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IN THIS ISSUE

MESSAGE FROM THE CHAIR

To the friends of Cozen O'Connor:

Our Winter, 2013 Business Law Observer covers several areas in which new or proposed rules or regulations have been announced by governmental and regulatory agencies, including the Internal Revenue Service, the Department of Justice, and the Securities and Exchange Commission. The IRS is studying the issue of whether a rescission of a prior transaction will be given effect so as to be treated as tax neutral. Although the reasons for the unwinding are not determinative, the calendar years in which the transactions occur are critical. Our article gives guidance on the pitfalls and possible adverse tax consequences.

The SEC has proposed amendments to Rule 506 of Regulation D allowing internet, general solicitation and general advertising to raise capital in securities offerings solely to accredited investors, as mandated by the JOBS Act, but no final rules have been issued. The steps that must be taken to verify accredited investor status, which are critical to the legal compliance of such an offering, are addressed by the proposed rules.

Patent inventorship requires that inventors of a patented invention be correctly named, failure of which could lead to their unenforceability or invalidity. Careful reading of the article on this topic is highly recommended.

The International Code Council has designated 2012 a "code update year" bringing changes to the model construction codes for new and significant renovation projects involving commercial and residential buildings. The most far reaching effects of these changes are in energy efficiency, green technology and catastrophic protection. While most jurisdictions follow these changes, there has been controversy in certain states with respect to adoption of the 2012 codes. Those of you in the construction industry should be aware of these changes.

Lastly, the Federal government has issued a Resource Guide to the Foreign Corrupt Practices Act, a law which has been enforced more vigorously in recent years. Unfortunately the Guide is not as helpful as it might have been. Our article addresses the teachings of the Guide.

We hope you enjoy this issue, and that it informs you about developments affecting your business. We welcome your inquiries about these and any other concerns you may have.

Best Regards,

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The Income Tax Rescission Doctrine – The Code's "Etch-A-Sketch" Tax Planning Tool

By Thomas J. Gallagher

Neither the tax code nor the regulations to the tax code answer the question whether a transaction purporting to unwind or rescind an earlier transaction will be given effect so that neither transaction will be treated as having occurred for federal income tax purposes. This area of the income tax law has been the subject of dispute for a long period of time with only limited government guidance. Recently, the IRS announced it was studying the issue and planned to release guidance concerning the scope and application of the doctrine. Because an effective rescission can be a powerful tool for taxpayers to undo transactions that present adverse or unanticipated economic or tax consequences, understanding the requirements for successful rescission relief is important for taxpayers.

Where the rescission doctrine applies, taxpayers can unwind or substantially modify an already closed and completed transaction for both non-tax and tax-related reasons without tax consequences. Typical non-tax motivations include mistakes as to the underlying transaction, the occurrence of unanticipated events, or even the unwinding of a sale of property that was alleged to be voidable under state law. Tax-motivated reasons can also prompt a rescission including, for example, the failure to properly anticipate the taxpayer's tax circumstances prior to carrying out the transaction. Under its current view, the IRS permits the rescission of an earlier transaction even though the principal, and maybe sole, motivation is tax-based. There is no particular form or document needed to accomplish a rescission. It is not even clear whether a rescission transaction need be identified as such by the taxpayer. In practice, however, taxpayers usually document the unwinding by entering into a document that somewhere contains the statement the transaction is a rescission of an earlier transaction.

Under the case law and IRS rulings, if a rescission occurs within the same tax year as the year of the transaction being unwound, e.g., a sale of property, the subsequent reconveyance of the property is effective on a retroactive basis so that it is as if the initial transaction never occurred. On the other hand, where the year of sale has already closed, a subsequent rescission transaction, even where the buyer and seller are placed in exactly the same position as the *status quo ante*, is treated as a separate taxable event with its own separate tax consequences to the parties. This is true even where the right to rescind is provided explicitly in the initial agreement.

