which foreign products are eligible for public procurement in China. MOF procedures and Article 11 of the implementing regulations define "imported products" as products that are manufactured abroad and enter China after going through PRC Customs declaration, inspection, and clearance procedures. The key factor in determining whether a product is domestic appears to be whether it passes through PRC Customs. Therefore, products made in China's bonded zones using imported materials may be considered "domestic" for government procurement purposes, as long as they do not require passage through or inspection by PRC Customs.

Indigenous Innovation Policies Also Restrict Foreign Competition

The preference for domestic products and services in procurement is not the only method that the PRC government uses to limit competition from foreign firms. China also promotes the procurement of "indigenous innovation products," a policy intended to stimulate the development and sale of homegrown concepts and technologies.

In 2006, China introduced the Medium- and Long-Term National Plan for Science and Technology Development (2006-20), a national policy that directs PRC agencies and provincial governments to buy products listed in certain procurement catalogs. So far, very few products made by FIEs have qualified as indigenous innovation for procurement purposes and been listed in provincial procurement catalogs. For example, of the 523 products listed in Shanghai's catalog, only two are produced by FIEs, both of which are long-standing Chinese-foreign joint ventures (JVs) with a majority Chinese stake, according to a U.S.-China Business Council report.

Domestic Favoritism Calls into Question China's WTO Commitments

In countries that have signed the World Trade Organization's ("WTO") Agreement on Government Procurement ("GPA"), the primary international agreement that enforces open access to domestic procurement markets, such discrimination against foreign firms is prohibited. Under the GPA, each signatory party must treat other GPA parties' products and services "no less favorably" than it treats its domestic products and services. Furthermore, GPA parties may not treat domestic suppliers differently on the basis of degree of foreign affiliation or ownership.

China committed to joining the GPA as part of its WTO accession in 2001, but the terms of its GPA membership are still under negotiation. China has submitted proposals to join the GPA in December 2007 and, most recently, in July 2010.

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The 2007 offer was rejected by the GPA member parties because it included high domestic content thresholds and neglected to cover procurement by sub-central government entities or in the services sector. At the time of this writing, the GPA member parties are reviewing China's most recent proposal. According to the U.S. Trade Representative, however, the current offer still contains many shortcomings, including that sub-central government entities are still not covered and thresholds remain higher than those of other GPA members.

Some Progress—But Challenges Remain

China has made recent changes to its indigenous innovation policies that address some foreign-company concerns. Initially, to be considered "indigenous innovation," a product must have had a trademark that was owned by a Chinese company with full ownership of the product's intellectual property (IP) in China. In April 2010, the PRC relaxed these strict requirements. Under the proposed guidelines, a product would be eligible for indigenous innovation accreditation as long as the applying party has exclusive rights to the product's trademark in China and is licensed to use the IP in China.

Though the relaxed trademark and IP rules are welcome changes, the requirements remain onerous for many FIEs. For example, the draft notice would require that the qualifying product's IP not have any disputes or controversies with another product's IP. Such disputes and controversies are common for FIEs that operate in China, however, as China's legal framework for IP protection is still developing. FIEs that seek indigenous innovation accreditation for their products may have to choose between enforcing their IP rights and seeking potential procurement opportunities.

Best Practices for Foreign Companies in China's Procurement Market

Despite assurances from PRC officials that FIEs will be treated the same as other China-based enterprises, eliminating foreign competition may be the impetus behind China's public procurement policies. The PRC government has long been concerned that too much technology used in China has been developed abroad and that China's unprecedented economic growth has been overly dependent on foreign products, brands, and technology. By requiring PRC agencies and ministries to procure local products and services, China aims to cultivate domestic high-tech and innovative companies.

Though many foreign companies are understandably frustrated with the lack of access to China's procurement market, the following steps may increase their chances of successfully selling products or services to PRC entities.

- **Produce goods with at least half of their value added in China.** Products that contain at least 50 percent domestic content will likely be considered "domestic" for public procurement purposes.

- **Consider making or assembling products that contain foreign components in special bonded zones.** Goods that do not require PRC Customs inspection and release may be considered domestic for government procurement purposes.

