AMERICAN UNIVERSITY BUSINESS LAW REVIEW

Volume 3 · 2014 · Issue 3

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AMERICAN UNIVERSITY BUSINESS LAW REVIEW

The AMERICAN UNIVERSITY BUSINESS LAW REVIEW is published three times a year by students of the Washington College of Law, American University, 4801 Massachusetts Avenue, N.W., Suite 615A, Washington, D.C. 20016. Manuscripts should be sent to the Executive Editor at the above listed address or electronically at blr-ee@wcl.american.edu.

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Subscription rate per year: $45.00 domestic, $50.00 foreign, $30.00 alumni, $20.00 single issue. Periodicals postage paid at Washington, D.C., and additional mailing offices. Office of Publication: 4801 Massachusetts Avenue, N.W., Suite 615A, Washington, D.C. 20016. Printing Office: Joe Christensen, Inc., 1540 Adams Street, Lincoln, Nebraska 68521. POSTMASTER: Send address changes to the AMERICAN UNIVERSITY BUSINESS LAW REVIEW, 4801 Massachusetts Avenue, N.W., Suite 615A, Washington, D.C. 20016.

Subscriptions are renewed automatically on expiration unless cancellation is requested. It is our policy that unless a claim is made for nonreceipt of the AMERICAN UNIVERSITY BUSINESS LAW REVIEW issues within six months of the mailing date, the *American University Business Law Review* cannot be held responsible for supplying those issues without charge.

Citations conform generally to *The Bluebook: A Uniform System of Citation* (19th ed. 2010).
To be cited as: 3 AM. U. BUS. L. REV.

American University Business Law Review
Print ISSN 2168-6890
Online ISSN 2168-6904

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VOLUME 3 · 2014 · ISSUE 3

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ARTICLE

FOREIGN CORRUPT PRACTICES ACT RIPPLES

MIKE KOEHLER*

An obvious reason to comply with the Foreign Corrupt Practices Act ("FCPA") is that non-compliance can expose a company to a criminal or civil FCPA enforcement action by the Department of Justice ("DOJ") and/or the Securities and Exchange Commission ("SEC"). However, this Article highlights that settlement amounts in an actual FCPA enforcement action are often only a relatively minor component of the overall financial consequences that can result from FCPA scrutiny or enforcement in this new era.

By coining a new term of art – the "three buckets" of FCPA financial exposure - and through various case studies and examples, this Article demonstrates how FCPA scrutiny and enforcement can impact a company's business operations and strategy in a variety of ways from: pre and post-enforcement action professional fees and expenses; to market capitalization; to cost of capital; to merger and acquisition activity; to impeding or distracting a company from achieving other business objectives; to private shareholder litigation; to offensive use of the FCPA by a competitor or adversary to achieve a business objective or to further advance a litigating position.

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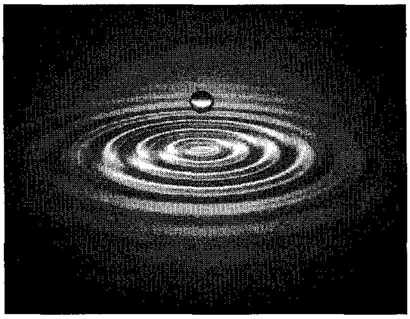
* Mike Koehler is an Assistant Professor, Southern Illinois University School of Law. Professor Koehler is the founder and editor of the FCPA Professor website (www.fcpaprofessor.com) and his FCPA expertise and views are informed by a decade of legal practice experience at a leading international law firm. The issues covered in this article assume the reader has sufficient knowledge and understanding of the FCPA, as well as FCPA enforcement, including the role of the Department of Justice and Securities and Exchange Commission in enforcing the FCPA and the resolution vehicles typically used to resolve FCPA scrutiny. Interested readers can learn more about these topics, and others, by reading Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT'L L. 907 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705517. The author's FCPA Professor website is also a useful resource for FCPA developments and analysis, specifically the "FCPA 101" page of the site (http://www.fcpaprofessor.com/fcpa-101).

This Article thus shifts the FCPA conversation away from a purely legal issue to its more proper designation as a general business issue that needs to be on the radar screen of business managers operating in the global marketplace. By highlighting the many ripples of FCPA scrutiny and enforcement, it is hoped that more business managers can view the importance of FCPA compliance more holistically and not merely through the narrow lens of actual enforcement actions.

INTRODUCTION

An obvious reason to comply with the Foreign Corrupt Practices Act ("FCPA") is that non-compliance can expose a company to a criminal or civil FCPA enforcement action by the Department of Justice ("DOJ") and/ or the Securities and Exchange Commission ("SEC").However, this Article highlights that settlement amounts in an actual FCPA enforcement action are often only a relatively minor component of the overall financial consequences that can result from FCPA scrutiny or enforcement in this new era.

This Article is guided by the below picture which best highlights the financial consequences that can result from FCPA scrutiny or enforcement. In short, think of the drop of water as being FCPA scrutiny or enforcement by the DOJ and/or SEC resulting in the many ripples discussed in this Article.



Part I of this Article coins a new term of art – the "three buckets" of FCPA financial exposure – and examines various financial consequences that directly result from FCPA scrutiny or enforcement. The "three buckets" are: (i) pre-enforcement action professional fees and expenses; (ii) settlement amounts in an actual FCPA enforcement action; and (iii) post-enforcement action professional fees and expenses. Of these "three buckets," while settlement amounts in an actual FCPA enforcement action tend to get the most attention, pre-enforcement action professional fees and expenses are often the most expensive aspect of FCPA scrutiny and enforcement largely because of the "where else" question.

Part II of this Article further adds to the overall financial consequences that can result from FCPA scrutiny or enforcement and uses various case studies and examples to demonstrate how FCPA scrutiny and enforcement can further negatively impact a company's business operations and strategy in a variety of ways from: market capitalization; to cost of capital; to merger and acquisition activity; to impeding or distracting a company from achieving other business objectives; to private shareholder litigation; to offensive use of the FCPA by a competitor or adversary to achieve a business objective or to further advance a litigating position.

This Article accepts the fact that FCPA scrutiny and enforcement results in many other ripples in this new era. Yet, throughout this Article many questions are posed regarding the legitimacy of certain ripples. Moreover, while it is beyond the focus of this Article, it must nevertheless be highlighted that because of the many ripples of FCPA enforcement, it is important that FCPA enforcement be subjected to meaningful judicial scrutiny and that enforcement actions represent legitimate instances of provable FCPA violations, not merely settlements entered into for reasons of risk aversion. This would seem like an obvious statement. However, the reality is that the majority of corporate FCPA enforcement actions in this new era are based on aggressive and controversial enforcement theories, yet resolved via non-prosecution and deferred prosecution agreements (NPAs / DPAs) not subjected to any meaningful judicial scrutiny by risk-averse business organizations mindful of the adverse consequences of putting the enforcement agencies to its burden of proof in an adversarial proceeding.[1]

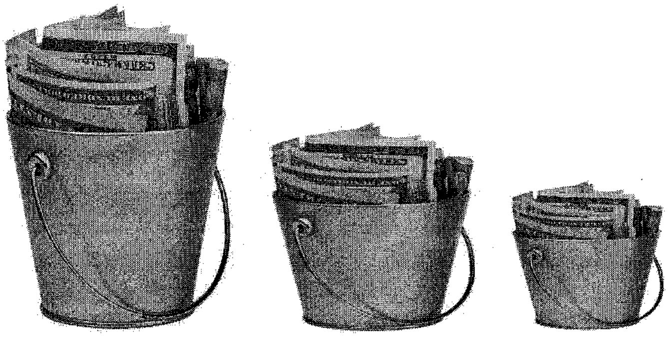
Regardless, by examining the FCPA's many other ripples, this Article shifts the FCPA conversation away from being a purely legal issue to its more proper designation as a general business issue that needs to be on the radar screen of business managers operating in the global marketplace. By highlighting the many ripples of FCPA scrutiny and enforcement, it is hoped that more business managers can view the importance of FCPA compliance more holistically and not merely through the narrow lens of actual enforcement action.

I. THE "THREE BUCKETS" OF FCPA FINANCIAL EXPOSURE

An obvious reason to comply with the FCPA is that non-compliance can expose a company to a criminal or civil FCPA enforcement action by the DOJ and/or SEC. However, settlement amounts in an actual FCPA enforcement action are often only a relatively minor component of the overall financial consequences that can result from FCPA scrutiny or enforcement in this new era.

Part I of this Article coins a new term of art – the "three buckets" of FCPA financial exposure – and examines various financial consequences that directly result from FCPA scrutiny or enforcement in this new era. The below pictures best highlight the "three buckets" of FCPA financial exposure in terms of typical magnitude in relation to each other.

1. For additional reading on this troubling aspect of FCPA enforcement, *see, e.g.*, Mike Koehler, *The Façade of FCPA Enforcement*, 41 GEO. J. INT'L L. 907 (2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1705517; *see also*, *Hearing Before the H. Comm. on the Judiciary*, 112th Cong. (2011) [hereinafter *Foreign Corrupt Practices Act*] (statement of Michael B. Mukasey, Partner, Debevoise & Plimpton LLP) *available at* http://www.instituteforlegalreform.com/uploads/sites/1/Mukasey06142011.pdf; Mike Koehler, *Former Attorney General Alberto Gonzales Criticizes Various Aspects Of DOJ FCPA Enforcement*, FCPA PROFESSOR (Apr. 4, 2013), http://www.fcpaprofessor.com/former-attorney-general-alberto-gonzales-criticizes-various-aspects-of-doj-fcpa-enforcement; Mike Koehler, *DOJ Prosecution of Individuals – Are Other Factors at Play?*, FCPA PROFESSOR (Jan. 21, 2014), http://www.fcpaprofessor.com/doj-prosecution-of-individuals-are-other-factors-at-play-3.



Pre-enforcement action professional fees and expenses *Enforcement action settlement amounts* *Post-enforcement action professional fees and expenses*

A. Pre-Enforcement Action Professional Fees and Expenses

Every instance of FCPA scrutiny has a point of entry – in other words, a set of facts that give rise to the scrutiny in the first place. This point of entry is often the beginning of a long and expensive journey for the company under scrutiny and the first bucket of FCPA financial exposure is pre-enforcement action professional fees and expenses.

