

Morgan Lewis

Successor Liability in Export and Import Transactions

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Ground Rules

- No Charge
- Electronic submission of questions
- Slides Available on Morgan Lewis Web Site

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- NOT legal advice!
- Accurate as of date of Webinar

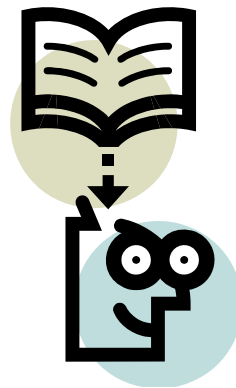
Successor Liability Under US Import & Export Law

- When successor takes on burdens of a previous unrelated entity through merger, acquisition, or divestiture [MAD].
- Successor liability allows a governmental agency or creditor to pursue purchaser even when the purchaser did not expressly assume such liabilities as part of the purchase or participate in illegal activity.



Successor Liability

- NO Company should inadvertently “inherit” civil, administrative or criminal responsibilities for any illegal activities for which it lacks thorough understanding
- Process of ascertaining potential exposure for successor liability is referred to as Due Diligence
- We will discuss Due Diligence later in this Webinar



Law of Successor Liability Under US Import & Export Law

- Largely a creature of decisions of Agency administrative tribunals or policies
- Courts & agency tribunals generally left to their own devices to fashion standards for successor liability
- Few US statutes imposing a regulatory regime expressly mention successor liability

Law of Successor Liability Under US Import & Export Law

- In absence of controlling US statutory language, courts and agency tribunals turn to State law to fashion rules for successor liability
- Leads to lack of uniformity across all federal regulatory schemes for application of identical rules for federal regulatory successor liability

Law of Successor Liability Under US Import & Export Law

- General Successor Liability principles derive ultimately from State law
- Large majority of federal matters adopting successor liability theories fall within:
 - Environmental Remediation
 - Labor

How Successor Liability in Export Actions Began

- AECA, EAA, IEEPA, TWEA, Tariff Act of 1930, FCPA don't specifically deal with USG enforcement via successor liability
- Prior to 2002, successor liability in export transactions was not a critical issue
- Enforcement agencies generally pursued remedies/penalties against violators themselves

Example of Int'l Trade Statute Authorizing Successor Liability

- Iran and Libya Sanctions Act [ILSA] of 1996, Section 5(c):
 - The sanctions shall be imposed on any person the President determines “is a successor entity to the person referred to in paragraph (1)

Executive Order 13590 Expressly Imposed Successor Liability

- E.O. 13590 imposed additional Iran Sanctions Nov. 21, 2011, citing the statutory authority as IEEPA
- E.O. 13590 authorizes sanctions against any person [including non-US] who knowingly sells, leases, or provides to Iran goods, services, technology or support , that has a certain value that could directly & significantly contribute to the maintenance or enhancement of Iran's ability to develop petroleum resources located in Iran.

Executive Order 13590 Expressly Imposed Successor Liability

- E.O. 13590, Section 1(c) expressly authorizes imposition of sanctions for violations of E.O. 13590 against primary violators' US and non-US successors
- E.O. 13590 also expressly authorizes imposition of sanctions for violations of E.O. 13590 against parents, subsidiaries and affiliates of primary violators under certain circumstances

How Successor Liability in Export Actions Began

- Prosecuting actual violator only is currently NO longer the case
- BIS, OFAC, DDTTC, DoJ and CBP now impose successor liability for violations of the export/import & FCPA statutes and regulations they respectively enforce
- Successor liability trend started for BIS with admin case Sigma-Aldrich in 2002

How Successor Liability in Export Actions Began

- ALJ in admin Sigma-Aldrich case established landmark export agency precedent
- Ruled BIS can pursue enforcement via successor liability under the EAR
- ALJ applied General Federal rules of construction applicable for all Federal statutes – not just export control

How Successor Liability in Export Actions Began

- ALJ looked to 1 USC Sec. 5 [enacted in 1873] provides in part:
 - *“The word ‘company’ or ‘association’, when used in reference to a corporation, shall be deemed to embrace the words ‘successors and assigns’ of such company or association in like manner as if these last named words... were expressed.”*

How Successor Liability in Export Actions Began

- ALJ also concluded state law principles supported imposing successor liability
- ALJ found “substantial continuity” of the business of the assets purchased

Successor Liability

- Sigma-Aldrich – ALJ ruled “innocent” asset-purchaser can be penalized for EAR export violations committed by an unrelated seller before the asset sale occurred
- Respondent did not challenge this ALJ holding in US courts
- Respondent agreed to settle for over \$1M

