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INTERNATIONAL REGULATORY COMPLIANCE CHALLENGES FACING EPC CONTRACTORS

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INTERNATIONAL REGULATORY COMPLIANCE CHALLENGES FACING EPC CONTRACTORS

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I. INTRODUCTION

Many U.S. engineering, procurement and construction (EPC) contractors engage in significant work abroad. Most are attuned to the challenges of working in difficult environments. Many are aware of specific local law issues. Not all, however, are well-versed in U.S. laws and regulations that affect their work abroad, or which may add an extra regulatory burden to their global projects, even while working in the U.S. For instance, perhaps some EPCs might not consider whether sharing drawings related to a nuclear power plant with non-U.S. national engineers might create an export control issue. Nor, for example, might all EPCs consider whether hiring an agent to assist in procuring business abroad creates a corruption risk. Moreover, perhaps not all EPCs consider what laws and regulations might relate to hiring and transporting foreign craft labor, or to retaining private security services.

The purpose of this Paper is to provide an overview of certain key legal regimes that pertain to EPCs such as those alluded to above, and including export controls, economic sanctions, the Foreign Corrupt Practices Act (FCPA), human rights/corporate responsibility (CR) and Sustainability. The article is also intended to more briefly touch upon a few select issues related to government contracting. Once an overview is provided, specific issues that arise in the EPC context will be discussed, and approaches for developing compliance systems will be suggested. While we attempt in this Paper to provide background and insights on a number of important regulatory areas, this Paper cannot cover

all relevant topics. Therefore EPC contractors and their counsel should assess the legal risks of each project on a case-by-case basis.

II. EXPORT CONTROLS

EPC Contractors are in the services business. They are not manufacturers performing supply contracts. As service contractors, EPC contractors may not realize that export controls have a direct and significant impact on much of their work abroad, as well as impacting some of their practices even within the U.S.

In fact, all companies that ship commodities, technology, and software abroad (which EPCs frequently do) must comply with U.S. export controls, which are administered primarily by the Department of State and the Department of Commerce. In other words, the "service" that EPCs often provide is arranging the shipping of other manufacturers' products abroad which will be incorporated into a large project. Companies exporting nuclear and nuclear-related items may also be subject to export controls administered by the Department of Energy and the Nuclear Regulatory Commission. A summary of each regime is below.

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A. Summary of Export Control Regimes

1. EAR

The Bureau of Industry and Security ("BIS") in the Department of Commerce ("DOC") administers the "Export Administration Regulations" ("EAR").² The EAR controls exports and reexports of U.S.-origin of commodities, software and technology which have both military and commercial applications ("dual use") items, and in some instances, foreign-origin items that include some U.S.-origin content or are based on U.S.-origin technology. The following categories of exports, reexports and transactions are controlled by the EAR:

All items located in the United States, even if of foreign origin;³

U.S.-origin items (including technical data, software, and technology), wherever located;⁴

Certain foreign-produced products derived or produced from U.S. technology;⁵

Foreign-produced products incorporating more than a "de minimis" amount of U.S.-origin components or material;⁶ and

Any item destined for an end use or end users related to chemical, biological, nuclear or missile weapons activities, if a U.S. person is involved in the transaction.⁷

Exports "subject to the EAR" must be shipped pursuant to a license, pursuant to a license exception, or under circumstances where no license is required. Items listed in the Commerce Control List ("CCL") may require a license for export or reexport.⁸ A license is not typically required for items not specifically listed on the CCL; these items are known as "EAR99" items and are essentially purely commercial items, rather than dual-use.⁹

2. ITAR

The Directorate of Defense Trade Controls ("DDTC") in the Department of State administers the International Traffic in Arms Regulations ("ITAR").¹⁰ The ITAR control items specifically

designed or modified for a defense application, and defense services, i.e., assistance with respect to the maintenance, operation, production, destruction and/or use of defense articles.¹¹ Under the ITAR, any export, reexport, or retransfer of ITAR-controlled defense articles or defense services outside the US or to a “foreign person” in the U.S. requires a license, agreement or other authorization.¹² Companies involved in manufacturing or exporting defense articles, or in the provision of defense services are required to register with DDTC as a pre-requisite to obtaining any export licenses or authorizations.¹³ Notably, there are a range of countries that are subject to strict arms export controls under the ITAR (see ITAR Part 126.1), including a number of countries that are not otherwise subject to stringent U.S. trade restrictions and with which the U.S. is engaged in substantial bilateral trade (such as China). For these countries, exports of ITAR-controlled goods, technical data, or defense services are essentially prohibited, except under certain very limited conditions.

3. NRC/DOE

The Nuclear Regulatory Commission (“NRC”) regulations, which were implemented under authority of the Atomic Energy Act, prescribe licensing, enforcement, and rulemaking procedures for the export from the United States of “nuclear material” (including radioactive and by-product materials) and “nuclear facilities and equipment.”¹⁴ The Department of Energy (“DOE”) is primarily responsible for implementing section 57b of the Atomic Energy Act, which controls activities by U.S. persons and companies relating to the production of certain nuclear material outside the United States.¹⁵

B. Common Issues

1. Specialized Issues During Engineering

a. Identification of Controlled Technologies

During the engineering phase of a project, it is essential that any controlled technical data

be identified and classified for export control purposes. Accordingly, an EPC’s engineering department, with the assistance of legal or compliance personnel, should identify components and technical data that may be export controlled. For example, are drawings that might show how security equipment is integrated into a power plant controlled? If so, under what classification or category? Ideally, such information should be maintained in a database or matrix managed either by the engineering department or a separate export compliance function so that there is a central repository of export control information. In order to accomplish this classification and matrix development process effectively, it may be helpful to appoint several engineers as subject matter experts in the export control area so that they can assist in making such determinations.

b. Intangible Exports

If technical data is controlled, EPC contractors must be mindful of the fact that it cannot be shared with certain foreign nationals if controlled by the EAR, or with all foreign nationals if controlled by the ITAR. Such restrictions are applicable not only with respect to a contractor’s domestic facilities (so-called “deemed exports”)¹⁶, but also with respect to any offshore engineering centers, which are increasingly common. Therefore, any decisions to perform engineering work in low cost centers abroad should include an export compliance component.