For instance, in 2008, beauty products company Avon disclosed that it was conducting an FCPA internal investigation regarding compliance in China.[2] As is typical, the investigation soon spread to other countries, and six years later the internal investigation is still active and the company has disclosed approximately $350 million in pre-enforcement action professional fees and expenses.[3]

Wal-Mart's FCPA scrutiny has resulted in even higher pre-enforcement action professional fees and expenses. In late 2011, Wal-Mart disclosed that it was conducting an FCPA internal investigation concerning certain permitting, licensing and inspection issues in Mexico.[4] Wal-Mart's scrutiny has likewise followed a typical pattern in that the company's internal review expanded beyond Mexico and the company's pre-enforcement action professional fees and expenses began to skyrocket. During 2013, the company made various disclosures regarding its FCPA scrutiny including

2. Avon Prods., Inc. Quarterly Report (Form 10 - Q) (Oct. 30, 2008) *available at* http://investor.avoncompany.com/Cache/22219072.pdf?IID=3009091&FID=22219072&O=3&OSID=9 (follow "SEC Filings" hyperlink: then search "10-Q for "2008").

3. *See, e.g.*, Peter Henning, *The Mounting Costs of Internal Investigations*, N.Y. TIMES, Mar. 5, 2012, http://dealbook.nytimes.com/2012/03/05/the-mounting-costs-of-internal-investigations/ (discussing pre-enforcement action professional fees and expenses as of March 2012).

4. Wal-Mart Stores, Inc., Quarterly Report (Form 10-Q) (Dec. 8, 2011), *available at* http://services.corporate-ir.net/SEC.Enhanced/SecCapsule.aspx?c=112761&fid=7888537.

the following:

> On FCPA, we continue to work closely with anticorruption compliance experts to review and to assess our programs and help us implement concrete steps for each particular market. In the various markets, these experts have spent tens of thousands of hours on anti-corruption support and training.[5]

Each quarter of 2013, Wal-Mart disclosed its pre-enforcement action professional fees and expenses and quarterly totals equated to the company spending approximately $1.25 million per working day on its FCPA scrutiny.[6] Most recently, Wal-Mart disclosed anticipated expenses in 2014 of $200 to $240 million in connection with its FCPA scrutiny.[7]

It is not just large multinationals subject to high-profile FCPA scrutiny that are spending millions of dollars in pre-enforcement action professional fees and expenses every year. For instance, beverage company Beam Inc. disclosed approximately $4.2 million in one year for "legal, forensic accounting, and other fees related to [its] internal investigation into FCPA compliance in [its] India operations."[8]

Comparing pre-enforcement action professional fees and expenses to settlement amounts is not possible in all cases as companies have different disclosure requirements and practices. However, where a comparison is possible, it is clear that pre-enforcement action professional fees and expenses are typically the greatest financial consequence to a company resolving an FCPA enforcement action. For instance, RAE Systems resolved a coordinated DOJ and SEC enforcement action by agreeing to pay a combined $2.95 million in settlement amounts.[9] In connection with this FCPA scrutiny, the company disclosed $4.2 million in pre-enforcement action professional fees and expenses.[10]

While the ratio of pre-enforcement action professional fees and expenses

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5. *Wal-Mart Fourth Quarter Fiscal Year 2013 Earnings Call*, WAL-MART STORES, INC. (Feb. 21, 2013) [hereinafter *Wal-Mart Q4 Earnings Call*], *available at* http://cdn.corporate.walmart.com/63/1a/461d1fa2470fa596b46198e72886/management-earnings-call-transcript.pdf.

6. Mike Koehler, *Friday Roundup*, FCPA PROFESSOR (Aug. 16, 2013), http://www.fcpaprofessor.com/friday-roundup-88.

7. Mike Koehler, *Friday Roundup*, FCPA PROFESSOR (Feb. 21, 2014), http://www.fcpaprofessor.com/friday-roundup-109.

8. Beam Inc., Annual Report (Form 10-K) (Feb. 26, 2013), *available at* http://www.sec.gov/Archives/edgar/data/789073/000119312513076953/d457573d10k.htm.

9. Mike Koehler, *The Former CFO of RAE Systems Speaks*, FCPA PROFESSOR (Aug. 14, 2012), http://www.fcpaprofessor.com/the-former-cfo-of-rae-systems-speaks.

10. *Id.*

to enforcement action settlement amount in RAE Systems was relatively modest, such ratios have exceeded 10:1 or even greater. For instance, in the NATCO enforcement action the company agreed to pay a $65,000 civil penalty to resolve an SEC enforcement action. The company's pre-enforcement action professional fees and expenses were reported to be $11 million and caused the company cash-flow problems.[11] Likewise, in the Veraz Networks enforcement action, the company agreed to pay a $300,000 civil penalty to resolve an SEC enforcement action. The company's pre-enforcement action professional fees and expenses were approximately $3 million.[12]

The above examples highlight the fact that pre-enforcement action professional fees and expenses are typically the most expensive aspect of FCPA scrutiny and enforcement. The question is why are pre-enforcement action professional fees and expenses so expensive?

Resolution documents from an FCPA enforcement action against telecommunication company Alcatel-Lucent provide insight into the expansive nature of FCPA scrutiny. The DOJ noted:

> At the request of the government, [Alcatel-Lucent] undertook a 'Global Review' to evaluate its relationship with agents, interactions with government officials, and gifts, travel and entertainment provided in countries around the world. . . . In particular, Alcatel-Lucent and its outside counsel conducted investigations of 34 countries around the world to uncover potential misconduct. The internal investigation examined Alcatel-Lucent's agent and consultant approval, review, and termination processes, the activities of a number of terminated agents, and the knowledge and involvement of senior management in any potential wrongdoing. This effort was closely coordinated with the government. . . . [As part of its agent and consultant approval process review], Alcatel-Lucent retained an independent investigative firm to review all of Alcatel-Lucent's 300 then-existing agents and consultants. . . . Additionally, . . . Alcatel-Lucent commenced a review of its Board of Directors' and other senior management's knowledge of, and involvement in, any of the wrongdoing. As part of this review, interviews were conducted of 26 individuals who were either current high-ranking members of Alcatel-Lucent's management, former high-ranking members of Alcatel's management, or were in a position to

11. Nathan Vardi, *The Bribery Racket*, FORBES (June 7, 2010, 12:00 AM), http://www.forbes.com/global/2010/0607/companies-payoffs-washington-extortion-mendelsohn-bribery-racket.html.

12. Mike Koehler, *Disconnected . . . Another Telecommunications Company Settles an FCPA Enforcement Action*, FCPA PROFESSOR (June 30, 2010), http://fcpaprofessor.blogspot.com/2010/06/disconnected-another-telecommunications.html.

> provide information relevant to the review. Alcatel-Lucent and its counsel also reviewed documents collected from these individuals. . . . Overall, Alcatel-Lucent's outside counsel interviewed over 330 witnesses as part of these investigations, collected data from 201 individuals, and reviewed over 2 million documents, of which over 200,000 documents were produced to the government.[13]

As hinted at above, a main reason pre-enforcement action professional fees and expenses are typically the most expensive aspect of FCPA scrutiny and enforcement is because of the "where else" question. The "where else" question generally works as follows: A company voluntarily discloses to the enforcement agencies specific conduct that occurred in country X that could implicate the FCPA. Before the enforcement agencies will agree to resolve any enforcement action concerning the conduct in country X, the enforcement agencies will often ask "where else." In other words, if the conduct giving rise to FCPA scrutiny occurred in country X, how do the enforcement agencies know that similar conduct did not also occur in countries A, B, C, D, etc. In short, the "where else" question asked in instances of FCPA scrutiny often results in a company conducting a world-wide compliance review of its entire operations.

Because cooperation with the government's investigation is an important factor the enforcement agencies weigh in deciding whether to bring an enforcement action,[14] business organizations invariably, yet reluctantly, accept FCPA counsel's recommendation to broaden the internal investigation to best demonstrate cooperation. The next thing the company knows, it is paying for a team of lawyers (accompanied by forensic accountants and other specialists) to travel around the world to answer the "where else" question even though the voluntary disclosure that started the whole process involved specific conduct in a specific country.

Where an instance of FCPA scrutiny is prompted by board of director or senior executive conduct that raises the possibility of a culture of corruption within a company or conduct that otherwise suggests widespread and systematic practices, the "where else" question is a legitimate law enforcement question. However, the "where else" question is asked in nearly every instance of FCPA scrutiny as evidenced by FCPA resolution documents. For instance, the Magyar Telekom FCPA enforcement action focused on business conduct in Macedonia and

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13. Government's Memorandum in Support of the Proposed Plea Agreements and Deferred Prosecution Agreement, United States v. Alcatel-Lucent, S.A., No. 10-CR-20906, 2011 WL 2038435 (S.D. Fla. May 23, 2011).

14. PRINCIPLES OF FED. PROSECUTION OF BUS. ORGS., tit. 9, ch. 9-28.000 (U.S. Dep't of Justice 2008), *available at* http://www.justice.gov/opa/documents/corp-charging-guidelines.pdf.

Montenegro, but in resolving its FCPA scrutiny, the company, in the words of the DOJ, conducted a "thorough global internal investigation concerning bribery and related misconduct."[15] Likewise, the Tenaris FCPA enforcement action focused on business conduct in Uzbekistan, but in resolving the action the DOJ cited the company's "voluntary investigation of the Company's business operations throughout the world."[16]

The "where else" question is even asked in instances of FCPA scrutiny focused on conduct in foreign subsidiaries that comprise a meaningless percentage of the company's overall operations. For instance, the Tyson Foods FCPA enforcement action focused on conduct in Mexico involving a subsidiary company that "comprised less than one percent of Tyson's global net sales."[17] Even though approximately eighty-five to ninety percent of Tyson's sales were domestic, in resolving the enforcement action, Tyson subjected all of its wholly-owned production facilities, including those located outside of Mexico, "to rigorous FCPA reviews".[18]

An FCPA practitioner, formerly an SEC FCPA enforcement attorney, stated as follows regarding the "where else" question:

> [Q:] What percentage of FCPA enforcement actions that you have been involved in have resulted in the 'where else' question being asked?
> [A:] In my time as a regulator at the Securities and Exchange Commission's Division of Enforcement and in private practice, the 'where else' question has been asked in virtually every single FCPA matter in which I have been involved. I have asked it and it has been asked of me.
> [Q:] Do you believe the 'where else' question was appropriate in these instances?
> [A:] In some instances it was entirely appropriate for the SEC, the DOJ, and other regulators to ask the 'where else' question. In others, however, the allegations did not support a 'where else' question and it appeared to be more of a fishing expedition and boiler plate question than a well-reasoned question under the facts. 'Where else' is a reasonable and appropriate question when the alleged misconduct appears to be systemic and/or the company under investigation appears to lack the controls necessary to prevent the payment of bribes to foreign government officials. It is not, however, an appropriate question where it is intended to force companies to conduct multi country internal investigations with

15. Mike Koehler, *A Q&A with Claudius Sokenu on "Where Else"*, FCPA PROFESSOR (Apr. 4, 2012), http://www.fcpaprofessor.com/a-qa-with-claudius-sokenu-on-where-else.