IRS GUIDANCE

The existing IRS published authority provides very limited guidance for what will constitute a successful rescission. In Rev. Rul. 80-58, the IRS determined whether a rescission transaction involving the sale of land and its reconveyance by the seller to the buyer under the terms of the contract of sale constituted a successful rescission for federal income tax purposes. Relying on *Penn v. Robertson*, 115 F.2d 167 (4th Cir. 1940), the IRS concluded, where the rescission placed the seller and buyer at the end of the taxable year of sale in the same positions as they were prior to the sale, the original sale would be disregarded "because the rescission extinguished any taxable income for that year with regard to the transaction." Where the rescission occurred in the following year, however, the IRS concluded both the original sale transaction in the first year, and the later reconveyance, were given independent effect for income tax purposes. In reaching these conclusions, the IRS relied on the annual accounting period principle that "requires the determination of income at the close of the taxable year without regard to subsequent events." On its face, Rev. Rul. 80-58 has two simple conditions. The parties to the transaction must be returned to the *status quo ante,* and the restoration must be accomplished within the same taxable year as the original transaction.

> **"Importantly, these rulings clarified that hindsight as to the tax consequences of the original transaction is not a bar to successful rescission relief."**

The IRS has applied Rev. Rul. 80-58 in a series of private letter rulings. Importantly, these rulings clarified that hindsight as to the tax consequences of the original transaction is not a bar to successful rescission relief. For example, where the S election of a corporation was terminated by the issuance of a class of convertible preferred stock to three separate partnerships and, within the same taxable period, the preferred stock was cancelled and the parties returned to the *status quo ante*, the IRS ruled the corporation's S election was unaffected. In another case, where a parent corporation acquired stock in a subsidiary corporation (OldSub) for cash and liquidated that corporation, it realized (belatedly) the liquidation may have been imprudent for tax purposes. Within the same taxable year, it formed a new subsidiary (NewSub) and transferred all of the assets and liabilities of OldSub to NewSub. The IRS ruled that the liquidation and reincorporation of OldSub and NewSub should be disregarded as a successful rescission of the initial transaction.

These rulings provide helpful, but hardly expansive, guidance concerning the parameters of the rescission doctrine. For example, a taxpayer was required to recognize gain from the unauthorized sale of a portion of the stock held in his brokerage account by his broker. The taxpayer purchased replacement shares of stock within the same taxable year as the first sale, paying a substantially higher price than paid for the shares sold. In the subsequent taxable year, the stockholder and his broker entered into a rescission and settlement agreement and the broker paid damages. The IRS refused to treat the later acquisition of shares as a valid rescission because the taxpayer was unable to unilaterally return to the *status quo ante*. Further, the later rescission agreement was not effective within the same taxable year as the original sale.

The willingness of the IRS to grant rescission relief in the income tax context stands in contrast to its approach to attempted rescissions in the gift tax context. Generally, a successful rescission for gift tax purposes requires that there have been a *mistake of fact at the time that the purported gift was made*. Where the taxpayer was mistaken as to the application of the gift tax law, the attempted rescission was unsuccessful.

INTERPRETING THE STATUS QUO ANTE REQUIREMENT

In Rev. Rul. 80-58, the taxpayer was able to satisfy the *status quo ante* requirement by re-conveying the land following the failure to achieve zoning approval within the same taxable year as the first transaction. How the *status quo ante* requirement applies where, for example, the item originally transferred was an operating business and, prior to the rescission, the operating business remained an ongoing, income-producing business activity, is unclear and creates uncertainty when planning a successful rescission.

In its private letter rulings, the IRS treats this requirement as satisfied where the parties are returned to the positions they *would have occupied* if the first transaction had not occurred. This condition assumes, without stating so, that: (i) the *original* parties to the transaction are the parties that participate in the rescission transaction and (ii) no consideration is paid in order to induce one or the other of the parties to assent to the rescission transaction. As noted above, where the legal existence of one of the entities was terminated, the IRS has permitted the "resurrection" of that entity by the formation of a new entity under state law.

A more troublesome issue is the IRS's view, expressed in its letter ruling policy, that no consideration can be paid in connection with the unwinding transaction in order to induce the cooperation of the parties. To the extent that one of the parties to the transaction involving parties acting at arms-length cannot be provided with an inducement to rescind an otherwise closed transaction, the availability of the rescission doctrine would be limited to transactions solely among parties that are members of the same economic unit. In that case, the reach and utility of the rescission doctrine would be greatly limited.