Successor Liability

- Nov 2002 BIS Sigma-Aldrich press release:
- *“A company will be held accountable for violations of US export control laws committed by companies that they acquire.”*



Successor Liability

- In 2002, BIS Director of Office of Export Enforcement (OEE) stated:
- *“An asset purchaser assumes both civil and criminal liability of the seller for the seller’s non-compliance with export regulations.”*

Successor Liability

- OEE Director also said:
- *“Position of BIS and Dept. of Justice that private parties cannot contract around such liability.”*



Successor Liability

- BIS has charged Respondents since 2002 and obtained settlements from companies where the Respondent either:
 - Purchased ownership/equity interest in offending exporter or
 - Purchased assets only of offending exporter

Successor Liability

- BIS's successor liability practices have not been tested in US Federal Court and either been upheld or invalidated
- Nor has Congress seen fit to stop the BIS practice with appropriate legislation
- Thus, EAR successor liability is the de facto rule in the real world of business
- **E.O. 13590- November 2011 – expressly validated principle of imposition of successor liability**

Successor Liability

- Why does successor liability rule persist?
 - ALJ will follow “law” in admin cases as pronounced by BIS
 - Court litigation is time consuming
 - Court litigation is very expensive
 - Possible negative actions by regulator on needed licenses
 - Congress’ apparent acquiescence

DDTC, OFAC

- We found no DDTC or OFAC reported ALJ legal opinions imposing successor liability such as BIS Sigma-Aldrich
- DDTC and OFAC actual practice IS to impose successor liability broadly
- “If BIS can do it, so must we be able to”

DDTC

- DDTC mandates notification from registrants of an acquisition ITAR 122.4(a)(2)
- DDTC requires acquiring registrant to state that it “assumes all rights, responsibilities, liability, and obligations that existed, exist, or may develop regarding licenses, agreements, or other approvals [of the acquired entity]...”

Common Export **Violations**

- *The following are susceptible to imposition of Successor Liability:*
 - ✓ Exporting and reexporting without product specific license
 - ✓ Exporting and reexporting to prohibited country
 - ✓ Exporting and reexporting to SDN, Denied or Debarred Party

Common Export **Violations**

- *(Cont'd)*:
 - ✓ False statements/material omissions on export control documents
 - ✓ Deemed exports, e.g., foreign employees
 - ✓ No destination control statements

Common Export **Violations**

- *(Cont'd)*:
 - ✓ AES filings incorrect
 - ✓ Payment of sales commissions not reported
 - ✓ Failure to keep required records

Successor Liability in Importing

- Penalty decisions of CBP less publicized than BIS, DDTC
- CBP has indicated willingness to impose successor liability

Successor Liability in Import Actions

- Federal Court case that tacitly allows CBP to pursue successor liability for unpaid import duties under the Tariff Act of 1930
- US v. Ataka America, Inc., 826 F. Supp. 495 (Ct. Int'l Trade 1993).

Common Import **Violations**

- *The following are susceptible to imposition of Successor Liability:*
 - ✓ Undervaluing imported merchandise
 - ✓ Erroneous HTSUS classification
 - ✓ Improper claim for duty free treatment
 - ✓ NAFTA or other FTA documentation incomplete

Successor Liability in Bankruptcy Proceedings

- Bankruptcy court's order of sale "free and clear" under bankruptcy code does not stop the agency assertion of successor liability
- A purchaser of a bankrupt's assets from a bankruptcy court will be held liable by agency for the bankrupt's violations
- Following language taken from recent DDTC Settlement:

Successor Liability in Bankruptcy Proceedings

Respondent TS Trade also agrees that any such additional civil penalty shall be nondischargeable under Section 523(a)(7) of the Federal Bankruptcy Code and subject to the terms of paragraph seven (7) of this Agreement. Respondent TS Trade also waive the right to contest the validity of this Consent Agreement or the Order, including in any action that may be brought for the enforcement of any civil fine, penalty or forfeiture in connection with this Consent Agreement or Order.