2. Specialized Issues During Subcontracting/Procurement

a. Commodity Classification

The Department of Commerce requires, in many cases, export licenses for commodities that have been designated on the CCL because they have been determined to have both military and commercial capabilities (i.e., “dual-use” items). EAR controlled items are identified in the CCL, which is divided into

Export Control Classification Numbers (“ECCNs”).¹⁷ which consist of five-character codes. There are ten industry category groups on the CCL: (0) Nuclear Materials, Facilities and Equipment, and Miscellaneous; (1) Materials, Chemicals, “Microorganisms,” and Toxins; (2) Materials Processing; (3) Electronics Design, Development and Production; (4) Computers; (5) Telecommunications and Information Security; (6) Sensors; (7) Navigation and Avionics; (8) Marine; and, (9) Propulsion Systems, Space Vehicles, and Related Equipment.¹⁸

In a prime contracting role, the EPC must understand whether any of the products it is procuring are subject to the EAR and if so, what ECCNs are applicable. Typically, because a contractor is not an original equipment manufacturer, the EPC will need to obtain the ECCN information from the entities from which it procures specific items for a project. This process should be integrated into the prime’s subcontracts and purchase orders such that lower tier entities will be obliged to provide such information. It is much better to obtain this information early and reliably, then when the product is at the dock about to ship.

b. Screening

It is important to ensure that the parties an EPC contractor deals with are not on any USG debarred lists related to exports.¹⁹ The debarment concept should be familiar to entities that do debarment and suspension checks under U.S. Government contracting programs, except that it is broader and includes the need to check several lists. These lists include:

Denied Persons: A list of persons and entities that have been denied export privileges published by BIS.²⁰

Debarred Parties: A list of debarred entities published by DDTC.²¹

Entity List: A list of known proliferants published by BIS.²²

Specially Designated Nationals: The Department of Treasury’s Office of Foreign

Assets Control (OFAC) publishes a list of individuals and entities with whom any transactions are restricted. Exports to countries or entities on the list may not be conducted without prior authorization from OFAC.²³

In this regard, it is good practice for a contractor’s procurement department to have a subscription to a computer based screening service. The contractor can run the names into the database at the time that a prospective subcontractor or supplier pre-registers to become an approved vendor or to receive an RFP/RFQ. The name can be re-run at the time of entering into a purchasing commitment and periodically thereafter.

c. Technical Data in RFPs/RFQs

Even if a party is not debarred from export transactions, it is possible that it might not be able to become involved in a particular procurement as a result of country-specific export control considerations. For instance, if the technical data in an RFP would be restricted for a particular country, it would not be possible for the EPC, as a general matter, to involve a subcontractor from that country involved in the procurement.

d. Subcontractor Compliance/Flowdowns

Export control compliance is important throughout the entire supply chain, not only at the first tier. Thus, it is important that the export control considerations discussed in this Paper be flown down consistently to subcontractors. Indeed, for EPCs involved in DoD contracting, there is now a mandatory Defense Acquisition Regulation Supplement (DFARS) provision regarding export controls.²⁴

3. Specialized Issues During Construction

a. Third Country National Hires

EPCs often employ third country hires during the construction phase of a project. While utiliz-

ing third country nationals for craft labor often makes good business sense, if technical data will be accessible to such persons, it is important that such data is not controlled for their countries, just as it is important to check that technical data is not controlled for the country in which the project is being performed, i.e., local hires.

b. Security Contractors

Even if a contractor's own work is not subject to the ITAR, sometimes—particularly in support of work in challenging environments—EPC contractors are accompanied by security contractors. Oftentimes work performed by security contractors is subject to the ITAR, e.g., shipping weapons or personal protective equipment into project locales can implicate the ITAR or foreign export laws. Likewise perimeter security equipment and night vision technology are often subject to the ITAR.

4. Miscellaneous

Most EPCs only perform a relatively modest amount of ITAR controlled work. However, some contractors are involved in the construction of secure buildings. Likewise contractors sometimes engage in weapons demilitarization services for both the U.S. and foreign governments. Such activities would typically be ITAR controlled. Likewise, on occasion, contractors have ancillary business lines that may implicate the ITAR, e.g., force protection activities or military training.

It is essential for any entity that manufactures or exports defense articles or defense services to register with DDTC.²⁵ Therefore, some EPC contractors will need to be registrants. However, registration is merely the first step in the defense trade. Once registered, the EPC will need to determine when export licenses are required, or whether it may be necessary to obtain "technical assistance agreements" (TAAs) which allow the provision of defense services to foreign customers.²⁶

5. Anti-boycott rules

The U.S. has two sets of Anti-Boycott rules, one enforced by the DOC²⁷ and one enforced by the Treasury Department ("Treasury") and the Internal Revenue Service ("IRS").²⁸ The Anti-Boycott rules prohibit persons subject to the rules ("Relevant Persons") from agreeing, implicitly or explicitly, with or participating in transactions where restrictions are placed on suppliers, couriers, vendors, or products to be used or supplied to a boycotting country. Relevant Persons may include entities not organized in the United States. Both sets of rules generally apply to dealings with countries on the list that is published periodically by Treasury of countries which may require participation in, or cooperation with, an international boycott. That list currently consists of Kuwait, Lebanon, Libya, Qatar, Saudi Arabia, Syria, United Arab Emirates, and the Republic of Yemen.²⁹ The status of Iraq is still under review.³⁰ The Anti-Boycott rules also apply to dealings with other countries which a person knows or has reason to know require participation in or cooperation with an international boycott.