16. *Id.*

17. *Id.*

18. *Id.*

> little more than the uninformed hunch of a government official who has little or no experience in how businesses work around the world.[19]

That the "where else" question is asked in the absence of any meaningful check or judicial oversight raises a host of problematic issues. Moreover, while the purpose of this Section is to demonstrate the *fact* that pre-enforcement action professional fees and expenses are typically the most expensive aspect of FCPA scrutiny and enforcement, it must nevertheless be highlighted that FCPA attorneys to whom the "where else" question is posed have little incentive to pushback as the question often leads to multi-year, multi-country billing bonanzas. As *Forbes* noted in an article titled "The Bribery Racket:"

> "A company that suspects bribery overseas hires a battery of lawyers, accountants and investigators who may then report any findings to Justice in hopes of some undefined leniency. More likely, the company pays out huge fines and then hires more lawyers as government-mandated compliance monitors, a job that can stretch into years of legal billing."[20]

The Wall Street Journal has observed:

> "[The FCPA] has become big business for the lawyers who delve into the operations of companies in response to an investigation by the Justice Department and the Securities and Exchange Commission—or to avoid one. The result is a mini-industry of investigators and white-collar criminal-law practices."[21]

Likewise, an article titled "Lawyers Need to Brake Their Bribe-Case Gravy Train" observed:

> "Lawyers need to pull the brake on their bribery-probe gravy train. Wal-Mart Stores shelled out about $80 million last quarter alone – some $1.25 million per working day – on an internal corruption investigation. [. . .] Wasteful scorched-earth legal tactics inflate costs, while potentially ruinous U.S. penalties make companies scared to skimp. Smarter lawyering could slow the runaway spending. Scrutiny under the FCPA typically throws multinationals into attorney-hiring overdrive. Having legal eagles delve into corporate innards helps a company look

19. *Id.*

20. Vardi, *supra* note 11.

21. Joe Palazzolo, *FCPA Inc.: The Business of Bribery*, WALL ST. J., Oct. 2, 2012, http://online.wsj.com/news/articles/SB10000872396390443862604578028462294611352.

> cooperative and thereby win leniency from the government. [. . .] There is a better way. A records search at a multinational's headquarters can quickly reveal how and, generally, where and to whom bribes are being paid, according to veterans of the Siemens case and others. Investigations in just a few countries can then ferret out the details of a global scheme. That's often enough to reach a reasonable settlement with Uncle Sam. Yet unnecessarily far-flung and costly probes persist. Not only does the prospect of enormous fees encourage lawyers running an investigation to engage in overkill. A company's officers also don't want to be seen to cut corners or get in the attorneys' way. The usual healthy corporate tendency to police costs carefully doesn't apply. For big companies the waste may not show, either. Even a legal bill of, say, $500 million is a drop in the bucket for a company like Wal-Mart with revenue nearly 1,000 times that figure every year. That shouldn't, however, let lawyers off the hook. Ethics rules require their fees to be reasonable. In bribery cases, that standard is at risk of becoming corrupted."[22]

As to sky-rocketing pre-enforcement action professional fees and expenses, it was notable that in 2013, the DOJ's FCPA Unit Chief called out the industry at an American Bar Association event and suggested that FCPA counsel is often seeking to "overdo it" through a global search of operations for FCPA issues.[23] He discussed a case in which a company and its professional advisors came to a meeting with a global search plan and he said "no, no, no, that is not what I want."[24] The FCPA Unit Chief indicated that the lawyers and other professional advisors in the room "looked unhappy," but that the general counsel of the company was happy.[25]

Regardless of the merits of the "where else" question in most instances, and regardless of the necessity of many pre-enforcement action professional fees and expenses, the take-away point from this section is the *fact* that such fees and expenses are often the most expensive aspect of FCPA scrutiny and enforcement in this new era. In fact, pre-enforcement action professional fees and expenses have become so pronounced that a marketplace has developed to provide insurance for such expenses.[26] Such

22. *Further to Wal-Mart's Pre-Enforcement Action Professional Fees and Expenses*, FCPA PROFESSOR (Aug. 28, 2013), http://www.fcpaprofessor.com/further-to-wal-marts-pre-enforcement-action-professional-fees-and-expenses.

23. *Friday Roundup*, FCPA PROFESSOR (Sept. 20, 2013), http://www.fcpaprofessor .com/friday-roundup-93.

24. *Id.*

25. *Id.*

26. *See, e.g.*, Mike Koehler, *FCPA Insurance*, FCPA PROFESSOR (Mar. 9, 2011), http://www.fcpaprofessor.com/fcpa-insurance; Mike Koehler, *Friday Roundup*, FCPA PROFESSOR (July. 29, 2011), http://www.fcpaprofessor.com/friday-roundup-30; Mike Koehler, *A Q&A Regarding FCPA Insurance*, FCPA PROFESSOR (Apr. 10, 2012),

insurance, of course, does not address the root causes of why pre-enforcement professional fees and expenses have skyrocketed, rather it merely seeks to capitalize on the *fact* that such pre-enforcement action professional fees and expenses have skyrocketed.

B. *Enforcement Action Settlement Amounts*

To state the obvious, failure to comply with the FCPA can expose a company to a criminal or civil enforcement action by the DOJ and/or SEC.[27] Because the focus of this Article is the many *other* ripples of FCPA scrutiny besides an actual FCPA enforcement action, this Section does not discuss in great detail the many legal and policy issues related to FCPA enforcement action settlement amounts.[28] However, to best understand the

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http://www.fcpaprofessor.com/a-qa-regarding-fcpa-insurance-2.

27. There is substantial overlap between the DOJ and SEC's FCPA enforcement programs. FCPA enforcement actions against issuers (companies – domestic and foreign – with shares registered on a U.S. exchange or otherwise required to make filings with the SEC) typically involve related and coordinated enforcement actions by the DOJ for criminal FCPA violations (whether anti-bribery violations or books and records and internal control violations) and by the SEC for civil FCPA violations (whether anti-bribery violations or books and records and internal control violations). The overlap, however, between the DOJ and SEC's FCPA enforcement programs is not complete. As a general matter, the SEC has jurisdiction over issuers. In other words, the SEC generally does not have jurisdiction over private companies or foreign companies that are not issuers. Thus, certain FCPA enforcement actions do not have an SEC component. As a general matter, the DOJ has criminal jurisdiction over issuers, domestic concerns, (i.e. any business entity with a principal place of business in the U.S. or organized under U.S. law), and non-U.S. companies and persons to the extent a bribery scheme involved conduct "while in the territory of the U.S." In addition, the DOJ has a higher burden of proof in a criminal prosecution. As a result, and given the DOJ's prosecutorial discretion, certain FCPA enforcement actions may only include an SEC component. As to the DOJ's discretion, the DOJ has stated that it "has declined to prosecute both individuals and corporate entities in numerous cases based on the particular facts and circumstances presented in those matters, taking into account the available evidence." *See* Criminal Div., U.S. DEP'T OF JUSTICE & ENFORCEMENT DIV., U.S. SEC, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT 1, 75 (2012) [hereinafter THE GUIDANCE], *available at* http://www.sec.gov/spotlight/fcpa/fcpa-resource-guide.pdf. Based on information in the DOJ and SEC authored Guidance, it appears that factors motivating a so-called declination include voluntary disclosure and cooperation, effective remedial measures, and small improper payments. *Id.* at 77-79. In addition, the DOJ has separately stated that it has declined prosecutions when, among other things, a single employee, and no other employee, was involved in the improper payments at issue; and the improper payments at issue involved minimal funds compared to the overall business revenues. *See DOJ Declines to Get Specific in Declination Responses*, FCPA PROFESSOR, (Oct. 12, 2011), http://www.fcpaprofessor.com/doj-declines-to-get-specific-in-declination-responses.

28. For instance, the composition of FCPA settlement amounts in many corporate enforcement actions is controversial. Many FCPA enforcement actions involving both a DOJ and SEC component include features of "double-dipping" (in which the company pays an amount representing the benefit received from the alleged improper payments twice – first to the DOJ and then to the SEC). *See Double-Dipping*, FCPA

"three buckets" of FCPA financial exposure, it is nevertheless useful to highlight certain facts and figures concerning actual FCPA settlement amounts.

Table I contains the largest FCPA corporate settlement amounts in history.

Table I – Largest FCPA Corporate Settlements[29]

Company	**Amount**	**Year**
Siemens	$800 million (DOJ- $450 million) (SEC- $350 million)	2008
KBR / Halliburton	$579 million (DOJ- $402 million) (SEC- $177 million)	2009
Total	$398 million (DOJ- $245 million) (SEC- $153 million)	2013
Alcoa	$384 million (DOJ- $209 million) (SEC- $175 million)	2014
Snamprogetti / ENI	$365 million (DOJ- $240 million) (SEC- $125 million)	2010
Technip	$338 million (DOJ- $240 million) (SEC- $98 million)	2010
JGC	$219 million (DOJ- $219 million)	2011

PROFESSOR (June 4, 2013), http://www.fcpaprofessor.com/double-dipping. Likewise, it is common in FCPA enforcement actions for the SEC to seek a disgorgement amount even in the absence of anti-bribery violations (a practice known as no-charged bribery disgorgement). *See "No-Charged Bribery Disgorgement,"* FCPA PROFESSOR (Aug. 22, 2011), http://www.fcpaprofessor.com/no-charged-bribery-disgorgement.

29. As of February 18, 2014. http://www.fcpaprofessor.com/fcpa-101#q17

Daimler	$185 million (DOJ- $94 million) (SEC- $91 million)	2010
Weatherford Int'l	$153 million (DOJ- $87 million) (SEC- $66 million)	2013
Alcatel-Lucent	$137 million (DOJ- $92 million) (SEC- $45 million)	2010

Even though corporate FCPA enforcement actions in this new era have resulted in several large settlement amounts, it would be inaccurate to conclude from Table I that every corporate FCPA enforcement action in this new era yields nine-figure settlement amounts. To provide a more comprehensive view of FCPA enforcement action settlement amounts, Tables II and III highlight all corporate FCPA settlement amounts from 2013 and 2012.