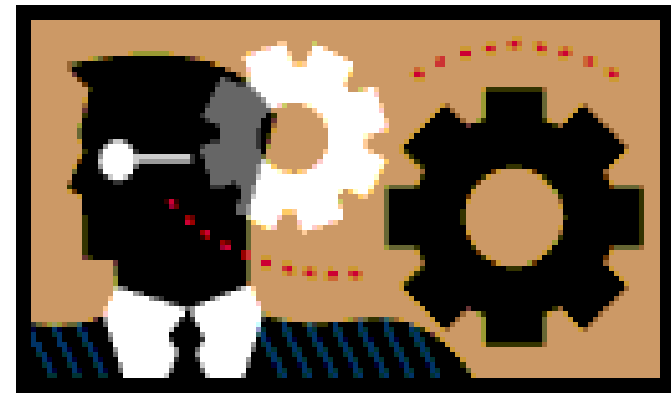
Successor Liability in Bankruptcy Proceedings

- We found no reported Federal Bankruptcy case either upholding or invalidating the practice of imposing successor liability for purchases made from the estate of a bankrupt violator



RECAP

- Neither EAA, AECA, IEEPA, Tariff Act of 1930, FCPA, nor their implementing regulations, expressly authorize successor liability
- BIS, DDTTC, OFAC, DOJ and CBP agency policies impose successor liability on asset or equity purchasers of/from violators



RECAP

- No US Court case specifically invalidating the agencies' practices of imposing successor liability in export/import or FCPA
- No Congressional action specifically approving or invalidating the agencies' practices of imposing successor liability

FUTURE OF SUCCESSOR LIABILITY

- On June 14, 2011 former US Attorney General Mukasey testified before House subcommittee on Crime, Terrorism & Homeland Security
- Asked Congress to enact limits of FCPA successor liability as asserted by DoJ saying DoJ policy has gone too far
- **E.O. 13590 - IEEPA portends support for very broad Agency assertions of successor liability, both domestically and extraterritorially**

Successor Liability can lead to large fines

- In Dec. 2008, Luxembourg-based Qioptiq agreed to pay DDTC \$25 million fine
- Settlement for ITAR violations committed by a foreign company acquired by Qioptiq
- ITAR violations occurred before Qioptiq purchased violator

Successor Liability can lead to large fines!

- Qioptiq case related primarily to re-exports by acquired company, not by Qioptiq itself, of US-origin ITAR-controlled defense articles
- Violations by non-US persons from one foreign country to third foreign country, without DDTC re-export authorization

Successor Liability can lead to large fines!

- FCPA successor liability discovered after post closing by eLandia acquisition of Latin Node
- Latin Node made improper payments to Honduran & Yemeni officials
- eLandia disclosed FCPA violations to DOJ

Successor Liability can lead to large fines!

- Latin Node pleaded guilty to FCPA violations
- \$2 million fine imposed to be paid by eLandia

Coping with Risks of Successor Liability

- How can a company assure itself that it will avoid or mitigate successor liability problems before closing a MAD deal?
- **Generally Perform Due Diligence Investigation of Target's Actions**

Due Diligence

- In MAD transactions, focus on 3 points:
 - What are risks of successor liability exposure?
 - What are business benefits of deal?
 - What actions should management take in light of successor liability risks and business benefit?

Opinion Procedure Release [OPR] for FCPA

- Opinion Procedure Release Unique to FCPA
- Foreign Corrupt Practice Act Opinion Procedure, 28 CFR Sec. 801. et. seq.
- Allows company to submit a set of facts to DOJ to determine if DOJ would take any enforcement action based on those facts
- Needs to be actual situation company is facing

Opinion Procedure Release [OPR] for FCPA

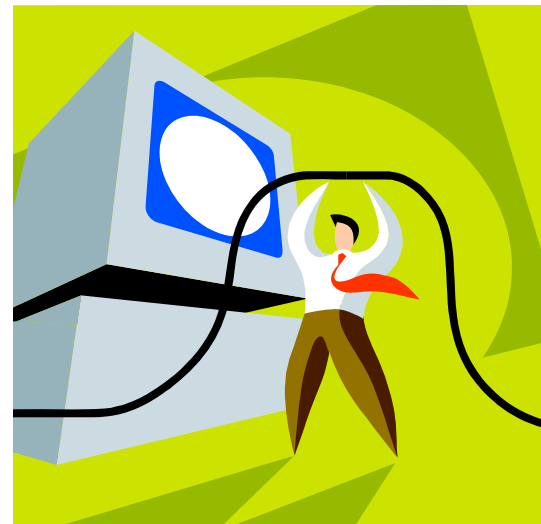
- Several OPRs deal with issues of successor liability under FCPA
- Requestors sought to obtain assurances from DOJ that they would not be held liable for their acquisition target's pre-closing conduct