Not only must any U.S. person refuse to take part in a boycott, one must also report certain boycott requests to the U.S. DOC and/or to the IRS. Generally, a request is not a violation (and need not be reported) if it is a request for an affirmative statement with regard to the origin of the goods (e.g., "These goods are the manufacture of the United States"). However, a request for a negative statement of origin is reportable (e.g., "These goods are not of Israeli origin").³¹

C. Common Issues/Compliance Approaches/Systems

As discussed above, export controls impact many aspects of an EPC contractors' operations. Several suggested compliance approaches are as follows:

Identify possible export implications of a project early, preferably prior to bid

submission. This will allow you to plan for and build in the cost of compliance into your bid or proposal. For example, if the project engineering cannot be off-shored, you should not include your low cost foreign engineering center in the bid. If substantial licenses will be required to ship certain products to a project site, the time and cost of the licensing and compliance process should also be built into the bid and the critical path. In addition, the potential impact of export controls should be delineated in any internal bidding pre-approvals.

Develop a product data base with respect to items to be procured. Request export control information from any suppliers or subcontractors, and in instances where your engineers or procurement personnel create or transmit technical data in support of a bid package, be mindful of its status prior to sending to possible suppliers.

Screen possible customers, suppliers, subcontractors and vendors – and in some cases, local or third country hires, against various export control restricted lists. This proof of screening should be documented.

Train business development and procurement personnel, in particular, with respect to U.S. anti-boycott rules, as they are often on the “front lines” of possibly boycott requests, many of which will need to be reported.

III. SANCTIONS

The U.S. maintains economic sanctions against certain countries and entities for foreign policy reasons. Sanctions are administrated by the U.S. Department of Treasury’s Office of Foreign Assets Control (OFAC).³² In addition to U.S. Sanctions, other countries and international organizations also have sanctions programs (including the European Union and the United Nations),³³ though this Paper will focus solely on U.S. sanctions.

A. Scope

The OFAC sanctions restrictions apply, for the most part, to “U.S. persons,” a term defined to include U.S. incorporated entities and their

foreign branches, U.S. permanent residents, and foreign persons located in the United States.³⁴ Certain provisions of the sanctions regulations—in particular, restrictions related to the transfers of U.S. origin goods from foreign locations to sanctioned countries—also apply to foreign persons.³⁵

In many instances, the restrictions applicable to U.S. persons do not apply to independently operating foreign subsidiaries of U.S. companies, though certain sanctions programs (such as those restrictions regarding Cuba) extend in full to independent foreign subsidiaries.³⁶ However, the OFAC regulations include broad restrictions that prohibit U.S. persons from taking any action to “facilitate” or “approve” business by foreign persons with sanctioned countries (even if the foreign persons are not themselves subject to OFAC restrictions.)³⁷ This could include activities such as referring sanctioned country business opportunities to corporate affiliates or third parties, or providing internal corporate approvals for specific sanctioned-country transactions undertaken by foreign affiliates.³⁸

The U.S. maintains broad based sanctions against Cuba, Iran and Sudan. There are also sanctions involving Burma, North Korea and Syria. Libya and Iraq sanctions have been removed in recent years, as have sanctions regarding Afghanistan—though with respect to Afghanistan residual sanctions remain regarding the Taliban.³⁹ OFAC also administers specialized sanctions regimes that are more narrowly applicable to certain countries and industries, e.g., the diamond trade, as well as generalized sanctions with respect to listed terrorist entities.

B. Major U.S. Sanctions Program Summaries

1. Iran

U.S. sanctions against Iran have been in place since 1987 and were substantially expanded in the mid-1990s. The Iran sanctions

regulations prohibit U.S. persons, wherever located, from participating in virtually all trade and investment activities in Iran, including exporting or reexporting U.S. origin goods, services or technology to Iran, importing most Iranian-origin goods and services, and “facilitating” business of third-country nationals or companies with Iran.⁴⁰

2. Sudan

These sanctions largely parallel the sanctions applicable to Iran, prohibiting U.S. persons from importing goods or services from Sudan from exporting goods, technology or services to Sudan, and from engaging in financial transactions with Sudan. Like the Iran sanctions, these prohibitions include exports by U.S. persons to a third country with the knowledge that such items will be reexported to targeted countries or otherwise “facilitating” business by third country nationals with Sudan.⁴¹ The sanctions against Sudan do not, however, apply to activities or related transactions with respect to Southern Sudan, including Darfur or other specified areas, where the activities or transactions in question do not involve any property or interests in property of the Government of Sudan, although all petroleum-related transactions are still subject to controls.⁴² A new certification requirement relevant to government contracting also precludes certain businesses (e.g., foreign contractors with otherwise lawful operations in Sudan) from participation in USG prime contract work as a result of their work in Sudan.⁴³

3. Syria

President Bush signed the Syrian Accountability and Lebanese Sovereignty Restoration Act in December 2003 to impose a broad set of export controls on Syria, which is also listed by the State Department as a state sponsor of terrorism.⁴⁴ Aside from sanctions applying to transactions with Specially Designated Nationals (SDNs), these sanctions are administered by the Department of Commerce rather than OFAC.⁴⁵