Table II – 2013 FCPA Enforcement Action Settlement Amounts[30]

Company	**Amount**
ADM	$54.2 million (DOJ- $17.7 million) (SEC- $36.5 million)
Bilfinger	$32 million (DOJ- $32 million)
Weatherford Int'l	$153 million (DOJ- $87 million) (SEC- $66 million)

30. *See DOJ Enforcement of the FCPA – Year in Review*, FCPA PROFESSOR (Jan. 8, 2014), http://www.fcpaprofessor.com/doj-enforcement-of-the-fcpa-year-in-review-4 [hereinafter, *Year in Review – Jan. 8, 2014*]; *see also SEC Enforcement of the FCPA – Year in Review*, FCPA PROFESSOR (Jan. 6, 2014), http://www.fcpaprofessor.com/sec-enforcement-of-the-fcpa-year-in-review-3.

Stryker	$13.2 million (SEC- $13.2 million)
Diebold	$48.1 million (DOJ- $25.2 million) (SEC- $22.9 million)
Total	$398 million (DOJ- $245 million) (SEC- $153 million)
Ralph Lauren	$1.6 million (DOJ- $882,000) (SEC- $735,000)
Parker Drilling	$15.8 million (DOJ- $11.8 million) (SEC- $4 million)
Philips Electronics	$4.5 million (SEC- $4.5 million)

Table III – 2012 FCPA Enforcement Action Settlement Amounts[31]

Company	**Amount**
Eli Lilly	$29.4 million (SEC- $29.4 million)
Allianz	$12.4 million (SEC- $12.4 million)
Tyco	$26.8 million (DOJ- $13.7 million) (SEC- $13.1 million)

31. *See DOJ Enforcement of the FCPA – Year in Review*, FCPA PROFESSOR (Jan. 9, 2013), http://www.fcpaprofessor.com/doj-enforcement-of-the-fcpa-year-in-review-3; *see also SEC Enforcement of the FCPA – Year in Review*, FCPA PROFESSOR (Jan. 8, 2013), http://www.fcpaprofessor.com/sec-enforcement-of-the-fcpa-year-in-review-2.

Oracle	$2 million (SEC- $2 million)
Pfizer	$41.3 million (DOJ- $15 million) (SEC- $26.3 million)
NORDAM Group	$2 million (DOJ- $2 million)
Orthofix Int'l	$7.4 million (DOJ- $2.2 million) (SEC- $5.2 million)
Data Systems & Solutions	$8.8 million (DOJ- $8.8 million)
Biomet	$22.8 million (DOJ- $17.3 million) (SEC- $5.5 million)
BizJet / Lufthansa	$11.8 million (DOJ- $11.8 million)
Smith & Nephew	$22.2 million (DOJ- $16.8 million) (SEC- $5.4 million)
Marubeni	$54.6 million (DOJ- $54.6 million)

Settlement amounts in an actual FCPA enforcement action will obviously be specific to the unique facts and circumstances at issue. However, it is notable that seemingly routine FCPA enforcement actions in this new era of enforcement are being resolved for amounts that were record-setting just a few years ago. As FCPA practitioners have rightly observed: "an unmistakable characteristic of [2013] FCPA enforcement is that the market rate for resolving a corporate FCPA enforcement action spiked precipitously in 2013."[32]

Indeed, FCPA settlement amounts have come a long way in a short amount of time. For example, in 2007, Baker Hughes resolved the *largest* FCPA enforcement action of all-time by agreeing to pay a combined $44 million in DOJ and SEC enforcement actions.[33] According to the DOJ criminal information, the company made approximately $4.1 million in improper payments – via an agent – in connection with the Karachaganak Project in Kazakhstan, a "giant gas and oil field".[34] The DOJ's sentencing guidelines calculation stated that the "benefit received or to be received [from the alleged improper conduct was] approximately $19 million."[35]

The SEC enforcement action against Baker Hughes was based on the same core conduct and the SEC's release stated:

> Baker Hughes paid approximately $5.2 million to two agents while knowing that some or all of the money was intended to bribe government officials, specifically officials of State-owned companies, in Kazakhstan. . . . Baker Hughes engaged the agent and was awarded an oil services contract in the Karachaganak oil field in Kazakhstan that generated more than $219 million in gross revenues from 2001 through 2006.[36]

In addition, the SEC release stated:

- from 1998 to 2004, Baker Hughes authorized commission payments of nearly $5.3 million to an agent (who worked in Kazakhstan, Russia and Uzbekistan) under circumstances in which the company failed to determine whether such payments were, in part, to be funneled to government officials in violation of the FCPA;

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32. 2013 *Year End FCPA Update*, GIBSON DUNN 1, 3 (Jan. 6, 2014), http://www.gibsondunn.com/publications/Documents/2013-Year-End-FCPA-Update.pdf.

33. *See* Press Release, U.S. Dep't of Justice, Baker Hughes Subsidiary Pleads Guilty to Bribing Kazakh Official and Agrees to Pay $11 Million Criminal Fine as Part of Largest Combined Sanction Ever Imposed in FCPA Case (Apr. 26, 2007), *available at* http://www.justice.gov/opa/pr/2007/April/07_crm_296.html; *see also* Press Release, U.S. SEC, SEC Charges Baker Hughes With Foreign Bribery and with Violating 2001 Commission Cease-and-Desist Order (Apr. 26, 2007) [hereinafter SEC Press Release], *available at* http://www.sec.gov/news/press/2007/2007-77.htm.

34. U.S. Attorney Charges at 4, United States v. Baker Hughes Servs. Int'l, Inc., No. H-07-129 (S.D. Tex. filed Apr. 11, 2007), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/baker-hughs/04-11-07bakerhughesintl-info.pdf.

35. Plea Agreement at 9, United States v. Baker Hughes Servs. Int'l, Inc., No. H-07-129 (S.D. Tex. filed Apr. 11, 2007) *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/baker-hughs/04-11-07bakerhughes-plea.pdf.

36. SEC Press Release, *supra* note 33.

- in Indonesia, between 2000 and 2003, Baker Hughes paid certain freight forwarders to import equipment into Indonesia using a "door-to-door" process under circumstances in which the company failed to adequately assure itself that such payments were not being passed on, in part, to Indonesian customs officials;
- in Nigeria, between at least 2001 and 2005, Baker Hughes authorized payments to certain customs brokers to facilitate the resolution of alleged customs deficiencies under circumstances in which the company failed to adequately assure itself that such payments were not being passed on, in part, to Nigerian customs officials; and
- in Angola, from 1998 to 2003, Baker Hughes paid an agent more than $10.3 million in commissions under circumstances in which the company failed to adequately assure itself that such payments were not being passed on to employees of Sonangol, Angola's state-owned oil company, to obtain or retain business in Angola.[37]

In 2013, comparatively minor FCPA enforcement actions, per the enforcement agencies' own allegations, were resolved for amounts larger than what was a record-setting amount just a few years ago.

For instance, the Diebold enforcement action focused primarily on excessive travel and entertainment and DOJ allegations that company subsidiaries provided various things of value (such as Las Vegas sightseeing, a dance show, a Grand Canyon tour, a Universal Studios tour and a Napa Valley tour) totaling approximately $1.75 million to alleged Chinese and Indonesian "foreign officials" at state-owned banks over a five year period.[38] As to the core conduct, the DOJ's sentencing guidelines calculation referenced a "value of benefit received [from the alleged improper conduct] of more than $7 million."[39]

The SEC enforcement action against Diebold was based on the same core conduct and alleged that company subsidiaries in China and Indonesia spent approximately $1.8 million on travel, entertainment, and other

37. *Id.*

38. Information, United States v. Diebold, Inc., No. 5:13CR464 (N.D. Ohio filed Oct. 22, 2013), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/diebold/information.pdf. The enforcement action also contained non-specific monetary allegations concerning relationships with private business customers in Russia. However, the DOJ's sentencing guidelines calculation makes clear that the Russia conduct was a minor factor in determining the fine and penalty amount. *See* Deferred Prosecution Agreement, United States v. Diebold, Inc., No. 5:13CR464 (N.D. Ohio filed Oct. 22, 2013) [hereinafter Diebold DPA], *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/diebold/combined_dpa.pdf.

39. Diebold DPA, *supra* note 38.

improper gifts for senior officials with the ability to influence the alleged state-owned bank purchasing decisions.[40]

Thus, per the enforcement agencies' own allegations, the Diebold enforcement action involved *significantly less egregious* conduct than the Baker Hughes enforcement action. Yet, the combined $48 million settlement amount in the Diebold was more than the record-setting $44 million Baker Hughes enforcement action from just a few years ago.[41]

The $32 million DOJ enforcement action against German engineering company Bilfinger S.E. is another instructive example from 2013 that demonstrates how FCPA settlement amounts have come a long way in a short amount of time. The DOJ criminal information alleged, in pertinent part, that Bilfinger conspired with others to obtain and retain contracts related to the Eastern Gas Gathering System (EGGS) project in Nigeria through the promise and payment of over $6 million in bribes to various alleged Nigerian officials.[42] As noted in the DOJ's release, the enforcement action was directly related to a prior 2008 FCPA enforcement against Willbros Group, Bilfinger's joint venture partner in connection with the same EGGS project.[43]

The DOJ's DPA in the previous Willbros enforcement action did not set forth a detailed advisory Sentencing Guidelines calculation as is the norm in most current FCPA DPAs including the Bilfinger DPA. Nevertheless, the DOJ settlement amount in the Willbros action was *$22 million.*[44] This $22 million settlement amount was in connection with not only the EGGS project, but *also* DOJ allegations that "certain Willbros employees based in South America agreed to make approximately $300,000 in corrupt

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40. Complaint at 2, U.S. SEC v. Diebold, Inc., (D.D.C. filed Oct. 22, 2013), *available at* http://www.sec.gov/litigation/complaints/2013/comp-pr2013-225.pdf. (alleging further that Diebold falsified books and records to hide approximately $1.2 million of bribes paid to employees at privately owned banks in Russia).

41. Of course, factors beyond the core conduct at issue – such as voluntary disclosure, cooperation and a company's past history – can influence settlement amounts in an FCPA enforcement action. However, the Baker Hughes and Diebold enforcement actions were substantively identical in these regards (i.e. both companies had a past history, both companies voluntarily disclosed and both companies cooperated).

42. Information, United States v. Bilfinger SE., (S.D. Tex. filed Dec. 9, 2013), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/bilfinger/bilfinger-information.pdf.