CONCLUSION

The rescission doctrine is a powerful, taxpayer-friendly doctrine that permits the parties to a transaction to unwind bilateral transactions after the fact where the circumstances warrant. The precise mechanics for the unwinding in the case of operating businesses are unclear, however, and resort to the doctrine requires careful attention to the economic underpinnings of the original transaction and the positions of the parties. Practitioners remain hopeful the IRS follows through on its plan to issue more robust guidance in this area.

If you have any questions about the rescission doctrine or how the issues discussed herein apply to your particular circumstances, contact Thomas J. Gallagher at thomasgallagher@cozen.com or 215.665.4656.

Proposed Amendments to Rule 506 as Mandated by the JOBS Act

By Mark M. Dugan

On August 29, 2012, the Securities and Exchange Commission (the SEC) proposed rules to eliminate the prohibition against general solicitation and general advertising in certain securities offerings. As mandated by the Jumpstart Our Business Startups Act (the JOBS Act), the rules (as proposed) would allow issuers to utilize general solicitation and general advertising in the offer of their securities under Rule 506 of Regulation D (Rule 506), provided that all purchasers of the securities are accredited investors. The proposed rules were subject to a 30-day comment period, after which the SEC will either adopt the rules as proposed or will do so with certain amendments. The comment period has expired, but as of the date of this publication, the SEC has not yet adopted final rules.

Section 201(a)(1) of the JOBS Act, the purpose of which was to promote and facilitate the capital funding of small businesses and was signed into law by President Obama on April 5, 2012, instructed the SEC to remove the general solicitation and general advertising prohibitions in connection with Rule 506 offerings. This change would permit issuers to notify the public of their intention to sell securities for capital raising purposes. The general solicitation and general advertising rules were, however, only to be relaxed as they apply to the sale of securities to *accredited investors* because the JOBS Act requires issuers to "take *reasonable steps* to verify that purchasers of the securities are accredited investors, using such methods as determined by the Commission."

> [T]he proposed rules fulfill Congress's clear directive that issuers be given the ability to communicate freely to attract capital, while obligating them to take steps to ensure that this ability is not used to sell securities to those who are not qualified to participate in such offerings - former SEC Chairman Mary Schapiro.

"[The proposed Rule,] when adopted, will authorize general solicitation in the offer and sale of securities"

The SEC proposed new Rule 506(c) that, when adopted, will authorize general solicitation in the offer and sale of securities subject to the following conditions:

> the issuer must take reasonable steps to verify that purchasers are accredited investors; all purchasers must be accredited investors, either because they come within one of the enumerated categories of persons that qualify as accredited investors or the issuer reasonably believes that they do, at the time of the sale of the securities; and all terms and conditions of Rule 501 and Rules 502(a) and 502(d) must be satisfied.

It is important to note that the proposed rules do not affect the existing safe harbor under Rule 506(b), which allows issuers to privately sell securities, *without* the use of general solicitation, to an unlimited number of accredited investors and up to 35 unaccredited investors. The SEC noted in the proposed rules that the Rule 506(b) safe harbor would be preserved because it:

> represent[s] an important source of capital for issuers of all sizes … that either do not wish to engage in general solicitation in their Rule 506 offerings (and become subject to the new requirement to take reasonable steps to verify the accredited investor status of purchasers) or wish to sell privately to non-accredited investors who meet Rule 506(b)'s sophistication requirements.

The JOBS Act did not specifically dictate how issuers should satisfy the requirement that they take "reasonable steps" to verify purchasers' accredited investor status and therefore left that determination to the SEC. The proposed rules provide that the determination of whether an issuer took reasonable steps would be an objective one, determined on a case-by-case basis, based on factors such as:

1. "the nature of the purchaser and the type of accredited investor that the purchaser claims to be;
2. the amount and type of information that the issuer has about the purchaser; and
3. the nature of the offering, such as the manner in which the purchaser was solicited to participate in the offering, and the terms of the offering, such as a minimum investment amount."