The Syria restrictions ban the export or reexport to Syria of virtually all U.S.-origin goods and technology, although certain limited subsets of goods can be licensed by the Commerce Department for export or re-export on a case by case basis. In contrast to the OFAC-administered trade restrictions applicable to Iran and Sudan, the Syria restrictions generally do not prohibit U.S. persons from doing business in or providing commercial services to Syria, provided that the use of restricted U.S. goods or technology is not involved.⁴⁶

4. Other Sanctions Programs

Until recently, Iraq and Libya had been subject to long-standing U.S. economic embargoes similar to the restrictions currently applicable to Iran. In recent years, however, those sanctions have been lifted.⁴⁷ OFAC retains residual sanctions regulations relating to other countries, such as Afghanistan and the Balkans, but those restrictions at this point are essentially limited to prohibited dealings with SDNs (such as designated Taliban-supported entities in Afghanistan).⁴⁸

C. Common Issues/Compliance Approaches

It is important to identify potential sanctions issues early. Contractors need to ensure that their employees are briefed on the relevant sanctions regimes and that they are likewise aware that the restrictions are broader than simply working in a particular country, and that facilitating commerce with a sanctioned country is also a violation. Contractors might consider including sanctions issues in any pre-bidding assessment prior to deciding to commit to a particular opportunity or program.

Contractors should be mindful of issues involving subsidiaries. To the extent that a foreign subsidiary is able to operate lawfully in Iran and Sudan, for instance, U.S. entities and U.S. persons (wherever located) cannot be involved

in corporate approvals or otherwise facilitate the actions of the subsidiary, or refer opportunities to the subsidiary.

It is likewise important to screen potential business partners and subcontractors for SDN risks. Many large companies now have automated software programs to accomplish this task.

Logistics channels, including those involving non-U.S. lower tier contractors, also should be considered. For instance, it would generally be improper to ship items through Iran and Syrian into Iraq. It is important to remind line level personnel of such restrictions.

IV. FOREIGN CORRUPT PRACTICES ACT

A. Overview

The Foreign Corrupt Practices Act (FCPA)⁴⁹ has two major components: antibribery prohibitions and accounting requirements. The antibribery prohibitions (on which this Paper will primarily focus) were created to address what were thought of as corrupt practices utilized by U.S. companies obtaining business abroad. In 1977, when the law was enacted, typical examples of such practices included large bribes to foreign government officials to obtain government contracts, as well as the payments of large fees to “consultants” who did not perform services, but instead acted as conduits who passed the money on to government officials. The accounting provisions of the FCPA were enacted because such payments were frequently disguised by slush funds, off-book accounts and other financial practices, both in the U. S. and abroad.

The elements of an anti-bribery violation are as follows:

a covered person, with a nexus to U.S. commerce (when required), takes an action in furtherance of a payment of—or an offer, authorization, or promise to pay money or the giving of anything of value to

- (a) any “foreign official,”
- (b) any foreign political party or party official,
- (c) any candidate for foreign political office, or
- (d) any official of a public international organization, or
- (e) any other person while “knowing”⁵⁰ that the payment or promise to pay will be passed on to one of the above “corruptly” for the purpose of
 - (a) influencing an official act or decision of that person,
 - (b) inducing that person to do or omit to do any act in violation of his or her lawful duty,
 - (c) securing any improper advantage, or
 - (d) inducing that person to use his influence with a foreign government to affect or influence any government act or decision, in order to obtain, retain, or direct business to any person.⁵¹

A quick review of the foregoing elements demonstrates that the FCPA can cover activities well beyond the stereotypical case of providing money to a foreign decision-maker. For example, the term “anything of value” may include an equity interest in a joint venture company, a contractual right or interest, or personal property. In addition, other activities, such as gifts, entertainment, charitable contributions, travel and travel-related expenses, can also implicate the FCPA and have been the subject of recent enforcement actions.

The FCPA’s sole statutory exception is for gratuities to government officials who perform “routine governmental action.”⁵² The examples of such action enumerated in the statute itself are: (1) obtaining business permits (that do not involve the obtaining of business); (2) processing governmental papers such as visas; (3) providing police protection, mail delivery or scheduling inspections associated with contract performance or the shipment of goods; (4) providing phone,

power or water service, loading and unloading cargo, or protecting perishable products from deterioration; or (5) other similar activities which are ordinarily and commonly performed by an official. Pursuant to the statute, therefore, these “facilitating” or “grease” payments—which are used to expedite the processing of permits, licenses, or other routine documentation or action—are not prohibited by the antibribery provisions of the FCPA.

This facilitating payment exception is not contained in many countries’ domestic bribery laws or FCPA analogues, which raises conflict-of-law issues. In addition, the exception is of limited scope, partially because there is no parallel exception on the books and records side of the statute for such payments.

1988 amendments to the FCPA added two affirmative defenses. First, the statute notes that there is an affirmative defense where the payment at issue “was lawful under the written laws and regulations of the foreign official’s ... country.”⁵³ The second affirmative defense relates to certain payments made to reimburse foreign officials for expenses directly associated with visits to product demonstrations or tours of company facilities or in connection with the execution or performance of contracts.⁵⁴

The facts of most cases do not typically support the application of the first defense, especially when interpreted literally. The defense may, however, still be applied—at least by analogy—to actions which are legally required by the written laws and authorities of the host country, such as the requirement that a parastatal entity participate in a project, or that the investor satisfy other terms or conditions mandated by the government.⁵⁵ In practice, the second defense is used much more frequently.

