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International Regulatory Compliance Challenges Faced By EPC Contractors Supporting The U.S. Government Abroad

As most contractors will acknowledge, working for the U.S. Government has many benefits, as well as risks and burdens. On the benefits side, the U.S. is the world's largest purchaser of goods and services and, in many cases, is the largest single customer for engineering, procurement and construction (EPC) contractors. Moreover, unlike commercial customers, the Government is obliged by law to pay its contractors on time, which may be of particular importance in the current economy. However, there are many traps for the unwary in Government contracting, including a panoply of rules and regulations, such as special cost accounting rules, penalties for false claims, and socioeconomic and labor requirements that do not apply in the commercial world. Indeed, some of these rules are counterintuitive to persons and companies with vast commercial experience but little Government experience, and activities that in the commercial world might be common and accepted—and, at worst, risk civil lawsuit—can spark criminal investigations in the Government contracting world.

In the past decade, Government contracting has become more international. Service contractors, and in particular EPC contractors, have been the most apt to be “boots on the ground” supporting the U.S. For example, EPC contractors have traveled the globe designing and building embassies and military bases, supporting Government-funded projects, providing reconstruction services in war zones and technical support to the military and civilian agencies in furtherance of such efforts, as well as actively supporting U.S. demilitarization programs, to name a few.

Many EPC contractors are reasonably proficient in specialized Government contracting rules and regula-

tions. And, in recent years, most have tried hard to comply with such rules in challenging environments abroad, sometimes under the extreme duress inherent in contingency operations. However, when working abroad—even for the U.S.—EPC contractors need to be aware of the general overlay of rules and regulations that apply to all international work. For instance, the U.S. Foreign Corrupt Practices Act (FCPA), export controls, economic sanctions and human rights issues are as applicable and important when supporting the U.S. abroad as when pursuing non-U.S. work abroad. Although these rules are not always specified in great detail (if at all) in the Federal Acquisition Regulation, Defense FAR Supplement or other agency-specific clauses of Government contracts, they still apply to overseas contracting. This article provides some examples of how each set of rules affects EPC contractors operating abroad under Government contracts and suggests several strategies for compliance.

FCPA—The FCPA prohibits contractors from offering or providing anything of value to a foreign government official to obtain or retain business, or to secure any improper business advantage. The last few years have seen a surge in FCPA enforcement actions, culminating most recently in nine-figure settlements for both Siemens and Halliburton/KBR-affiliated entities at the end of 2008 and the beginning of 2009. FCPA violations can result in collateral sanctions, including suspension and debarment from Government contracting or work under international financial institution, e.g., World Bank, contracting programs.

The engineering and construction industry historically has been at high risk for corruption. As a consequence, most large U.S. EPC contractors are aware of the FCPA, and many have long-standing compliance programs. However, when working for the Government, EPC contractors may have a false sense of security. After all, they recognize that the FCPA applies only to payments to “foreign officials,” but may forget that the FCPA applies when the U.S. is the customer. EPC contractors are correct that payments to U.S. officials do not “count” for FCPA purposes—although they are covered by other laws restricting gratuities to federal officials, but there are a near infinite number of scenarios in which

an improper payment could be offered or provided to a foreign official, even in the context of a Government contract performed overseas. In practical terms, that means that building an airbase for the U.S. may present almost as many FCPA risks as building an LNG facility for a foreign government. Indeed, because EPC contractors must be concerned about laws and regulations affecting potential bribery to U.S. contracting officials, as well as to local officials incident to Government work abroad, the compliance environment is arguably even more challenging.

For instance, Government contractors operating abroad have frequent opportunities to interact with foreign officials, whether going through customs, obtaining licenses, permits and visas, or setting up project offices. In some circumstances, the foreign official might solicit a bribe, or the U.S. contractor might offer one. It also is conceivable that EPC employees operating under Government contracts will view local markets as opportunities for future commercial business and may be tempted—on occasion—to engage in questionable conduct with local officials to enhance the possibility of downstream work with the host country. Moreover, it is not just the activities of the contractors, but also the activities of those operating on their behalf, that can create FCPA risks. That means that although a contractor may have an ethics and compliance program to help ensure that its employees do not make improper payments, third-country national subcontractors (or smaller, less-sophisticated U.S. subcontractors) operating under the EPC contractor's Government prime contract, have the potential to make payments that could be attributed to the EPC contractor.