- **Offer energy-efficient and environmentally friendly products and services.** Article 9 of the draft implementing regulations would require PRC agencies to give preference in procurement to energy-efficient and environmentally friendly products. Whether China will give these products preference over non-energy-efficient domestic products remains unclear, but the regulations indicate that the State Council will likely formulate procurement policies according to national economic and social development goals. Clean-energy development is high on China's list of priorities, so an FIE may be able to improve its access to procurement opportunities by highlighting its product's energy efficiency.

- **Take advantage of provincial "buy local" provisions.** Compared with other administrative functions, local agencies and ministries have a significant amount of discretion in the procurement of goods and services. The PRC central government has delegated approval authority for all foreign-invested projects below $100 million to local authorities and, by some estimates, local officials are responsible for financing 75 percent of all PRC stimulus spending. Strengthening relationships with local partners and officials will increase foreign companies' procurement opportunities at the provincial, county, and municipal levels.

- **Highlight JV status.** Since only FIEs that are part of Chinese-foreign JVs have succeeded in getting their products into indigenous innovation catalogues, foreign companies with part ownership in Chinese-foreign JVs should emphasize their JV status before and during the bidding process.

- **Develop and highlight strong internal anti-bribery and anticorruption practices.** Under the draft implementing regulations, entities with a history of anti-bribery or Foreign Corrupt Practices Act violations may be blacklisted for PRC procurement. Since FIEs likely face a higher level of scrutiny in the procurement process, those submitting bids for procurement should preempt close inspection by highlighting their robust internal anti-bribery and anticorruption practices.

Conclusion

China had not finalized the implementing regulations as *The Sentinel* went to press, so how—or whether—the proposed policies will be carried out remains unclear. The international community welcomed many of the positive developments reflected in the draft implementing regulations, such as defining "domestic" goods and services in a manner that encompasses all enterprises in China, regardless of foreign ownership. Unfortunately, China's indigenous innovation policies may still make it difficult for FIEs to crack China's procurement market. Foreign companies that seek access to China's immense procurement market are advised to track the evolution of the GPL and China's indigenous innovation policies.

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ENFORCEMENT HIGHLIGHTS: APRIL 2010–JUNE 2010

Department of Commerce Actions

On April 28, 2010, Emenike Charles Nwankwoala, of Laurel, Maryland, pleaded guilty to exporting arms without a license, exporting controlled goods without a license, and willful delivery of a firearm to a common carrier without notice. In May 2009, Nwankwoala admitted to an undercover agent from Immigrations and Customs Enforcement that for 10 years he had been acquiring shotguns and shipping them to Nigeria. He further admitted to making a large profit from the shipment, despite not having a license. Nwankwoala faces a maximum prison sentence of 10 years for exporting arms without a license, 20 years for exporting controlled goods without a license, and five years for willful delivery of firearms to a common carrier without notice.

Leigh T. Hansson
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Global Regulatory Enforcement

On May 11, 2010, the Department of Commerce's Bureau of Industry and Security ("BIS") announced that Balli Aviation Ltd., a United Kingdom-based subsidiary of Balli Group PLC, was sentenced to pay a $2 million fine, combined with a $15 million civil settlement, after pleading guilty to two-counts of criminal information in its illegal export of commercial Boeing 747 aircrafts from the United States to Iran. They will also serve a five-year corporate probation that eliminates all of its export privileges. Under the civil settlement, $2 million will be suspended from the total if there are no other export violations.

On May 17, 2010, BIS announced that a federal jury in Massachusetts found two Chinese nationals—Alex Wu and Annie Wei—along with the corporation Wu founded—Chitron—guilty of conspiring to violate U.S. export laws and illegally export electronics components used in military radar and electronic warfare from the United States to China. Both individuals were also convicted of filing false shipping documents and immigration fraud. Wu and Wei currently face a prison sentence of up to 20 years with three years supervised release, in addition to a $1 million fine, after which both individuals will be deported to China. Wu's corporation, Chitron, faces a $1 million fine for the export of illegal items on the United States' Munitions List, as well as a $500,000 fine for the illegal export of commerce-controlled electronics.