Opinion Procedure Release [OPR] for FCPA

- Only Requestor is able to rely on the OPR – otherwise it's mere guidance to public
- www.usdoj.gov/criminal/fraud/fcpa/opinion
- See OPRs 2003-01; 2004-02; 2008-02 which involve successor liability issues

Pre-MAD Due Diligence

- Due Diligence means investigation of facts and analysis of export and import compliance by target before closing MAD transaction
 - Mitigate risk



Due Diligence

- Team must consist of buyer's and seller's export, import and leadership personnel
- Must dedicate sufficient resources and time
- Consider using export/import outside legal counsel



Due Diligence

- Buyer must prepare comprehensive list of questions designed to identify issues
- Foreign Buyer may need export license to even access some key information in hands of target company

Due Diligence

- Seller should have its export/import compliance “house in order” before it offers to sell equity/assets
- Seller’s imperfect records of export/import compliance will compromise sales price or abort deal

Due Diligence

- Organizing and implementing due diligence investigation approach and team membership will depend on factual scenario

Due Diligence

- Possible MAD Scenarios:
 - Acquisition of Foreign “Commercial” Company with Foreign Person Employees
 - Acquisition of Defense Articles product line from a Foreign Defense Manufacturer

Due Diligence

- Possible Scenarios:
 - US Company acquiring product line from another US Company
 - US Company acquiring wholly-owned US subsidiary of Foreign Company

Due Diligence

- Considerations:
 - Request confirmation for ITAR registration for previous 5 years
 - Have ITAR exports been made to China or any ITAR 126.1 destinations – mandatory disclosure to DDTC will be required [22 CFR 126.1(e)]
 - If target is custom-builder of components, what were end uses, who were end users?

Due Diligence

- Considerations:
 - Does target use foreign sales agents, i.e. brokers?
 - Are foreign brokers registered under ITAR Part 129?
 - Has target diligently overseen the activities of its foreign sales agents for FCPA?
 - Evidence of compliance with ITAR Part 129 and Part 130

Due Diligence

- Considerations:
 - Must examine target's Product Spreadsheet showing export control jurisdiction or classification determinations under EAR, ITAR [ECCNs and USML Categories]
 - Are there supporting DDTC CJ and BIS CCATS determinations?
 - No such spreadsheet – likelihood of export and/or reexport violations is higher

Due Diligence

- Considerations:
 - Is a foreign subsidiary of a US-target selling products or services to Iran or Cuba?
 - If yes – was a license obtained? If not, possible OFAC violation
 - Does foreign subsidiary provide products or services for Iran's petroleum/energy sector?

Due Diligence

- Considerations:
 - Do US target and/or its “controlled-in-fact” foreign subsidiaries sell products to countries boycotting Israel?
 - If so, then EAR anti-boycott compliance issues must be reviewed.
 - Are there any target-filed pending voluntary disclosures with the agency?

Due Diligence

- Considerations:
 - Target's sales to foreign governments – if so:
 - *Are there high “commissions” paid to agents involved in such sales?*
 - *High “commissions” raise possible FCPA violations*

Due Diligence

- Considerations:
 - Does target employ foreign national employees? I-129 Work Visa compliance procedure?
 - Valid work visa NOT substitute for export license under any circumstance, where employee works with export-controlled items or technologies
 - Deemed export violations for visitors and seminar presentations?

Due Diligence

- Considerations:
 - Recordkeeping requirements complete?
 - AES filings complete?
 - Have there been many “routed transactions”?
 - Where are the target’s export compliance training materials?

Due Diligence

- Considerations:
 - Records of ongoing & recent training sessions with lists of attendees?
 - Is there TTCP and/or TCP?
 - Can claims of duty free import entry be validated by supporting documents?
 - Can rules of origin claimed under FTA be demonstrably established?

Sales / Purchase Terms

- Regulatory Agency is NOT a party to sales agreement
- Purchase Agreement terms cannot stop Agency from imposing Successor Liability for penalty and/or sanctions against buyer for the seller's export or import violations committed before sale.

Sale / Purchase Terms

- Terms can provide for Escrow held by a third party
- Sum withheld from sales price for a sufficient period of time to offset the costs associated with potential penalties and violations



Sale / Purchase Terms

- Buyer can require target to file Voluntary Disclosure with relevant Agency for violations before closing sale
- Buyer can make closing terms contingent upon outcome of Agency action on Disclosure

Sale / Purchase Terms

- Can require indemnification for money “damages” caused by imposition of penalties by agency
- Can allow cancellation of MAD transaction based on Due Diligence results

Questions?



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