43. Press Release, U.S. Dep't of Justice, German Engineering Firm Bilfinger Resolves Foreign Corrupt Practices Act Charges and Agrees to Pay $32 Million Criminal Penalty (Dec. 11, 2013) *available at* http://www.justice.gov/opa/pr/2013/December/13-crm-1297.html.

44. Deferred Prosecution Agreement at 9, United States v. Willbros Group, Inc., No. H-08-287 (S.D. Tex. filed May 14, 2008) *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/willbros-group/05-14-08willbros-deferred.pdf.

payments to Ecuadoran government officials of the state-owned oil company PetroEcuador and its subsidiary, PetroComercial, to assist in obtaining a gas pipeline project."[45]

In short, the Bilfinger enforcement action involved the same EGGS project at issue in the Willbros enforcement. Moreover, the Willbros enforcement action was broader in scope than the Bilfinger action as it involved alleged corrupt payments in connection with other projects in other countries. Yet, the 2013 Bilfinger enforcement action was resolved for $32 million whereas the 2008 Willbros enforcement action was resolved for $22 million. The key difference between the two enforcement actions seems to be merely the passage of time.

C. Post-Enforcement Action Professional Fees and Expenses

The financial exposure of FCPA scrutiny and enforcement often continues even after enforcement action day and this Section discusses the "third bucket" of FCPA financial exposure, post-enforcement action professional fees and expenses.

Nearly all corporate FCPA enforcement actions in this new era are resolved via NPAs or DPAs.[46] A common clause in such agreements is a requirement that the company report to the enforcement agencies during the usual 2-3 year term of the agreement regarding, among other things, its implementation of a FCPA compliance program and its on-going compliance efforts.[47] While such a requirement may seem simple and straight-forward, it often involves internal reviews, follow-up reviews, and written reports that occupy FCPA Inc. participants for hundreds of hours and often cost the company millions of dollars in post-enforcement action professional fees and expenses.[48]

In addition to the above standard post-enforcement action compliance obligations in a typical FCPA NPA or DPA, the enforcement agencies are also often imposing "enhanced compliance obligations" on companies as a

45. U.S. Attorney Charges at 9, United States v. Willbros Group, Inc., No. H-08-287 (S.D. Tex. filed May 14, 2008) *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/willbros-group/05-14-08willbros-info.pdf.

46. *See Year in Review – Jan. 8, 2014, supra* note 30.

47. *See, e.g.*, Plea Agreement Letter from U.S. Dep't of Justice to Archer Daniels Midland Co. B-2 (Dec. 20, 2013), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/archer-daniels-midland/adm-npa.pdf.

48. The author coined the term "FCPA Inc" in April 2010. *See Mike Koehler Takes on FCPA Inc.*, CORP. CRIME REP. 15 (2010), *available at* http://www.corporatecrimereporter.com/fcpainc041210.htm. While perhaps viewed by some as a derogatory term, it is not intended to be. Rather, FCPA Inc. is a short-hand term used to describe a vibrant, niche industry consisting of numerous market participants including law firms, accounting firms, and compliance and consulting firms.

condition of settlement. For instance, healthcare company Johnson & Johnson ("J&J") resolved an FCPA enforcement action focused on subsidiary conduct in Greece, Poland, and Romania. The enforcement action was resolved via a DPA and the DOJ specifically noted: "J&J had a pre-existing compliance and ethics program that was effective and the majority of problematic operations globally resulted from insufficient implementation of the J&J compliance and ethics program in acquired companies."[49] The DPA contained the standard compliance obligations found in typical FCPA DPAs, but also included "enhanced compliance obligations" that J&J is required to abide by during the three-year term of the DPA.[50]

Even though the DPA stated that J&J, as part of the voluntary disclosure and cooperation process, "conducted an extensive, global review of all of its operations to determine if there were problems elsewhere," the "enhanced compliance obligations" nevertheless require J&J to "conduct risk assessments of markets where [the company] has government customers and/or other anticorruption compliance risks on a staggered, periodic basis."[51]

The DPA also required J&J to "identify no less than five operating companies that are high risk for corruption because of their sector and location and . . . conduct FCPA audits of those operating companies at least once every three years."[52] As stated in the DPA, "FCPA audits of other operating companies that pose corruption risk shall occur no less than once every five years."[53]

Pursuant to the DPA, "each FCPA audit shall include" the following:

> (i) on-site visits by an audit team comprised of qualified auditors who have received FCPA and anticorruption training; (ii) where appropriate, participation in the on-site visits by personnel from the compliance and legal functions; (iii) review of a statistically representative sample appropriately adjusted for the risks of the market, of contracts with and payments to individual health care providers; (iv) creation of action plans resulting from issues identified during audits; and (v) where appropriate, feasible, and permissible under local law, review of the books and records of distributors which, in the view of the audit team, may present

49. Deferred Prosecution Agreement at 3, United States v. Depuy, Inc., No. 1:11-cr-00099-JDB (D.D.C. filed Apr. 8, 2011) [hereinafter Depuy DPA], *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/depuy-inc/04-08-11depuy-dpa.pdf.

50. *Id.*

51. *Id.*

52. *Id.*

53. *Id.*

corruption risk.[54]

Likewise, the FCPA enforcement action against pharmaceutical company Pfizer also required the company to adhere to "enhanced compliance obligations" notwithstanding the following pertinent facts alleged by the enforcement agencies:

> (i) the substantial bulk of the enforcement action concerned conduct by entities Pfizer acquired in 2003 and 2009; (ii) in the 18 months following its 2009 acquisition of an entity giving rise to its scrutiny, Pfizer conducted a due diligence and investigative review of the entity's business operations and integrated Pfizer's internal controls system into the business entities; (iii) there was no allegation or suggestion that anyone at corporate headquarters knew of or approved the conduct at issue; (iv) as soon as the problematic conduct came to the attention of Pfizer's corporate headquarters, it made a timely voluntary disclosure to the enforcement agencies; and (v) Pfizer's self-investigation was thorough and wide-ranging.[55]

As to this last point, the DOJ stated: "From 2004 to the present, Pfizer, using external counsel and forensic accountants, internal Legal, Compliance, and Corporate Audit personnel, conducted an extensive, global review of its operations regarding allegations of improper payments to Government officials and government doctors[.]"[56] Likewise, the SEC stated: "[Since 2004, Pfizer] diligently and thoroughly undertook a global internal investigation of its operations in no less than 19 countries[.]"[57]

According to the enforcement agencies, Pfizer also undertook early and extensive remedial efforts and made substantial and continuing improvements to its global anti-corruption compliance policies and procedures. Specifically, the DOJ stated:

> [S]tarting immediately in 2004, Pfizer launched extensive remedial actions including: undertaken a comprehensive review of its compliance program, implementing enhanced anti-corruption compliance policies and procedures on a worldwide basis, developing global systems to support employee compliance with the enhanced procedures, adding

54. *Id.*

55. Deferred Prosecution Agreement at A-4, United States v. Pfizer H.C.P. Corp., No. 12-CR-169 (D.D.C. filed Aug. 7, 2012), [hereinafter Pfizer DPA] *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/pfizer/2012-08-07-pfizer-dpa.pdf.

56. *Id.*

57. Complaint, U.S. SEC v. Pfizer, Inc., (D.D.C.), *available at* http://www.sec.gov/litigation/complaints/2012/comp-pr2012-152-pfizer.pdf (last visited June 7, 2014).

> FCPA-specific reviews to its internal audits, performing proactive anti-corruption compliance reviews in approximately ten markets annually, and conducting comprehensive anti-corruption training throughout the organization.[58]

In other words, since learning of potential FCPA issues and for approximately eight years thereafter, Pfizer did the right thing and when the enforcement agencies use words like thorough, wide-ranging, extensive, global, worldwide, diligent, comprehensive, proactive, significant, innovative and sophisticated, there can be no reasonable doubt about this. Yet, just as in the J&J enforcement action, the Pfizer DPA also required the company to adhere to similar "enhanced compliance obligations."

Similar to the above section concerning pre-enforcement action professional fees and expenses, the purpose of this Section is to demonstrate the *fact* that the financial consequences of FCPA scrutiny and enforcement often continue even after enforcement action day. Yet, just as in the previous Section, it must nevertheless be asked whether many post-enforcement action compliance requirements are necessary or whether such requirements imposed by government enforcement agencies in the absence of meaningful checks or judicial oversight turn into boondoggles as well.

For instance, given the enforcement agencies' allegations and findings as to J&J and Pfizer, were the "enhanced compliance obligations" truly necessary? After all, in the J&J action, the DOJ concluded that the company already had generally "effective" compliance policies and procedures and that prior to resolving the enforcement action, J&J had already "conducted an extensive, global review of all of its operations to determine if there were problems elsewhere[.]"[59]

Or were the "enhanced compliance obligations" in the J&J and Pfizer enforcement actions examples of companies being required by the government (under risk of prosecution for failure to do so) to engage in fishing expeditions when the company had already gone fishing just for the sake of going fishing again? If so, they represent a boundless and unconstrained government-required transfer of shareholder wealth to FCPA Inc. Such fishing expeditions are of course lucrative for FCPA Inc. hence one reason not many in the industry have raised concerns about the emerging trend of "enhanced compliance obligations."

In addition to standard post-enforcement action compliance obligations or "enhanced compliance obligations" as a condition of resolving a corporate FCPA enforcement action, certain companies have also been

58. Pfizer DPA, *supra* note 55.
59. Depuy DPA, *supra* note 49.

required to engage an independent compliance monitor as a condition of settlement. For instance, in 2013, approximately 55% of corporate DOJ FCPA enforcement actions required the engagement of a compliance monitor, and in 2012, approximately 35% of corporate DOJ FCPA enforcement actions required the engagement of a monitor.[60]

As noted in the DOJ/SEC FCPA Guidance issued in 2012, "a monitor is an independent third party who assesses and monitors a company's adherence to the compliance requirements of an agreement that was designed to reduce the risk of recurrence of the company's misconduct."[61] The term monitor is a bit misleading as it suggests a single person. The reality is that a monitor is more like the conductor of a large orchestra and a monitorship can become an expensive and distracting requirement of resolving an FCPA enforcement action.