Although the FCPA has been in existence for over 30 years, only limited government compliance guidance is available. Except for the Opinion Procedure regulations which provide what some have suggested is limited substan-

tive guidance and only a trickle of review and opinion procedure releases, the Department of Justice (“DoJ”) has not released any implementing regulations or guidelines.⁵⁶ Moreover, virtually all cases thus far have been settled rather than litigated, particularly corporate cases. Therefore, even though the statute has been in force since 1977, a number of unresolved issues persist, some of which are quite basic. For instance, a common question is how much government ownership or control is necessary for an entity to qualify as an “instrumentality,” making a payment to its employees a payment to a government official. Another common question on which there is no guidance is whether payments above a certain monetary threshold can qualify as facilitating payments.

B. Common Issues for EPCs

The stereotypical FCPA case in the EPC industry involves the retention of a sales agent or consultant who in turns passes on money (or other things of value) to an employee of an end-user/owner. However, a number of recent enforcement actions (in a variety of industries) have demonstrated a willingness of to look at a broader set of “things of value” than simply cash payments made to an official directly or through an intermediary. These include charitable and political contributions, travel and travel-related expenses, and gifts and entertainment.

1. Charitable Contributions

In June 2004, a major US pharmaceutical corporation settled SEC allegations that the company had violated the FCPA’s internal controls and books and records provisions by making payments of \$76,000 between 1999 and 2002 to an Eastern European charity headed by the Director of a regional health fund, in exchange for the official’s alleged influence on the government’s decision to purchase the U.S. company’s products for the health fund.⁵⁷ Though this example occurred in the healthcare industry, EPCs frequently work in challenging

environments where it may seem appealing to provide such charitable donations, and thus need to be mindful of the risks posed by such contributions.

2. Travel and Travel-Related Expenses, Gifts and Entertainment

Numerous recent enforcement actions have focused on travel and travel-related expenses, gifts and entertainment. For instance, a recent case involving a multinational engineering concern involved a host of alleged benefits, including travel, shopping sprees, the use of automobiles, and gifts to officials in West Africa.⁵⁸ Note however, that notwithstanding recent cases based on the provision of such benefits for an improper purpose, there remains an affirmative defense in the statute for certain types of sponsorship activities.

3. Political Contributions

Political contributions also have been very much in the spotlight in recent prosecutions. A case involving a telecommunications contractor involved contributions ultimately used for the Presidential re-election campaign in West Africa.⁵⁹ In addition, U.S. authorities also brought a series of related 2001 prosecutions involving a port project in Latin America that concerned a political contribution scheme in that country by officials of a U.S. company seeking to pave the way for the project.⁶⁰ Again, because EPCs work in challenging countries where such contributions may be solicited, they should be mindful of the risks.

C. Compliance Approaches

It is important to have a compliance program that addresses a full range of potential FCPA risk points. This is particularly the case for EPCs that work in challenging environments such as the Middle East, Central Asia, Africa, Latin America, Southeast Asia or China. The compliance program should, among other things, address

third party due diligence, gifts and entertainment, charitable and political contributions, facilitating payments, internal controls, forensic testing and books and records provisions, to name a few areas.

EPCs should regularly train employees and third parties that work on their behalf. Special focus should be paid to marketing and business development personnel, as well as project managers, finance staff, and persons involved in traffic and logistics.

Due diligence regarding third parties, as well as teaming and joint venture partners is essential. It is important to have internal "cross checks" or segregation of duties in the diligence process. For example, the project manager for a planned opportunity should not have the final sign-off regarding the retention of a third party, and all joint venture partners should be subject to a broad array of corporate approvals.

Compliance efforts involving third parties should not end at pre-retention due diligence. Third parties should be subject to carefully prepared contracts delineating the EPC's expectations that the third party will not violate the FCPA or local anti-corruption laws. Such contracts should provide the EPC with broad discretion to terminate such relationships in the event of improper conduct and should allow for internal audit rights and periodic audits of third party activities.

V. CR & SUSTAINABILITY

In recent years, contractors and other U.S. companies operating abroad have begun to face dramatically growing expectations that they will adhere to certain social norms. Those expectations include, at their core, a cognizance of moral and legal obligations to workers and community members, and throughout supply chains. When it is perceived that contractors do not meet those expectations the consequences can be dramatic, necessitating a thoughtful compliance approach in several key areas.

A. Summary of regimes

1. Alien Tort Statute

Over the past decade, there has been a proliferation of high profile, multi-million dollar lawsuits in U.S. courts against contractors and other multi-national companies in U.S. courts based on alleged human rights abuses overseas. Most are based on the Alien Tort Statute (ATS), a law that has been on the books since 1789, which permits foreign claimants to file tort actions in U.S. federal courts based “violations of the law of nations.”⁶¹ Although the ATS was largely ignored for more than 200 years, it was recently rediscovered and now has been invoked against corporate defendants in roughly 125 cases, most of which have been filed in the last 10 years. Still other cases, relying on more traditional tort theories—such as securities fraud, breach of fiduciary duty, wrongful death, assault, intentional infliction of emotional distress, unfair competition and false advertising—also are being cited by plaintiffs in bringing their human rights claims against contractors and others.⁶²

Regardless of the precise 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 claim that they were trafficked to work in slave labor conditions.⁶³ But even where the company may prevail in court, lawsuits claiming collusion in human rights abuses creates the kind of substantial negative publicity that can drive down stock prices, impact customer relationships, and sour relationships with host countries.