As for the first factor, the proposed rules provide that the steps reasonably taken by an issuer confirming the accredited status of a purchaser who claimed to be accredited because it was a registered broker-dealer, for example, would naturally be quite different from the steps reasonably taken by an issuer confirming the accredited status of a natural person. The latter process, the proposed rules indicated, would be more onerous.

Discussing the second factor, the proposed rules provide that issuers with ample information about potential purchasers would have less of a burden in establishing accredited investor status than issuers with little or no prior knowledge of potential purchasers. The proposed rules provide that issuers selling to natural persons claiming to be accredited investors would be wise to look toward publically available information about the purchaser, as well as information provided directly by the purchaser such as a W-2, assuming the purchaser is willing to divulge such personal information.

On the third factor, the nature of the offering, the proposed rules provide that the means used by the issuer to contact potential purchasers and inform them of the securities offering would be relevant in establishing the extent of the steps necessary to reasonably verify accredited investor status:

> An issuer that solicits new investors through a website accessible to the general public or through a widely disseminated email or social media solicitation would likely be obligated to take greater measures to verify accredited investor status than an issuer that solicits new investors from a database of pre-screened accredited investors created and maintained by a reliable third party, such as a registered broker dealer.

In the example of the social media or website advertisement of an offering, the proposed release affirmatively states that relying on a simple check-the-box accredited investor questionnaire would *not* constitute reasonable steps to verify accredited investor status. The proposed rules also indicate the size of the minimum investment, provided such investments are made in cash and not financed, is also considered relevant, on the theory that an investor's ability to invest a sufficiently large sum tends to indicate accredited investor status.

As with most tests based on a series of factors, the reasonable steps inquiry will likely be one based on the particular facts and circumstances. The SEC specifically declined to take a position urged by many commentators that would have imposed more rigid and specific guidelines to be used in determining accredited investor status, opting instead to maintain flexibility in the process. The proposed rules even indicate that the flexible approach paves the way for "changing market practices, and [the implementation of] innovative approaches to meeting the verification requirement, such as the development of third-party databases of accredited investors."

Once the final rules are implemented, it remains to be seen whether the lack of specific guidelines will inhibit issuers from utilizing the new general solicitation rules, or whether market practices will develop that provide comfort to issuers who choose to take advantage of the new rules.

If you have any questions about the SEC's new proposed rules or the JOBS Act or how the issues discussed herein apply to your particular circumstances, contact Mark M. Dugan at mdugan@cozen.com or 215.665.2191.

Protecting Your Patents by Getting Inventorship Right

By Alan J. Morrison

A patent confers a powerful right to its owner to protect an invention, whether a chemical, a carburetor, an antibody or a television. A company's patent portfolio is one of its highly desired assets, and often exceeds millions of dollars in value. To be patented in the United States or anywhere else, an invention must, at a minimum, be new, useful and non-obvious. United States patent law is unique, however, in that it also places considerable importance on correctly naming the inventors of a patented invention. The consequences of getting inventorship wrong can be severe. This article briefly outlines the concept of inventorship, the consequences of improper inventorship determination, and steps for preempting such problems.

INVENTORSHIP DEFINED

Conception

The inventor of a patented invention is the person who conceived the invention. Conception involves having a definite and permanent idea of an invention in mind, where all that remains is to reduce the invention to practice. It is not an act of inventorship to relay to the true inventors that which was already known publicly. In other words, an inventor is free to use the services, ideas and aid of others in perfecting her invention without losing her right to a patent. Providing technical assistance that is merely the exercise of normal skill is not inventorship.

Determining inventorship differs from determining authorship of a publication, for example, in that authorship typically requires overall "fairness" and often factors in physical and financial contributions in addition to intellectual ones. Determining who conceived an invention might appear simple, but it is one of the most difficult tasks in American patent law.

Sole and Joint Inventors

A patented invention can be conceived by a sole inventor, or jointly by two or more inventors. For there to be joint invention, some amount of collaboration or connection between two or more inventors must occur. However, for inventors to be jointly named on a patent, it is not necessary that they (i) physically work together or at the same time, (ii) make the same type or amount of contribution, or (iii) make a contribution to the subject matter of every claim of the patent.