FCPA practitioners have rightly observed:

> Few penalties imposed on a corporate criminal offender cause as much consternation as do compliance monitors. After the late-night crisis management meetings, after the invasive and expensive internal investigation, after the shakeup of senior managers, and after the protracted negotiations with federal authorities, companies just want to get back to business. They want to sell their goods and services, be profitable, invest, and grow. In short, they want to move on. Fundamentally, the corporate compliance monitor stands in the way of forgetting the past and going back to 'business as usual'—at least when it comes to obeying the law. The monitor's purpose is to see that the company follows applicable laws and regulations going forward and institutes the proper policies and procedures to help ensure compliance. Corporations will never welcome this 'tail' to their criminal prosecutions. Monitorships inevitably involve significant expenditures of funds and time.[62]

According to the FCPA Guidance, the enforcement agencies consider the following factors when determining whether a compliance monitor is an appropriate requirement of a corporate FCPA enforcement action: seriousness of the offense; duration of the misconduct; pervasiveness of the misconduct, including whether the conduct cuts across geographic and/or product lines; nature and size of the company; quality of the company's compliance program at the time of the misconduct; and subsequent

60. *See* DOJ Enforcement of the FCPA - Year in Review 4, *supra* note 30; *see also* DOJ Enforcement of the FCPA - Year In Review 3, *supra* note 31.

61. THE GUIDANCE, *supra* note 27.

62. Joseph Warin et al., *Somebody's Watching Me: FCPA Monitorships and How They Can Work Better*, 13 U. PA. J. BUS. L. 321, 322 (2011).

remediation efforts.[63]

Based on these factors, it was not surprising that Siemens was required to engage a compliance monitor when resolving its FCPA enforcement action in 2008. In resolving the largest FCPA enforcement action of all-time, the enforcement agencies stated that "for much of its operations across the globe, bribery was nothing less than standard operating procedure for Siemens" and that Siemens had a "corporate culture in which bribery was tolerated and even rewarded at the highest levels of the company."[64]

In 2012, the term of Siemens' monitor ended and the DOJ determined that Siemens satisfied its settlement obligations with respect to the monitor. The DOJ's filing provides a rare insight into the extent of the monitor's work and stated:

> In accordance with the plea agreement, the Monitor conducted an initial review and three subsequent reviews of Siemens's anti-corruption compliance program, and documented the Monitor's findings and recommendations in four annual reports [. . .]. Over the course of those four years, the Monitor conducted on-site or remote reviews of Siemens' activities in 20 countries; conducted limited or issue-specific reviews in or relating to an additional 19 countries; reviewed over 51,000 documents totaling more than 973,000 pages in 11 languages; conducted interviews of or meetings with over 2,300 Siemens employees; observed over 180 regularly scheduled company events; and spent the equivalent of over 3,000 auditor days conducting financial studies and testing.[65]

Siemens has not disclosed its post-enforcement action professional fees and expenses, including monitor costs, but one can safely assume such fees and expenses were in the hundreds of millions of dollars and in addition to the approximate one billion dollars the company spent in pre-enforcement action professional fees and expenses (bucket #1) as well as the $800 million the company agreed to pay to resolve its FCPA scrutiny (bucket #2).[66]

Similar to pre-enforcement action professional fees and expenses,

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63. THE GUIDANCE, supra note 27.

64. Press Release, U.S. Dep't of Justice, Transcript of Press Conference Announcing Siemens AG and Three Subsidiaries Plead Guilty to Foreign Corrupt Practices Act Violations (Dec. 15, 2008), *available at* http://www.justice.gov/opa/pr/2008/December/08-opa-1112.html.

65. *The Work of a Monitor and Checking in on Siemens*, FCPA PROFESSOR (Jan. 22, 2013), http://www.fcpaprofessor.com/the-work-of-a-monitor-and-checking-in-on-siemens [hereinafter *Work of a Monitor*].

66. *See* Nathan Vardi, *How Federal Crackdown on Bribery Hurts Business and Enriches Insiders*, FORBES (May 06, 2010, 5:40 PM), http://www.forbes.com/forbes/2010/0524/business-weatherford-kbr-corruption-bribery-racket.html.

comparing post-enforcement action professional fees and expenses to settlement amounts is not possible in all cases as companies have different disclosure requirements and practices. However, where a comparison is possible, it is clear that post-enforcement action professional fees and expenses increase the overall financial consequences of FCPA scrutiny and enforcement as monitor costs can reach into the millions of dollars even in less high-profile FCPA enforcement actions.

For instance and as previously noted, oil and gas services company Willbros Group agreed to pay approximately $32 million in combined fines and penalties to resolve parallel DOJ and SEC FCPA enforcement actions. Pursuant to the DPA, the company was required to engage a compliance monitor and the company disclosed total monitor expenses of approximately $10 million.[67] Likewise, Faro Technologies agreed to pay approximately $3 million in combined fines and penalties to resolve parallel DOJ and SEC FCPA enforcement concerning conduct in China. Pursuant to the DPA, the company was required to engage a compliance monitor and the company disclosed monitor expenses of $1 million in just one quarter.[68] In short, the financial consequences of FCPA scrutiny and enforcement continue even after enforcement action day.

Regardless of which of the "three buckets" the money falls into, and regardless of the legitimacy and necessity of many of the professional fees and expenses discussed in this Section, the take-away point from Part I of this Article is understanding that the fines and penalties assessed in an actual FCPA enforcement action are often just the tip of the iceberg in terms of a company's overall financial exposure.

With a proper understanding of the "three buckets" of FCPA financial exposure, Part II of this Article further adds to the overall financial consequences that can result from FCPA scrutiny or enforcement by highlighting the many other negative business effects of FCPA scrutiny and enforcement.

II. THE BUSINESS EFFECTS OF FCPA SCRUTINY AND ENFORCEMENT

This Part uses various case studies and examples to demonstrate how FCPA scrutiny and enforcement can further negatively impact a company's business operations and strategy in a variety of ways from: market capitalization; to cost of capital; to merger and acquisition activity; to impeding or distracting a company from achieving other business objectives; to private shareholder litigation; to offensive use of the FCPA to

67. *Friday Roundup*, FCPA PROFESSOR (Apr. 13, 2012), http://www.fcpaprofessor.com/friday-roundup-37.

68. *Faro's Monitor – Late and Expensive*, FCPA PROFESSOR (Dec. 27, 2010), http://www.fcpaprofessor.com/faros-monitor-late-and-expensive.

achieve a business objective or to further advance a litigating position.

By examining the FCPA's many other ripples, this section shifts the FCPA conversation away from a purely legal issue to its more proper designation as a general business issue that needs to be on the radar screen of business managers operating in the global marketplace. By highlighting the many ripples of FCPA scrutiny and enforcement, it is hoped that more business managers can view the importance of FCPA compliance more holistically and not merely through the narrow lens of actual enforcement actions.

A. Market Capitalization

Market capitalization refers to the total market value of a public company's outstanding shares and is calculated by multiplying a company's shares by the current market price of one share. Market capitalization is an important data point for investors and an important metric by which business manager performance is judged. Because FCPA scrutiny or an enforcement action can impact a company's share price, a company's market capitalization can likewise be impacted by the scrutiny. Two examples of FCPA scrutiny – one involving a large well-known company and the other involving a small lesser-known company – highlight this issue.

Wal-Mart's previously discussed FCPA scrutiny was front-page news in 2012 when the *New York Times* published an article concerning alleged conduct in Mexico.[69] Even though Wal-Mart disclosed its FCPA scrutiny in a 2011 SEC filing, the market reacted swiftly to the *Times* article. On the last trading day before the *Times* article, Wal-Mart's stock closed at $62.45. The first trading day after the *Times* article, the stock dropped 4.7 percent and continued a downward trend for several days eclipsing approximately $20 billion in shareholder value.[70] Investors were likely spooked by the intense media coverage and likely became paranoid by comments that Wal-Mart could face approximately $13 billion in ultimate fines and penalties as a result of its FCPA scrutiny.[71] Such comments, of course, were widely speculative and entirely off base as the largest FCPA settlement in history is the $800 million action against Siemens.

69. *See* David Barstow, *Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top Level Struggle*, N.Y. TIMES, Apr. 21, 2012, http://www.nytimes.com/2012/04/22/business/at-wal-mart-in-mexico-a-bribe-inquiry-silenced.html?_r=2&hp&.

70. Mike Koehler, *Foreign Corrupt Practices Act Enforcement as Seen Through Wal-Mart's Potential Exposure*, 7 WHITE COLLAR CRIME REP. no. 19, 2012, *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2145678.

71. Eric Platt, *How a Walmart Bribery Fine Could Spiral Up over $13 Billion*, BUSINESS INSIDER (Apr. 23, 2012 2:42 PM), http://www.businessinsider.com/how-walmarts-fine-could-spiral-up-to-144-billion-2012-4.

In 2010, shares of SciClone Pharmaceuticals Inc. (a U.S.-based, China-focused specialty pharmaceutical company) were likewise impacted by the company's FCPA scrutiny as the company's shares plunged approximately 40% and closed down approximately 32% from its previous trading day.[72] Such a dramatic decline in a company's stock price is normally associated with a Chief Executive Officer resigning, a declaration of bankruptcy, or other crisis-like events. However, the decline in SciClone's stock price was likely due to the following disclosure made by the company:

> SciClone was contacted by the SEC and advised that the SEC has initiated a formal, non-public investigation of SciClone. In connection with this investigation, the SEC issued a subpoena to SciClone requesting a variety of documents and other information. The subpoena requests documents relating to a range of matters including interactions with regulators and government-owned entities in China, activities relating to sales in China and documents relating to certain company financial and other disclosures. The Company [also] received a letter from the DOJ indicating that the DOJ was investigating FCPA issues in the pharmaceutical industry generally, and had received information about the Company's practices suggesting possible violations.[73]

The dramatic decline in SciClone's share price was thus merely based on disclosure that the company had received an SEC subpoena and a letter of inquiry from the DOJ as part of an industry-wide investigation of the pharmaceutical industry.

A company's stock price, and thus its market capitalization, can also be negatively impacted by investment analyst downgrades due to FCPA scrutiny. For instance, the shares of technology company NCR Corp. fell approximately 8% after an investment analyst downgraded the company's stock to neutral from outperform because of the company's FCPA scrutiny.[74] Among the concerns noted in the analyst report were: a multi-quarter investigation; potential fines and penalties from the single millions to tens of million; much of the company's share gains over the last two years came in emerging markets and such growth may be at risk if an

72. *Update 1-SciClone Shares Plunge on SEC, DOJ Probe*, REUTERS (Aug. 10, 2010, 12:19 PM), http://www.reuters.com/article/2010/08/10/sciclone-idUSSGE6790K32010081O.

73. SciClone Pharmaceuticals, Inc., Annual Report (Form 10-K) (Mar. 16, 2010), *available at* http://investor.sciclone.com/secfiling.cfm?filingID=1193125-10-58363.