2. Human Trafficking

Under federal law, federal government contracts must include a provision permitting termination if contractor or any subcontractor “(i) engages in severe forms of trafficking in persons

or has procured a commercial sex act during the period of time that the ... contract ... is in effect, or (ii) uses forced labor in the performance of the ... grant, contract, or cooperative agreement.”⁶⁴ Early this year, the federal government issued final regulations that require contractors to notify their employees of the government’s anti-trafficking policy, take “appropriate” action against employees that violate the policy, and notify the government contracting officer of alleged violations.⁶⁵ The regulations also allow the government to remove individual contractor employees, terminate a contract or subcontractor, suspend contract payments, or—most dramatically—suspend or disbar a contractor that fails to comply with the regulations.⁶⁶

B. Common Issues

The “red flag” scenarios that lead to potential exposure are varied. Most frequently, however, they do not involve misdeeds by the company itself. Instead, corporate human rights lawsuits often arise based on the acts of others, with victims seeking to attribute the wrongdoings to the company itself through theories of vicarious liability. Frequently that involves conduct by government entities, as many human rights claims tend to arise based on actions by or in conjunction with state actors. In particular, ATS and other human rights lawsuits commonly arise based on acts committed by police, military and other state security agents allegedly on a company’s behalf.⁶⁷

It also often involves conduct by subsidiaries and suppliers, as it is common for claims to be levied against a company based on the acts of their agents or affiliates. As but one example, a federal lawsuit was filed in the U.S. in early 2009 against a major US EPC claiming that a subcontractor trafficked laborers to Iraq against their will to work at a U.S military facility; the actual alleged misdeeds were not performed by the US EPC, but it nonetheless is now compelled to defend itself in court and from the drumbeat of negative publicity associated with the case.⁶⁸

Yet another recurrent situation involves labor and workforce issues. Whether through tensions with unions, child laborers, trafficked workers, or inadequate working conditions, human rights issues – as in the matter described above – often arise based on the perceived treatment of workers.⁶⁹ Indeed, the government’s new anti-trafficking regulations that apply to contractors acknowledge, at least implicitly, that concern.

VI. ADDITIONAL AREAS

While this Paper has focused predominantly on export controls, sanctions, FCPA and CR issues, given that many EPCs perform USG contracts abroad, it is important to note several additional laws that are particularly relevant to such work. A brief summary of these laws is as below. Note, of course, that this is only a summary of several laws and that U.S. Government contracting, particularly when performed abroad, poses many traps for the unwary.

A. False Claims Act

Contractors that perform USG contracts related work are also subject to the civil False Claims Act.⁷⁰ An EPC can violate the Act if it submits a false claim to the USG knowingly or willfully, or with reckless disregard as to the truth or falsity of the claim. Contractors are subject to per claim penalties of up to \$11,000 plus treble damages. The Act contains a whistleblower provision, known as *qui tam* that allows persons—known as relators—to file suits in the name of the USG and to recover a portion of the proceeds. Over the years, there have been a number of false claims act cases involving EPCs. More cases are expected with respect to contingency operations in Iraq and Afghanistan. EPCs can help manage false claims risks by stressing the importance of truthful and accurate submissions to the government (including invoices and time sheets) to their employees and by engaging in regular monitoring and auditing. Given the new contractor business ethics and conduct rule finalized in

2008 in the Federal Acquisition Regulation (FAR), which calls—among other things—for contractor disclosure of “credible evidence” of False Claims Act violations, it is important for EPCs to remain vigilant in this area.⁷¹

B. Anti-Kickback Act

Many contractors that perform USG related work are aware of various gift and gratuity restrictions that related to working with the U.S. government. In other words, just like a bribe to a foreign government official would violate the FCPA, a bribe to a USG official would violate federal law. However, above and beyond such laws, it is important for contractors to realize that here is a separate criminal statute, the Anti-Kickback Act of 1986, that makes it illegal for a lower-tier contractor to offer or give something of value to a prime contractor in exchange for improper treatment under a prime contract, and it is illegal for the prime contractor to solicit or receive anything in exchange for improper treatment under a federal subcontract.⁷² Therefore, the commercial relationship between primes and subcontractors, including when operating abroad, is subject to criminal enforcement. Indeed, most government contracts contain a requirement that the contractor have policies and procedures to prevent and detect kickback violations.⁷³

VII. FURTHER GUIDELINES

Given all these laws and regulations, an EPC contractor might be best served by implementing a multi faceted approach to managing compliance risk. This approach may include the following component, some of which may already be required in a U.S. government contracting setting as a result of FAR’s business ethics and conduct rules:

A. The Tone at the Top

Tone at the top refers to the ethical atmosphere created by the top management of the

EPCs. The tone set by management generally has a trickledown effect on the employees of the contractor. If management upholds high ethical standards and integrity the employees are more likely to follow suit. If management focuses instead on performance “at any cost” this can send a different message to employees and can permeate the company. Management can set the proper tone by communicating what is expected of employees, leading by example, punishing violations, and rewarding integrity. While management is the front line in setting the tone, a company’s board of directors can also be key in setting the tone by their involvement in understanding, promoting and monitoring appropriate compliance programs.

B. Code of Conduct/Ethics

EPCs should consider developing a clear and concise statement on management’s philosophy on conduct and ethics. Typically, the code should be regularly updated and compliance with the code should be monitored and enforced by management. Management should consider requiring employees, contractors, agents and other third-parties identified as a source of compliance risk to read and sign the code. A recertification process on an annual basis to ensure the proper level of awareness is also good practice.