With this in mind, it is essential that EPC contractors recognize that FCPA compliance must be emphasized and rolled out as vigorously in their international government contracting units as in their commercial business lines. From a compliance perspective, the good news is that prohibitions against gifts, gratuities and kickbacks are generally well understood and appreciated in a Government contracting setting, particularly following heightened emphasis and requirements for contractor ethics programs implemented at the end of 2008. As a consequence, EPC employees working on Government contracts may be receptive to compliance initiatives because they know that bribery offenses, involving either a U.S. or foreign official, are enumerated grounds for suspension and debarment. However, in a contingency environment, the complex mix of the strain of battle, pressure to perform and challenging

local environments requires compliance vigilance to manage FCPA risks.

Export Controls—Although many EPC contractors have some understanding of the FCPA, they often have a less-mature awareness of export controls. After all, much EPC work is high technology, but the sensitive nature of EPC work is less obvious than that of the weapons industry. Moreover, EPC contractors deal in services and not supplies, so export controls are less likely to be part of their corporate DNA because they typically do not engineer, manufacture and ship products on their own. However, EPC contractors perform many tasks for the Government, particularly in support of Department of Defense programs, that do involve significant technical elements—i.e., designing secure buildings, installing radar and destroying old munitions. Contractors might also be surprised that relatively “medium-tech” products, technology and software—including items widely purchasable abroad—may themselves be subject to export controls.

EPC contractors typically do not manufacture high-tech equipment, but they frequently operate in a logistics, procurement or project management role in which they may be responsible for sending other entities' equipment around the world. Therefore, although they may not realize that this is the case, EPC contractors can be “exporters,” and their risks as service contractors are just as high, if not higher, than those of supply contractors, particularly because they may not be familiar with the control status of third-party equipment that they are responsible for shipping. In addition, when operating in challenging environments abroad, EPC contractors may use security contractors that carry or use highly controlled equipment. Add to this traditional unfamiliarity with export controls the fact that EPC contractors may incorrectly assume that because they work for the Government, export controls do not apply, and it becomes apparent that this is an area ripe for potential problems.

Contractors working abroad, therefore, must recognize that export controls apply to their projects and must identify which rules apply. Much of their work typically is subject to the Commerce Department's Export Administration Regulations (EAR), which govern dual-use commodities, software and technology. A surprising amount of EPC work, however, is subject to the International Traffic in Arms Regulations (ITAR), which govern the defense trade, including defense services such as demilitarization. Unlike dual-use export control rules, ITAR programs may significantly impact

the ability of the contractor to use non-U.S. persons to support the project.

To successfully address export control issues, contractors must develop plans for identifying potential export-controlled content they are shipping that may require export licenses or other authorization. Ideally, such planning occurs at the beginning of a project, so that export issues do not result in work falling off the critical path, although in practical effect, such planning is difficult in an ever-changing contingency environment abroad. Successful management of export control risks also requires a fair amount of coordination with suppliers and original equipment manufacturers, from which EPC contractors will need to obtain information regarding the export control status of the projects and technology being shipped. The compliance requirements need not fall solely on an EPC contractor. Rather, with sufficient awareness, and by establishing accountability, an EPC contractor can reduce the burden and compliance risk by ensuring that suppliers are handling the issues.

Apart from physical exports, EPC contractors' engineering and procurement departments will also need to be mindful of controls on intangible exports such as technical data and controlled drawings included in bid packages. It is essential to ensure that an export control provision is included in any subcontract or purchase order, and, in many cases, even at the request for proposals or quotations stage. This could impact the supply chain because contractors may not be able to use third-country subcontracting firms without first obtaining an export license for export-controlled items. There may also be supply chain issues involving the Arab League's boycott of Israel, and contractors need to be mindful of boycott risks and reporting requirements that are part of the EAR, as well as the Internal Revenue Code, because severe tax consequences can result from inattentiveness. Although most persons view this law as prohibiting participation in the Arab economic boycott of Israel, there are at least three important nuances to keep in mind to reduce risks of violating this law: (1) the antiboycott provisions do apply to economic boycotts of countries other than Israel; (2) the antiboycott laws prohibit conduct that on its face does not appear to be offensive, e.g., in the Internal Revenue Code, agreeing to comply with the laws of Saudi Arabia; and (3) the antiboycott laws extend to furnishing certain information that might be viewed as discriminatory vis-à-vis race, gender, national origin or religion.

In addition, EPC contractors need to be mindful of export control compliance in the supply chain, particularly because they may hire many subcontractors, including third-country firms and nationals with little knowledge—and in many cases, respect—for the broad extraterritorial nature of U.S. export controls. Apart from actual items that may be shipped in support of work or technical data that might be shared, EPC contractors should recognize that security contractors can also pose export control compliance risks as a certain percentage of that work could implicate the ITAR, even in otherwise commercial programs.