74. Notable Calls, *NCR Corp (NCR): Downgraded as Potential FCPA Issues Add Meaningful Risk – Wedbush*, WALL STREET PIT (Aug. 14, 2012 8:34 AM), http://wallstreetpit.com/95128-ncr-corp-ncr-downgraded-as-potential-fcpa-issues-add-meaningful-risk-wedbush/.

FCPA investigation restricts current business practices; and that companies uninhibited by the FCPA, such as China-based competitors, could gain market share.[75]

Whether FCPA scrutiny will impact a company's market capitalization often depends on the nature of the company (for instance, SciClone is a China-focused pharmaceutical company with a substantial portion of its revenue tied to that country making FCPA scrutiny in China a significant event) or the means by which the FCPA scrutiny is communicated (such as a front-page article in the *Times* about Wal-Mart).

Indeed, investor reaction to FCPA scrutiny or enforcement is not often as dramatic as the above examples suggest. For instance, a *Wall Street Journal* analysis sought to measure market reaction to an FCPA investigation by asking "whether and to what extent shareholders trade on the announcements of FCPA investigations (internal or government) and settlements."[76] The analysis, based on more than 40 corporate cases since 2004, found "a lot of shrugging on the part of investors" and that "the average change in stock price from the day before to the day after the disclosure of an FCPA investigation was a decrease of 1%."[77] An analysis by Nera Economic Consulting drew a similar conclusion. Using a market model analysis that measured the relationship between stock price movement of companies that resolved FCPA enforcement actions against the S&P 500 index prior to the first apparent announcement of FCPA-related allegations, the analysis found that "in some instances the implication of an alleged FCPA violation is considered serious by the market."[78] However, for most companies that resolve an FCPA enforcement action, the analysis found that "there was no statistically significant price reaction" by the market upon apparent first announcement of FCPA-related allegations.[79]

Even if the stock of certain companies decline upon news of FCPA scrutiny, business managers may find comfort in the short duration of the FCPA induced dip. For instance, even SciClone's stock soon recovered its lost value and began trading at a higher price.[80] Likewise, Wal-Mart's stock soon recovered all of its value and outperformed the market after its

75. *Id.*

76. Joe Palazzolo, *Does the FCPA Move Markets*, WALL ST. J. L. BLOG (Oct. 2, 2012 11:12 AM), http://blogs.wsj.com/law/2012/10/02/does-the-fcpa-move-markets/.

77. *Id.*

78. Raymond Wong & Patrick Conroy, *FCPA Settlements: It's a Small World After All*, NERA ECONOMIC CONSULTING (Jan. 28, 2009), http://www.nera.com/extImage/Pub_FCPA_Settlements_0109_Final2.pdf.

79. *Id.*

80. *See The Silver Lining*, FCPA PROFESSOR (June 7, 2012), http://www.fcpaprofessor.com/the-silver-lining.

FCPA-induced dip.[81]

These examples suggest that FCPA-induced dips in stock prices may be the result of misinformed doomsday scenarios and not financial fundamentals. Based upon the above studies, it appears that in most instances of FCPA scrutiny markets care little and that investment professionals may realize how diluted FCPA enforcement has become in this new era. Indeed, commenting on the rapid rise in Wal-Mart's stock price after the *New York Times* induced FCPA dip, a Forbes commentator stated:

> My 30 years of experience in the markets has repeatedly shown to me that whenever a company is accused of violations of FCPA, headlines are always scary, but in the end, the downdraft in the stock invariably becomes a buying opportunity.[82]

Even if a company's FCPA-induced stock dip is short-lived and even if a company's stock price declines on average only 1% after disclosure of FCPA scrutiny, one business effect of FCPA enforcement, or merely the mention of FCPA scrutiny, can be a negative impact on a company's market capitalization.

B. Cost of Capital

FCPA scrutiny can also negatively impact a company's cost of capital, specifically a company's credit rating. A company's credit rating matters for a number of reasons. For instance, a company with a lower credit rating may be faced with a smaller pool of potential investors and thus may have to offer those investors a higher interest rate. Likewise, a company's credit rating will determine the interest rate at which the company can borrow money and certain institutional investors may be barred from owning non-investment grade corporate bonds.

A report by ratings agency Fitch Ratings, titled "U.S. Foreign Corrupt Practices Act-No Minor Matter," highlights the variety of cost of capital effects that can arise from FCPA scrutiny or enforcement.[83] The report noted that FCPA scrutiny can have ratings implications for companies with modest free cash flow ("FCF") and/or liquidity constraints. The report

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81. *Id.*

82. Nigam Arora, *Mexican Bribery Gave Me a Chance to Make Money in Wal-Mart*, FORBES (May 17, 2012 12:44 PM)), http://www.forbes.com/sites/greatspeculations/2012/05/17/mexican-bribery-gave-me-a-chance-to-make-money-in-wal-mart/.

83. FITCH RATINGS, U.S. FOREIGN CORRUPT PRACTICES ACT – NO MINOR MATTER, (2010).

further noted "that it can take years from the discovery of a violation to the time of a plea agreement is reached" and stated:

> In the interim, corporate credit profiles, liquidity, and ratings may weaken. The fine that could be easily paid with cash on hand today might not be readily payable years down the road if a company's credit profile has weakened and liquidity becomes constrained.[84]

As to the financial effect of "deferring the legal consequences" of alleged FCPA violations via NPAs and DPAs, the report noted that prosecutions declined or deferred pursuant to these agreements could be activated if the company fails to adhere to its obligations under the agreements, meaning "that investors and analysts cannot take a deep breath or relax until" the time period in the NPA or DPA has expired.[85]

The Fitch report also highlighted the significant amount of pre-enforcement action professional fees and expenses typically incurred by companies under FCPA scrutiny. Indeed, Avon's bond rating has been downgraded due to "expenses related to the ongoing investigation under the FCPA."[86]

Although the Fitch report noted that many FCPA fines are "imposed on large investment grade corporations whose substantial cash balances easily afforded them the ability to absorb the payments with no or minimal increases in leverage," the report also noted that "there have also been [FCPA] violations by non-investment grade companies."[87] One instance discussed in the Fitch report was the previously mentioned Willbros Group Inc. enforcement action. It was noted that: Willbros borrowed from banks on a secured basis; when the company became aware of its FCPA issues the scrutiny and related issues resulted in the restatement of its annual financial statements; and that the scrutiny required "several amendments on its bank credit facility" which was reduced from $150 million to $100 million.[88]

In short, as the above examples highlight, FCPA scrutiny and enforcement can also negatively impact a company's cost of capital and set into motion multiple negative financial consequences.

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84. *Id.*

85. *Id.*

86. *S&P Cuts Avon Products, Inc*, REUTERS (Mar. 16, 2012 2:48 PM), http://www.reuters.com/article/2012/03/16/idUSWNA272720120316.

87. FITCH RATINGS, *supra* note 83.

88. *Id.*

C. *Mergers and Acquisitions*

In addition to market capitalization and cost of capital, FCPA scrutiny and enforcement can also negatively impact merger or acquisition activity. Such negative impacts range from terminating planned merger or acquisition activity, to restructuring the terms and conditions of the planned transaction, to reducing the expected financial benefits of the transaction.

1. *Termination*

The failed merger between aerospace company Lockheed Martin Corporation and Titan Corporation best demonstrates this ripple of FCPA scrutiny and enforcement. In announcing the planned acquisition, Lockheed's Chairman and CEO stated:

> Titan provides additional presence within the U.S. Government customer base and expands our competencies. Titan is an excellent fit with Lockheed Martin, and its acquisition is consistent with our disciplined growth and cash deployment strategies. Titan's outstanding record of sales growth and the quality of its workforce made this transaction very attractive to us. This workforce, together with our highly skilled people, allows us to provide more cost effective and robust solutions to customers of both companies.[89]

However, soon thereafter, Lockheed announced that it "learned of allegations that improper payments were made, or items of value were provided, by consultants for Titan Corporation or its subsidiaries to foreign officials."[90] Lockheed stated:

> The allegations were identified as part of a review conducted with Titan of payments to Titan's international consultants in connection with the proposed acquisition of Titan. The alleged payments and provision of items of value, if true, raise questions concerning whether there has been a violation of the FCPA. . . . The review is ongoing. Titan is cooperating with this effort, as well as conducting its own review. Lockheed Martin and Titan have met with the SEC and the DOJ to discuss the allegations of improper payments. . . . Closing of the Titan transaction is subject to approval of Titan's stockholders, the absence of any material adverse change in Titan and other conditions set forth in the merger agreement. . . . Lockheed Martin will need to determine whether the conditions to

89. Press Release, U.S. SEC, Lockheed Martin Announces Agreement to Acquire Titan Corporation (Sept. 15, 2003), *available at* http://www.sec.gov/Archives/edgar/data/936468/000119312503050218/dex991.htm.

90. Press Release, U.S. SEC, Titan Updates Status of Review of International Consultants (Mar. 5, 2004), *available at* http://www,sec.gov/Archives/edgar/data/31158/000119312504065745/d425.htm.

the merger have been satisfied.[91]

Titan's FCPA scrutiny, which Lockheed could have inherited upon completion of the merger, resulted in a delay of the shareholder vote to approve the merger as well as an amended merger agreement extending the time period for the merger to occur. The amended merger agreement provided that "as a condition to the closing of the transaction, Titan must obtain written confirmation that the DOJ considers its investigation of these allegations resolved and does not intend to pursue any claims against Titan, or Titan must have entered into a plea agreement with the DOJ and completed the sentencing process."[92]

Ultimately, Titan's unresolved FCPA scrutiny caused Lockheed to abandon the merger because Titan "did not satisfy all the closing conditions."[93] Lockheed stated:

> Under the terms of the amended merger agreement, either party could terminate the merger agreement if Titan either (i) had not obtained written confirmation from the DOJ that the investigation of alleged FCPA violations was resolved as to Titan and the Department did not intend to pursue any claims against Titan; or (ii) Titan had not entered into a plea agreement [by a certain date] . . . Titan did not satisfy either requirement. . . . The corporation declined Titan's request for a further extension.[94]

In announcing termination of the merger, a Lockheed spokesperson said that the company "made every possible effort to make this happen, but it just reached a point where we didn't want the uncertainty surrounding this to continue indefinitely."[95]

Termination of the merger had several adverse consequences for Titan as well. In addition to losing an acquirer, news of the merger termination caused Titan's shares to fall by approximately 20% and investment analysts downgraded the company's stock.[96] Titan's FCPA scrutiny, of course, did not disappear and the company ultimately plead guilty to FCPA charges for, among other things, making payments through an agent of more than

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91. *Id.*

92. *Id.*

93. Press Release, U.S. SEC Lockheed Martin Terminates Merger Agreement with the Titan Corporation (June 26, 2004).

94. *Id.*

95. *Lockheed Drops Titan Merger After Delays by Bribery Probe*, L.A. TIMES, June 27, 2004, http://articles.latimes.com/2004/jun/27/nation/na-titan27.