On June 14, 2010, BIS entered into a $10,800 civil settlement with Messina, Inc., of Dallas, Texas, to resolve allegations that it violated the anti-boycott provisions of the Export Administration Regulations ("EAR") on two separate occasions. According to BIS, in 2004, Messina delivered two letter of credit certificates to a U.S. bank that were connected to transactions regarding the sale and transfer of goods to Iraq that were shipped through the United Arab Emirates. In the transaction, Messina supplied information that included details regarding other persons known or believed to be restricted from having a business relationship with or in a boycotting country, hence violating the anti-boycott provisions of the EAR.

Department of Treasury Actions

On April 23, 2010, the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC") announced that LD Telecommunications, Inc. has agreed to a settlement to resolve their alleged violations of the Cuban Assets Control Regulations between December 2005 and March 2006. According to the OFAC, LD Telecommunications initiated unlicensed funds transfers for telecommunications services in Cuba and will pay $21,671 in the settlement.

On April 23, 2010, Hilton International, Co. in McLean, Virginia, agreed to a $735,407 settlement in response to allegations of violations of the Sudanese Sanctions Regulations ("SSR") between June 2002 and February 2006. According to OFAC, Hilton International, a subsidiary of Hilton Worldwide, participated in 142 violations of the SSR with its illegal operation of two Hilton hotels in Sudan. The settlement agreement of $725,407 was based on the maximum statutory penalties at the time of the agreement, equal to $11,000 per alleged violation.

On June 3, 2010, OFAC announced that GEICO General Insurance Company in Chevy Chase, Maryland, had agreed to remit $11,000 to settle September 2006 to June 2007 allegations of violations of the Foreign Narcotics Kingpin Sanctions Regulations. The alleged violations claim that GEICO knowingly provided an automobile insurance policy with an OFAC license to an individual classified as a Specially Designated Narcotics Trafficker ("SDNTK").

On June 3, 2010, KLM Cargo was charged with violating the Sudanese Sanctions Regulations between January 2006 and September 2007, when it transported oil field equipment and hydraulic hoses to Sudan on behalf of two U.S. entities without a license to do so. It has agreed to pay a $5,336.36 penalty for the violations.

On June 22, 2010, OFAC announced an $860,000 settlement with Agar Corporation, Inc. involving the company's illegal export of oil and gas production equipment for use in Sudan, violating the Sudanese Sanctions Regulations (SSR), which forbids the export of particular goods to Sudan. Under the settlement, Agar Corporation pleaded guilty to one count of knowingly facilitating the export of 16 flow meters without authorization from Venezuela to Sudan through a related company, Agarcorp de Venezuela. Agar Corporation, Inc. will pay a $760,000 criminal penalty and a total criminal penalty of $1.14 million, after a forfeiture of $380,000.

FCPA Enforcement

On April 1, 2010, the United States filed a lawsuit against defense contractor Kellogg Brown & Root Services ("KBR") as part of the National Procurement Fraud Initiative, claiming that the corporation violated the False Claims Act by knowingly including unallowable costs for private armed security in bills to the U.S. Army under the Logistics Civil Augmentation Program ("LOGCAP") III contract. The government alleges that KBR and its subcontractors used private armed security from 2003 to 2007 and failed to obtain authorization for arming the subcontractors, and using private security contractors that were not registered with the Iraqi Ministry of the Interior.

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Enforcement Highlights—continued from page 11

On April 1, 2010, Daimler AG and three of its subsidiaries resolved charges regarding the Foreign Corrupt Practices Act ("FCPA") with a $185 million combined criminal and civil penalties settlement. According to the Department of Justice, DaimlerChrysler Automotive Russia and its German subsidiary, Export and Trade Finance GmbH, pleaded guilty to one count of conspiracy to violate the anti-bribery provisions of the FCPA and another count of actually violating them. The corporation also agreed to file criminal information that charged the company with another count of conspiracy to violate the records provision of the FCPA and another count for the violation. Some of Daimler's subsidiaries also admitted to making improper payments through commissions, delegation travel, and gifts to benefit foreign governments. The total value of the criminal fines is $93.6 million.

On April 5, 2010, Mobil Natural Gas Inc., Mobil Exploration & Producing U.S. Inc., and their subsidiaries, agreed to a $32.3 million settlement to resolve claims that they violated the False Claims Act by willfully underpaying royalties owned on natural gas produced from federal and American Indian leases. According to the Department of Justice, Mobil continually underreported the value of natural gas taken from the leases and, as a result, undervalued the royalties that they owed to the federal government and to American Indian tribes.