Correcting Inventorship

An issued patent is presumed valid. Likewise, it is presumed that the inventors named in an issued patent are named correctly. Incorrect inventorship can result from including someone who did not conceive the invention or omitting someone who did. If incorrect inventorship in a patent results from error, it can be corrected with adequate proof. Similarly, inventorship errors in patent applications are correctable.

CONSEQUENCES OF INCORRECT INVENTORSHIP

Invalidity and Unenforceability

Under certain circumstances, **a patent that incorrectly names inventors can be held invalid or unenforceable.** For example, a court can hold a patent unenforceable if it finds that, during prosecution of the patent application, fraud was committed on the Patent Office in connection with naming inventorship.

Change in Commercial Position

Correction of a patent's inventorship can alter the patent owner's commercial position. This is particularly true where correcting a patent's inventorship involves adding an omitted inventor who is then free, for example, to license his rights in the patent to a competitor.

Liability Under State Law

Omitting an inventor from a patent can subject the patent's named inventors and owners to claims under state law. Such claims can include, for example, fraudulent concealment, breach of fiduciary duty, unjust enrichment and breach of contract.

PREVENTATIVE STEPS

The old saying that an ounce of prevention is worth a pound of cure is appropriate here. Dealing with inventorship problems during litigation can be intensely time and resource consuming for the patentee, to say nothing of the business consequences of a court's adverse inventorship ruling. In contrast, properly determining inventorship prior to filing a patent application usually consumes no more than a few hours at little cost. Working closely with a patent attorney at an early stage, will result in identifying and addressing inventorship issues that would otherwise remain undetected until after litigation has begun.

With this in mind, the following steps can be taken to avoid costly inventorship problems:

- **Speaking with the Right People:** In gathering facts relevant to inventorship, it is important your patent attorney speak with one or more people personally familiar with the invention. Usually, the principal investigator of a laboratory will be one such person, but not always, and by no means exclusively. Ideally, your attorney should speak to all those involved in developing the invention. A group discussion among potential inventors may be needed if factual discrepancies arise.
- **Being Mindful of Inventorship "Agendas":** Be aware that you and others in your company may have an inventorship "agenda," whereby you and your colleagues have in mind a favored outcome – presumably well intended – based on your own understanding of fairness, the law and the facts. Such agendas often lead to incorrect inventorship determinations. Thus, when discussing inventorship with your attorney, you should be forthcoming with the facts relevant to inventorship. Simply offering your own legal conclusions on the matter may result in the omission of key factors relevant in determining inventorship.
- **Identifying Potential Inventors:** As early as possible, you and your attorney should identify all people involved with the invention, such as those listed on invention reports and authors on related scientific publications. These "potential" inventors can later be included or excluded as actual inventors based on additional information.
- **Having Your Attorney Educate You About Inventorship:** Determining inventorship regarding a patent application can proceed more smoothly if you are already aware of the legal standards of inventorship and the consequences of improper inventorship determination.

CONCLUSION

Determining inventorship is difficult, and reasonable minds can differ over the outcome. Fortunately, however, timely and careful inventorship determination helps ensure the resulting patents are free of inventorship problems.

If you have any questions about determining inventorship, patent filings or how the issues discussed herein apply to your particular circumstances, contact Alan J. Morrison at amorrison@cozen.com or 212.297.2696.

Construction Code Changes Affecting New Construction and Building Renovations for Commercial and Residential Projects

By Shari Shapiro

Most jurisdictions in the United States have a construction code setting the minimum standards for new construction and significant renovations of commercial and residential buildings. The construction codes are generally based on the model codes developed by the International Code Council (ICC), a nonprofit standard setting organization, that are updated every three years. 2012 is a code update year, and the recent changes have created controversy in some jurisdictions regarding adoption of the 2012 codes. Understanding the 2012 code changes that have a material impact on the design and performance of buildings is critical if you are planning new construction or building renovations in the near future.