Finally, it is important for EPC contractors to appreciate that primary contracting agencies such as DOD have relatively little direct jurisdiction over export controls, despite their primary roles as Government "customers." That means that even in the face of DOD's critical needs in the field, and despite pressures sometimes placed on EPC contractors by such defense-related customers, EPC contractors are bound by State and Commerce department export regulations. Indeed, even DOD's recent effort last summer to contractualize export controls through an interim DFARS provision (which is flowdown through the supply chain), reminds contractors of State and Commerce regulatory authority.

Sanctions—U.S. economic sanctions, implemented by the Department of the Treasury's Office of Foreign Assets Control (OFAC), also can present challenges for contractors. Although contractors likely know that they cannot work directly in places like Iran or Syria or much of Sudan (among others), and notwithstanding a FAR clause that reminds them of the need to comply with OFAC regulations, they may not realize that they are prohibited from dealing with entities from such countries, or that the U.S. has designated thousands of persons and entities around the world, including ones located in countries friendly to the U.S., as "specially designated nationals" (SDNs) with whom economic- or export-related dealings are illegal. Moreover, EPC contractors may not realize that logistics channels and supply lines may sometimes intertwine with sanctioned countries, e.g., the Iranian and Syrian borders of Iraq.

However, the greatest sanctions risks may reside at levels of the supply chain below EPC prime contractors themselves. Unless a prime contractor effectively flows down sanctions-related provisions, a second- or third-tier, third-country subcontractor—particularly in the Middle East—may attempt to purchase or source

a product from a sanctioned country, or hire a sanctioned-country firm to provide a service. Moreover, whenever local craft labor is hired for a construction project, particularly in the Middle East, contractors risk inadvertently hiring an SDN.

With the above risks in mind, it is particularly important that EPC prime contractors obtain verifiable assurances that their third-country subcontractors will comply with U.S. sanctions. It is also critical that EPC contractors engage in “screening” and due diligence for their own procurement and subcontracting practices, including ensuring that all prospective and actual vendors, suppliers, consultants, partners and subcontractors are screened against U.S. restricted parties lists for export controls and sanctions, including the SDN list.

Human Rights—Yet another challenge for contractors may be the rising tide of human rights lawsuits filed in the U.S. and abroad. Over the past 15 years, contractors and others have been targeted for a variety of alleged wrongs, from torture to murder to slavery. Most of these cases have relied on the Alien Tort Claims Act, a U.S. law enacted in 1789 that allows foreigners to file civil lawsuits in U.S. courts for serious violations of international law. Although for nearly 200 years the Act lay dormant, it was recently resuscitated, and has been invoked against corporate defendants in roughly 100 cases, most of which were filed after 2000. As these cases have become more prevalent, foreign plaintiffs recently have begun to rely on more traditional theories—such as securities fraud, assault and battery, unfair competition, and false advertising—in bringing their human rights claims.

Whatever the exact legal theory, the cases almost always involve graphic allegations of murder, torture, slavery and other deeply troubling harms. That obviously creates substantial litigation exposure; for example, in late 2008, a federal court awarded three plaintiffs \$80 million against a corporation based on their claims of forced labor. But claims of collusion in human rights abuses also create the kind of substantial negative publicity that can drive down stock prices and impact customer relationships—especially with the U.S. Government.

For contractors, as with the FCPA, export controls and sanctions, the primary concern may lie with subcontractors and other third parties. As recent high-

profile legal actions show, although U.S. human rights lawsuits target companies and corporate subsidiaries for their own actions, perhaps most suits are now premised on secondary theories of liability, claiming that a third party’s actions should be attributed to the company itself.

Given those threats, when operating in challenging environments abroad, incorporating human rights components into a corporate compliance plan becomes critical. It is essential that contractors train their employees, clearly set forth their expectations to subcontractors, and develop a means for identifying and investigating possible concerns. Depending on where the contractor operates, the nature of its contract and customers, and the risk profile of its subcontractor and supplier base, further steps might include specialized pre-contract due diligence as well as other efforts targeted at enhancing subcontractor compliance. In other words, EPC contractors should take a thoughtful, risk-based approach to dealing with this increasingly important and publicized area of concern.

Conclusion—Supporting the U.S. Government is not easy, but it is an important job. To do it right, EPC contractors must realize that their compliance obligations extend well beyond traditional Government contracting rules. No article can cover every possible area of compliance concern, and this article is no different. However, it has addressed several major areas of which all EPC contractors working on Government contracts abroad should be mindful. A strong compliance program will address these risks and establish standards that harmonize and reconcile a contractor’s diverse compliance obligations.



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