On April 7, 2010, Stephen Schultz was sentenced to 86 months in prison and five years supervised release in response to allegations that he was involved with several Costa Rica-based business fraud ventures. Schultz pleaded guilty to one count of conspiracy to commit mail and wire fraud, eight counts of mail fraud, and three counts of wire fraud, in part of the government's crackdown on business opportunity fraud.

On April 12, 2010, the Department of Justice announced that it has seized more than $40 million worth of gold, silver, and other jewelry as a result of a money laundering investigation that identified two companies in Colon, Panama, that were allegedly responsible for laundering narcotics profits from the United States into Panama. This investigation led to the indictment of an offshore business involved in the black market peso exchange, where profits from narcotics sold in the United States were exchanged for Columbian pesos and used to buy goods in the Colon Free Zone. As a result of the investigation, more than $2 million in U.S. currency was seized and all of the forfeited assets will be liquidated, with final proceeds from sales placed in DOJ's Assets Forfeiture Fund.

On April 13, 2010, Paul Zabcuk of The Woodlands, Texas, pleaded guilty to filing a false tax return, on which he failed to report his income and failed to report that he had interest in or signature authority over financial accounts at UBS AG in Switzerland. He opened the account under the name of ODF Limited, a Bahamian corporation, and generated a tax loss of $267,597.

On April 15, 2010, Dilraj Mathauda was sentenced to 115 months in prison and five years supervised release for illegally running a series of Costa Rican business opportunity fraud ventures. By convincing others to purchase their business opportunities, Mathauda and his co-conspirators made and forced others to make fraudulent statements to potential buyers, while potential purchasers were told false stories of Mathuada's success in the beverage and greeting card business.

On April 16, 2010, Mobil Oil Guam Inc. and Mobil Oil Mariana Islands Inc., both subsidiaries of Exxon Mobil Corporation, agreed to a $2.4 million settlement for violating the Clean Air Act by failing to control facility emissions. According to the Environmental Protection Agency, both companies illegally released hundreds of tons of polluting composites into the air from their gasoline terminals located in Guam and Saipan. Under the settlement, both companies will install air pollution controls and monitors, submit evaluation reports, and obtain the right permits. The subsidiaries claim that they will spend an additional $15 million to bring the gasoline terminals into compliance with the Clean Air Act.

On April 21, 2010, United States Army Sgt. Ray Scott Chase pleaded guilty to accepting $1.4 million in illegal gratuities from private contractors, in relation to military dining contracts in Kuwait. Chase admitted to receiving approximately $1.4 million from private contractors in return for official acts he performed involving food procurement, preparation, and service operations at Camp Doha and Camp Arifjan. Chase also admitted to avoiding currency transaction reporting requirements upon his return to the United States.

On April 26, 2010, Jaisankar Marimuthu of Chennai, India, was sentenced to 81 months in prison and $2.4 million in restitution for his role in an international online brokerage fraud scheme, in which he would hack into online brokerage accounts to manipulate stock prices. Part of a conspiracy operating from Thailand and China from February to December 2006, Marimuthu plead guilty to one count of conspiracy to commit wire fraud, securities fraud, computer fraud, and aggravated identity theft. Co-conspirator Thirugnanam Ramanathan also pleaded guilty to one count of conspiracy to commit wire fraud, securities fraud, computer fraud, and aggravated identity theft, and was sentenced to two years in prison.

On April 29, 2010, Fleet Management Limited, a Hong Kong ship management company was indicted for environmental crimes and obstruction, and was also charged with making false statements to the Coast Guard regarding the maintenance of oil record books required by the Act to Prevent Pollution from Ships ("APPS"). Two of the company's employees, Prem Kumar and Prasada Reddy Mareddy, were both charged with conspiracy. If convicted, both individuals could face a $250,000 fine and up to five years in prison. Kumar, who was separately convicted of obstruction of justice, could face a $250,000 fine and up to 20 years in prison. If convicted, Fleet Management Limited could face a fine of up to $3 million.

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