MAJOR CHANGES IN THE 2012 CODES

Energy Efficiency

Arguably the most far-reaching changes in the 2012 codes are changes to the International Energy Conservation Code (IECC), designed to improve building energy efficiency. The 2012 codes provide new provisions to improve building energy efficiency by 15 percent above the 2009 codes, and 30 percent over the 2006 codes. A 30 percent enhancement in energy efficiency can change the economic calculus of a new building project. On the other hand, additional investment in energy efficiency may change the cost of construction. Changes to the construction codes can also change the competitive landscape – an older building may be less valuable than its newer counterpart not only because of the granite lobby, but also because of the long term energy savings.

For residential and commercial buildings, the 2012 IECC includes a comprehensive set of measures designed to improve the thermal envelope and to increase the efficiency of the HVAC and electrical systems. For commercial buildings, the IECC also includes energy performance standards for windows, doors and skylights.

Advocates of energy efficiency, including the U.S. Department of Energy, stress the energy and financial savings of the 2012 code changes. Critics of the increased energy efficiency requirements claim it will cost too much to comply with 2012 IECC, and that the return on investment in additional energy savings is small. As described in more detail below, the controversy over the IECC changes has slowed the adoption of the 2012 codes as a whole in some jurisdictions.

Protection from Wind, Seismic and Fire Catastrophes

Construction and real estate professionals need to be aware of the provisions in the 2012 codes that are designed to reduce the catastrophic effects of natural disasters. Construction codes provide the minimum standards for construction. If the codes in a particular jurisdiction are not up-to-date, buildings constructed to older codes may not provide the same protection from natural disaster damage.

The 2012 International Residential Code (IRC) (applicable to one- and two-family dwellings) and the International Building Code (IBC) (applicable to all other construction) include changes to design requirements to prevent damage from high winds. There are changes in load, roofing, bracing and other standards to take into account potential wind damage. Similarly, the 2012 codes incorporate revised requirements for construction in earthquake-prone areas.

In the 2012 codes, there are a number of changes to enhance first responder access to high rise fires. For example, two fire service elevators are now required to serve every floor of a building with an occupied floor more than 120 feet above the lowest level of fire department access. Other fire safety related changes require that activation of a building fire alarm system also initiates a recall of all fire service elevators.

Incorporation of Green Technologies

Finally, the 2012 codes more directly address certain green technologies. Greywater recycling, the practice of allowing non-sewage water from domestic activities, such as laundry and dishwashing, to be reused on site, is now permitted in the 2012 codes. Photovoltaic solar panels (i.e., the method of converting solar radiation into direct current electricity) are addressed. Prior to the 2012 codes, there were no requirements for photovoltaic solar panels. The 2012 codes provide criteria for the placement of solar panels on the roofs of buildings and include safety features for the safety of first responders.

CONTROVERSY OVER ADOPTION OF THE 2012 CODES

The controversy primarily stems from the enhancements to the IECC. Several state home builders' associations and the National Association of Homebuilders have been vocal critics of the 2012 codes. They argue that the added cost of

the residential energy efficiency provisions will put homes out of reach of homebuyers. For example, in Illinois, the state's home builders association sought to delay adoption of the 2012 codes legislatively, alleging compliance with the new code will increase building costs by $5,000 for a 2,000 square foot home.

Advocates of enhanced energy efficiency dismiss these claims, noting that the additional cost of the energy efficiency upgrades will be recovered many times over from decreased energy costs.

In certain jurisdictions, the controversy over the IECC has slowed adoption of all of the 2012 codes. Pennsylvania rejected the 2012 codes entirely, and Michigan, Minnesota and Illinois have all seen regulatory and legislative activity related to the 2012 code adoptions.

In summary, the 2012 codes incorporate changes that can significantly alter the design and performance of buildings. Therefore, it is important to check the status of adoption of the 2012 codes in the applicable jurisdiction early in the development or construction process.

If you have any questions about the International Code Council's model 2012 codes or how the issues discussed herein apply to your particular circumstances, contact Shari Shapiro at sashapiro@cozen.com or 856.910.5050.