C. Mechanisms to Report Potential Violations

The contractor should consider implementing a system for employees to report violations. An anonymous and confidential whistleblower hotline administered by an outside organization is a practice used by many companies. Companies subject to the Sarbanes-Oxley Act are required to have procedures that allow for the confidential, anonymous employee reporting related to audit or accounting matters. Systems put in place to satisfy this provision could easily be expanded beyond accounting matters to cover reporting related to the laws

and regulations identified in this paper. Information about the hotline, especially about its confidential and anonymous nature, should be well publicized and placed in areas likely to be seen by employees (i.e. home web page, break rooms, human resources, etc.). The results of the hotline may be shared with management or outside directors by following a predetermined matrix based on the nature of the allegation and based on legal advice where appropriate.

D. Training

A comprehensive training program can include the contractor code of ethics and discuss the employee’s role in upholding the code as well as in reporting potential violations. Specific compliance issues included in this paper should also be considered for discussion where applicable to the employee’s roles and responsibilities. The training should be required for all appropriate categories of employees including management. Techniques to deliver the training may include lectures, workshops, films, and web based or software programs.

E. Risk Assessment and Internal Controls

A detailed risk assessment process related to the laws and regulations discussed in this Paper can provide a foundation for helping to avoid violations. By performing this assessment the contractor might become aware of the areas of weakness or gaps in control. The organization can then fill these gaps by designing controls and procedures that help address the issues. The risk assessment process should be based on an adaptable and flexible framework that considers the complexity of issues and factors pertaining to the compliance areas. Key aspects of the assessment can include:

- Identifying the appropriate business processes.

- Considering how these business processes may differ across countries and regions.

- Identifying how violations may occur in each of these processes.

Identifying the parties that have the ability to violate potentially the various laws and regulations.

Analyzing allegation and history of violations.

Assessing the measures in place to prevent, detect, and deter violations.

Reviewing competitors' disclosures.

Large or high profile projects may also benefit from having a project-specific risk assessment performed. Issues to consider at the project level include:

Restricted technologies and materials likely to be utilized in the project

Laws and regulations as discussed above as they pertain to the project country and country of origin for project major components or equipment

Use of off shoring and outsourcing

Types of approvals and licenses required by the project type

Significant transactions involving import/export and customs in the project country

Expected areas of involvement by third parties, nationalities of third parties and compliance training level maintained by third parties

Expected level of interaction with government officials

Major subcontractors utilized and an understanding of their systems in place for preventing and their level of sophistication in understanding the potential violations identified in this paper.

Ability of the EPC to interact or observe work of third parties involved on the project.

The identification and evaluation of these project-related compliance risks can then be used to determine if any additional project level procedures should be considered.

F. Due Diligence

Contractors should consider performing due diligence on new employees, sub-contractors,

consultants, agents, distributors, vendors, joint ventures, and during any acquisition or merger. In the case of new employees, background checks may include educational background, employment history, and bankruptcy, civil and criminal records among other things. Increasingly media searches and internet profiles are also useful tools for due diligence on potential employees. It is generally also a good practice to consider re-performing a background check when employees are given major promotions, particularly when several years have passed since initial hiring. In conducting background checks for companies, items to consider include criminal records, media and internet searches, bankruptcies, company histories, affiliates and subsidiary lists, joint venture partners and backgrounds of company officers. In addition to conducting the background checks, EPCs should consider documenting and preserving the search process and results for future reference. EPCs may also want to consider maintaining their own list of contractors and vendors to cross check for past history of compliance violations on their own projects, as for large companies, "word of mouth" news of issues may not adequately prevent a sub contractor who was dismissed on one project or division from being engaged on another project or by another division.

G. Deterrence and Early Detection

The contractor needs to design controls to help detect and deter any violations. Key components of such controls can include regular ongoing analysis to detect transaction anomalies, analysis of high risk transactions including financial items such as commissions, product discounts and analysis of high risk goods such as nuclear materials and dual use goods. The internal audit function can often assist with the process by providing an independent assessment of the effectiveness of risk management, control and governance processes and recommendations for improvements as necessary. In addition, the internal audit function may assist with the early

detection of anomalies using an analytics or a risk based audit approach. Internal audit may also be called upon to check that processes are being followed such as whether databases are being maintained and populated such as the one described above for export controlled components. In many instances the internal audit group will respond to whistleblower allegations. In some cases, an independent investigation directed at the behest of management, a special committee of the board of directors or the audit committee might be necessary. In these circumstances the proper protocols should be in place to help determine the steps to be taken and who to notify including general counsel, the board of directors or audit committee, outside counsel, forensic investigators, authorities, regulators, etc.

H. Potential Consequences

The effects of a violation can vary. In the most serious instances a violation can result in:

Severe civil and criminal penalties for the company and perhaps its officers and employees.

Significant legal expenses and litigation.

Loss of confidence by customers, lenders, regulators, stockholders.

Loss of revenue, comparative market standing, stock price, and influence.