The Time is Now to Invest in Anti-Corruption Compliance

By Stephen A. Miller, Melissa H. Maxman, and Brian Kint

Doing business internationally has always been fraught with risk, but businesses are justifiably troubled that much of the risk lately comes from our own government. The government has reinvigorated its enforcement of a 1978 U.S. law prohibiting bribery of foreign officials. Most U.S. businesses could support that effort, in theory, if the government's interpretation of the definition of "bribery" and "foreign official" weren't so hopelessly broad. The government recently attempted to provide some guidance to U.S. businesses on how to avoid prosecution under this law. The new guidance does not provide the clear roadmap most businesspeople might like — in large part because the law itself is vague — but it underscores the importance of implementing certain compliance strategies as soon as possible.

BACKGROUND

The Foreign Corrupt Practices Act prohibits any representative (including consultants or foreign sales representatives) of a company from paying or offering "anything of value" to a foreign official in a corrupt attempt to obtain or retain business. The statute permits both criminal and civil enforcement, which is carried out by the Department of Justice and the Securities and Exchange Commission (SEC). The statute is broad in almost every respect, including:

- Applying to any U.S. citizen, national or resident operating anywhere in the world, as well as to all companies that are required to file reports under the Securities Exchange Act (including foreign companies whose stock is traded on U.S. exchanges), and any company organized under U.S. law or with a principal place of business in the United States. Moreover, wholly foreign companies or citizens may be liable for "aiding and abetting" a U.S. company's violation.
- **"Anything of value":** there is no *de minimis* exception under the FCPA; anything of value can mean *anything*, including discounts, free samples, pens, meals, t-shirts, etc.
- **Foreign Official:** Federal prosecutors have taken an incredibly broad view of the definition of foreign official to include, essentially, any representative of a company in which a foreign government has an ownership stake or other controlling role.
- **"Obtain or Retain Business":** this standard has been interpreted to mean, broadly, any effort to generate more revenue for a company. *See, e.g., United States v. Kay*, 513 F.3d 432 (5th Cir. 2007) (holding that bribes paid to reduce customs duties and taxes owed by a company in Haiti violated the FCPA because the bribes were designed to aid the company's efforts to obtain or retain business).
- Low Standards for Requisite Knowledge
    - First, through the doctrine of "conscious avoidance," criminal prosecutors can impute criminal intent to a company (and its individual directors, potentially) if the company took no action to address a

substantial risk that FCPA violations were occurring in a particular country. Given the prevalence of corruption in some countries, companies may have to implement aggressive compliance measures as a necessary cost-of-doing-business in certain regions of the world.

- Second, the SEC may initiate a civil lawsuit to enforce the FCPA under a strict-liability standard based only on a showing of "control person" liability.

- **Payments by Third-Parties:** The FCPA holds companies responsible for payments or offers made by third-party intermediaries on the company's behalf. In other words, a company may be liable even if the payment or offer was not made directly to the foreign official so long as a company representative or consultant has reason to know that the payment would go to a foreign official.

The Act is broad enough to make international businesspeople wonder what transactions are not within its ambit. Nevertheless, this lack of clarity has not stopped the government from enforcing the law aggressively, which has led, with good reason, to international businesses investing millions of dollars in compliance programs to avoid FCPA violations. The investment in compliance is a sound one as prosecution of a case carries substantial investigative and discovery costs. Prosecution can also result in reputational injury, decline in share price, termination of corporate executives and directors, debarment, loss of export privileges, huge fines, engagement of a compliance monitor (at company expense), and onerous compliance obligations dictated by the government.

"NEW" GUIDANCE

As a result of this pressure, on November 14, 2012, the U.S. Department of Justice and the U.S. Securities and Exchange Commission issued "A Resource Guide to the U.S. Foreign Corrupt Practices Act." The Resource Guide is a classic example of "old wine in new bottles." It is more descriptive than prescriptive. Put another way, it mainly distills essential principles from the government's prior prosecutions and investigations into one volume.

Worse, the Resource Guide buries its guidance under caveat upon caveat. For example, the government goes to great lengths to emphasize that there is no "one size fits all" solution and that a "check-the-box" type of compliance program is likely to be ineffective. In many places, the Resource Guide reads as if the government is laboring to preserve its discretion to resolve each future case as it sees fit. Still, the Resource Guide does set forth certain "Hallmarks of Effective Compliance Programs," as summarized below, which should form the blueprint for future compliance efforts:

- **Commitment from Senior Management and a Clearly Articulated Policy Against Corruption:** Compliance must start from the top. Any effective compliance program must be not only strong on paper but also diligently enforced. This will create a strong culture of compliance that will permeate the entire organization.

- **Code of Conduct and Compliance Policies/ Procedures:** Compliance policies must be clear, concise and accessible to all employees. If a company has foreign subsidiaries, the compliance program should be translated into the local language. The policies should account for any unique risks the company may face and provide internal controls and auditing processes.

- **Oversight, Autonomy and Resources:** The individuals in charge of a company's compliance program must have the appropriate authority, adequate autonomy from management, and sufficient resources to implement and enforce the company's compliance program.

- **Risk Assessment:** One-size-fits-all compliance programs are generally ineffective. A helpful compliance program, therefore, should focus on high-risk areas and devote fewer resources to low-risk areas. Factors to consider in risk assessments are the country and industry involved, potential business partners, amount of foreign government involvement, and frequency of exposure to customs, immigration, tax and licensing officials in a foreign country.

- **Training and Continuing Advice:** Training can ensure a compliance program is understood and followed. Training programs should be tailored to fit the different needs of different employees. For example, sales personnel and accounting personnel will

confront different questions when facing compliance issues than those confronted by workers in a company's manufacturing plant. A company's FCPA training program should reflect these essential differences.

- **Incentives and Disciplinary Measures:** A compliance program should strive not only to punish bad behavior but also to reward positive behavior. Compliance should be a part of employee performance reviews and a metric for promotions and bonuses. Incentives and disciplinary measures must be applied consistently throughout the organization.
- **Third-Party Due Diligence:** Because third-parties are often used to facilitate and conceal bribes, companies must exercise special caution when dealing with agents, consultants, and distributors. Companies must scrutinize the qualifications of third-parties, as well as the business reason for including them in any transaction. A company should inform third-parties of its commitment to lawful business practices and seek reciprocal assurances.
- **Confidential Reporting and Internal Investigation:** A company's personnel must have a mechanism for reporting suspected misconduct anonymously and without fear of reprisal. Once a problem is reported, the company should have specified procedures for investigation and should document the company's response.
- **Continuous Improvement: Periodic Testing and Review:** A company's compliance program must adapt as its business, business environments and governing laws change. A company must regularly review and improve its compliance program so that it does not become outdated.
- **Mergers and Acquisitions: Pre-Acquisition Due Diligence and Post-Acquisition Integration:** When acquiring another company, a company should conduct due diligence designed to uncover any possible corruption at the target company. If corruption is discovered, it should be stopped and disclosed to the government. After the transaction closes, the company should integrate the acquired company into its compliance controls and internal procedures.

RESPONSE TO THE RESOURCE GUIDE

There is much that the Resource Guide does not address. For example, at a fundamental level, the FCPA may create a disadvantage for U.S. companies attempting to compete with foreign companies that are not subject to strict anti-corruption laws. Furthermore, designing and implementing a robust compliance program to avoid FCPA prosecution implicates broader areas of law. Enforcement of the compliance program, for example, may require termination of an employee, bringing employment law issues into the mix. The Resource Guide does not venture into such legal thickets, but experienced counsel will recognize the issues all too well.

Nonetheless, the Resource Guide should serve as a wake-up call to any U.S. company doing business internationally. In particular, companies and their executives should understand that, without a robust FCPA compliance program in place *before* trouble arises, they will deprive themselves of any basis upon which to seek leniency from the FCPA's onerous sanctions. The time to invest in that compliance effort is, therefore, now, both to prevent violations from occurring and to be able to demonstrate to the government that the company *by its actions* is not liable for encouraging corruption.

If you have any questions about the Foreign Corrupt Practices Act, or how the issues discussed herein apply to your particular circumstances, contact Stephen A. Miller at samiller@cozen.com or 215.665.4736, or Melissa H. Maxman at mmaxman@cozen.com or 202.912.4873.