VIII. REFERENCES

1. Deloitte also wishes to acknowledge the contributions of Andrea Ford and Ryan Thomas to this paper. Deloitte refers to one or more of Deloitte Touche Tohmatsu, a Swiss Verein, and its network of member firms, each of which is a legally separate and independent entity.
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3. 15 CFR § 734.3.
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11. 22 CFR Parts 120 and 121.
12. 22 CFR Part 123; see also 22 CFR Part 125.
13. 22 CFR Part 122. Registration related guidance materials are also available at DDTC's website at <http://www.pmdtdc.state.gov>.
14. 10 C.F.R. Part 110.
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33. See, e.g., European Commission, http://ec.europa.eu/external_relations/cfsp/sanctions/ measures.htm#Iraq.
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42. 72 Fed. Reg. 61513.
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45. See 31 CFR Part 542; 15 C.F.R. § 746.9.
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48. See Archive of Inactive Sanctions Programs available at <http://www.ustreas.gov/offices/enforcement/ofac/programs/archive/index.shtml>.
49. 15 U.S.C.A. 78m, 78dd-1, 78dd-2, 78dd-3, 78ff. See generally Lucinda A. Low, Owen Bonheimer & Negar Katirai, *Enforcement of the FCPA in the United States: Trends and Effects of International Standards*, The Foreign Corrupt Practices Act 2008: Coping with Heightened Enforcement Risks (PLI, 2008) (hereinafter Low et al., *Enforcement of the FCPA*) at 718.
50. Pursuant to this vicarious liability provision, the definition of “knowing” is broader than actual knowledge. In other words, a company is deemed to “know” that its agent will use money provided by the company to make an improper payment or offer if it is aware of a “high probability” that such a payment or offer will be made. 15 U.S.C.A. §§ 78dd-1(f)(2)(B), 78dd-2(h)(3)(B), and 78dd-3(f)(3)(B); see generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 719.
51. 15 U.S.C.A. §§ 78dd-1(a), 78dd-2(a), and 78dd-3(a); see generally Low, et al., *Enforcement of the FCPA*, supra n. 48 at 720.
52. 15 U.S.C.A. §§ 78dd-1(b), 78dd-2(b), 78dd-3(b); see generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 724.
53. 15 U.S.C.A. §§ 78dd-1(c)(1), 78dd-2(c)(1), 78dd-3(c)(1) (emphasis added). The legislative history of this provision states that “the absence of written laws in a . . . country would not by itself be sufficient to satisfy” the defense. H.R. Rep. No. 100-576, at 922 (1988); see generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 725.
54. 15 U.S.C.A. §§ 78dd-1(c)(2), 78dd-2(c)(2), 78dd-3(c)(2); see generally Low et al, *Enforcement of the FCPA*, supra n. 48 at 725.
55. Such requirements may not fully insulate companies from FCPA risks. For instance, a law might require participation by a local company, but may not require one owned by a foreign official. See generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 725.
56. Several factors have been identified as “red flags” by DoJ that should warn U.S. companies of potential FCPA violations. If one or more of these factors exist in a transaction it could be considered sufficient to alert a U.S. company to the “high probability” of an improper payment or offer by a foreign agent:
- a history of corruption in the country in question;
 - unusually high commissions or “unusual payment patterns or financial arrangements”;
 - the agent or venture partner is related to a government official or the agent’s company is owned in part by a government official or his family, or has been recommended by an official;
 - a refusal by the venture partner or representative to certify that they will not make payments or cause the principal to violate the FCPA;
 - the agent or venture partner has an apparent lack of qualifications or resources to perform the work agreed upon; or
 - there is a lack of transparency in accounting and expense records, or the agent or venture partner has requested that the company prepare false invoices or any other type of false documentation.
- “Foreign Corrupt Practices Act: Antibribery Provisions,” at <http://www.usdoj.gov/criminal/fraud/FCPA/dojdocb.html> (Sep. 11, 2006); see generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 726.
57. In the Matter of Schering-Plough Corp., SEC Admin. Proc. File No. 3-11517 (June 9, 2004); see generally Low et al., *Enforcement of the FCPA*, supra n. 48 at 750.
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59. *United States v. Titan Corp.*, Case No. 05CR0315-BEN (S.D. Ca. 2005) (plea agreement); *SEC v. Titan Corp.*, Case No. CV0504111 (D.D.C. 2005) (complaint); SEC Lit. Re. No. 19107 (March 1, 2005).
60. See *United States v. Halford*, Case No. 01 Cr. No. 221 (W.D. Mo. 2001); *United States v. Reitz*, Case No. 01 Cr. No. 222 (W.D. Mo. 2001); *United States v. King and Barquero-Hernandez*, Case No. CR-01-190 (W.D. Mo. 2001).
61. 28 U.S.C.A. § 1350; see generally Jonathan Drimmer, Andy Irwin, Ed Krauland and Lucinda Low, *International Regulatory Compliance Challenges Faced by EPC Contractors Supporting the U.S. Government Abroad*, International Government Contractor, Para. 10 at 4, February 2009 (Thomson-West) (hereinafter Drimmer et al., *EPC Contractors Supporting the U.S. Government Abroad*).
62. See, e.g., *Kasky v. Nike, Inc.*, 27 Cal. 4th 939, 119 Cal. Rptr. 2d 296, 45 P.3d 243 (2002), as modified, (May 22, 2002); *Sheet Metal Workers #218 Pension Fund v. Hills*, 1:07-CV-01957-PLF, Complaint, Oct. 31, 2007 (D.D.C.); see generally Drimmer et al., *EPC Contractors Supporting the U.S. Government Abroad* at 4.
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64. 22 U.S.C.A. § 7104(g).
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66. FAR 52.222-50.
67. See, e.g., *Romero v. Drummond Co., Inc.*, 552 F.3d 1303 (11th Cir. 2008); *Aldana v. Del Monte Fresh Produce, N.A., Inc.*, 416 F.3d 1242 (11th Cir. 2005); *Doe v. Exxon Mobil Corp.*, 393 F. Supp. 2d 20, 161 O.G.R. 1004 (D.D.C. 2005), appeal dismissed, 473 F.3d 345 (D.C. Cir. 2007), cert. denied, 128 S. Ct. 2931, 171 L. Ed. 2d 876 (2008); *Bowoto v. Chevron Corp.*, 2006 WL 2455752 (N.D. Cal. 2006).
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73. See generally FAR 3.502.

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