96. *Id.*

$2 million to the election campaign of Benin's then-incumbent president. In resolving its FCPA scrutiny, Titan agreed to pay approximately $28 million in combined fine and penalty amounts, the largest FCPA settlement in history at the time.[97]

Termination of the Lockheed – Titan merger has lessons for both an acquiring company and a target company. For an acquiring company, FCPA-related due diligence of a target company should be part of the merger due diligence agenda so that potential FCPA issues can be learned in advance of closing. For a target company, implementing proactive FCPA compliance policies and procedures to minimize risk can increase the value of the company and its attractiveness to a potential acquiring company.

Not all instances of FCPA scrutiny have as severe an effect on merger activity as in the Lockheed – Titan example. However, as demonstrated by the below examples, FCPA scrutiny and enforcement actions can also result in restructuring of the terms and conditions of planned transactions and reduce the expected financial benefits of the transaction.

2. Restructuring

An instructive case study for how FCPA scrutiny can significantly impact the terms and conditions of a planned merger involved engineering companies PBSJ Corporation and WS Atkins. In 2010, PBSJ disclosed an FCPA internal investigation in connection with certain projects undertaken by its subsidiary.[98] A few months later, PBSJ disclosed that its "Audit Committee completed the internal investigation [and] [t]he results of that investigation suggest that FCPA violations may have occurred."[99]

Shortly thereafter, PBSJ announced that it had entered into a definitive merger agreement in which WS Atkins planned to acquire PBSJ in an all-cash transaction. Proxy materials filed by PBSJ in connection with the merger provided an informative insight into how the FCPA issues impacted the terms and conditions by which PBSJ would attempt to sell itself.

Among other things, the proxy materials highlighted the actions of interested purchasers of PBSJ including: holding meetings with PBSJ's outside counsel and its in-house counsel to discuss the FCPA investigation; requesting the opportunity to meet with DOJ representatives regarding the FCPA investigation; and requesting access to attorney-client privileged

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97. Press Release, Office of the U.S. Attorney S. Dist. of Cal. (Mar. 1, 2005), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/titan-corp/03-01-05titan-pr-plea.pdf.

98. *The FCPA's Long Tentacles*, FCPA PROFESSOR (Aug. 3, 2010), http://www.fcpaprofessor.com/the-fcpas-long-tentacles.

99. *Id.*

documents regarding the FCPA investigation.[100]

In the end, PBSJ's board approved a merger agreement with Atkins even though PBSJ had received a higher offer from another company. However, the other company sought more stringent closing conditions regarding PBSJ's FCPA scrutiny. In approving Atkin's bid, the PBSJ proxy materials stated:

> Positive factors considered by the [PBSJ] board of directors included: . . . the terms of the merger agreement and the related agreements, including: the limited number and nature of the conditions to Atkins' obligation to consummate the merger, including its willingness not to impose special conditions related to our previously disclosed FCPA investigation beyond those developments that would independently constitute a material adverse effect.[101]

3. *Reduced Financial Benefits*

FCPA scrutiny or an enforcement action can also reduce the full financial benefits expected from a merger by imposing significant post-closing expenses on the acquiring company for the target company's pre-closing FCPA scrutiny.

For instance, facilities services company ABM Industries Inc. disclosed:

> [The] Company [has] began an internal investigation into matters relating to compliance with the FCPA and the Company's internal policies in connection with services provided by a foreign entity affiliated with a Linc joint venture partner. Such services commenced prior to the Company's acquisition of Linc. As a result of the investigation, the Company has caused Linc to terminate its association with the arrangement. The Company [has] contacted the DOJ and the SEC to voluntarily disclose the results of its internal investigation to date. The Company cannot reasonably estimate the potential liability, if any, related to these matters.[102]

As indicated by the disclosure, ABM's FCPA scrutiny does not involve anything it did. Rather, ABM's scrutiny is based on a foreign entity

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100. *Id.*

101. *Id.*

102. *ABM Industries Discloses Merger Related Issue*, FCPA PROFESSOR (Dec. 26, 2011), http://www.fcpaprofessor.com/abm-industries-discloses-merger-related-issue (containing links to original source documents).

affiliated with a joint venture partner of a company ABM acquired. The value of the merger was approximately $300 million and it is already being reduced by the acquired company's FCPA scrutiny as ABM has spent approximately $6.2 million in pre-enforcement action professional fees and expenses.[103] Factoring in ABM's potential exposure based on an actual FCPA enforcement action, 5% of the merger value could easily evaporate due to the acquired company's FCPA scrutiny.

In addition, post-enforcement action professional fees and expenses can further reduce the expected financial benefits of a merger. For instance, Alliance One International resolved an FCPA enforcement action by agreeing to pay $19.5 million in combined fines and penalties.[104] The entire enforcement action was based on the pre-merger conduct of acquired entities and pursuant to the NPA Alliance One was required to engage a compliance monitor for three years. Two years into the NPA, Alliance One has disclosed approximately $10 million in post-enforcement action monitoring costs.[105]

D. *Lost or Delayed Opportunities*

FCPA scrutiny or enforcement can also result in several other wide-ranging negative business effects such as lost or delayed opportunities.

For instance, for several years Swiss logistics company Panalpina was under FCPA scrutiny for business conduct in Nigeria and in 2010 the company agreed to pay approximately $82 million to resolve DOJ and SEC enforcement actions.[106]

In the midst of this scrutiny, during the company's annual meeting a shareholder demanded that someone "step up and take responsibility" for the company's poor performance.[107] In response, Panalpina's CEO stated, among other things, that "it is not easy being under investigation for two years, and [the FCPA investigation] is not making the situation any

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103. ABM Industries, Inc., Annual Report (Form 10-K) (Dec. 18, 2013); ABM Industries, Inc., Annual Report (Form 10-K) (Dec. 20, 2012).

104. Press Release, U.S. Attorney's Office, E District of Va., *Alliance One International Inc. and Universal Corporation Resolve Related FCPA Matters Involving Bribes Paid to Foreign Government Officials* (Jan. 1, 2011), *available at* http://www.justice.gov/usao/vae/news/2010/08/20100806allianceonenr.html.

105. *FCPA Issues Can Reduce the Value of a Merger*, FCPA PROFESSOR (June 14, 2012), http://www.fcpaprofessor.com/fcpa-issues-can-reduce-the-value-of-a-merger.

106. Press Release, U.S. Dep't of Justice, *Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More Than $156 Million in Criminal Penalties* (Nov. 4, 2010), http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html.

107. *"It's Not Easy Being Under Investigation for Two Years ...,"* FCPA PROFESSOR (Mar. 15, 2010), http://www.fcpaprofessor.com/its-not-easy-being-under-investigation-for-two-years.

easier."[108] The company's Chief Operating Officer added:

> You can say the whole FCPA and Nigeria situation reflects badly on the management, but the fact is that as long as we are still involved in the investigation we will continue to lose market share, because our customers have internal regulations which prevent them from doing business with companies which are under investigation by the DOJ. As soon as this investigation is over, we will win some of this business back. Customers have told us 'as soon as you have settled the FCPA, we will do business with you again.'[109]

The lost business opportunities that can flow from FCPA scrutiny is perhaps best demonstrated by JPMorgan's FCPA scrutiny. In August 2013, the *New York Times* reported that "[f]ederal authorities have opened a bribery investigation into whether JPMorgan Chase hired the children of powerful Chinese officials to help the bank win lucrative business."[110] The *Times* article stated:

> In one instance, the bank hired the son of a former Chinese banking regulator who is now the chairman of the China Everbright Group, a state-controlled financial conglomerate . . . After the chairman's son came on board, JPMorgan secured multiple coveted assignments from the Chinese conglomerate, including advising a subsidiary of the company on a stock offering, records show. The Hong Kong office of JPMorgan also hired the daughter of a Chinese railway official. That official was later detained on accusations of doling out government contracts in exchange for cash bribes, the government document and public records show. The former official's daughter came to JPMorgan at an opportune time for the New York-based bank: The China Railway Group, a state-controlled construction company that builds railways for the Chinese government, was in the process of selecting JPMorgan to advise on its plans to become a public company, a common move in China for businesses affiliated with the government.[111]

There have been FCPA enforcement actions that have included allegations regarding the hiring of children or spouses of alleged "foreign officials,"[112] and the *Times* article caused JPMorgan, and other companies

108. *Id.*

109. *Id.*

110. Jessica Silver-Greenberg, Ben Protess & David Barboza, *Hiring in China by JPMorgan Under Scrutiny*, N.Y. TIMES, Aug. 17, 2013, http://dealbook.nytimes.com/2013/08/17/hiring-in-china-by-jpmorgan-under-scrutiny/.

111. *Id.*

112. *JPMorgan's Hiring Practices in China Under Scrutiny*, FCPA PROFESSOR

in the financial sector, to conduct internal reviews of hiring practices in China and elsewhere.

As a result of JPMorgan's FCPA scrutiny, the company has withdrawn from several lucrative financial deals. For instance, it was reported by the *Wall Street Journal* that JPMorgan "has withdrawn from underwriting midtier lender China Everbright Bank Co.'s $2 billion initial public offering in Hong Kong."[113] The reason given was that since its FCPA scrutiny surfaced, "deals have faced intense scrutiny from the U.S. bank's compliance division."[114] Similarly, it was soon thereafter reported that JPMorgan "has pulled out of a $1 billion initial public offering of a Chinese chemical company and won't seek a role in the IPO of a Chinese state-owned train maker, as the bank walks away from deals that could come under scrutiny from U.S. investigators probing its hiring practices in China."[115]

Investment bank IPO fees are typically 1.5% to 3% of the deal's size and JPMorgan's FCPA scrutiny has thus already caused it, mere months after its scrutiny arose, to withdraw from, or not pursue, business opportunities in excess of $100 million.[116] This lost business, along with pre-enforcement action professional fees and expenses, is likely to be the greatest financial consequence of JPMorgan's FCPA scrutiny.

FCPA scrutiny can also delay company growth and make general business conditions more difficult as further demonstrated by Wal-Mart's scrutiny. According to the *Wall Street Journal*, three years ago Wal-Mart set out to be India's top retailer by 2015. However, the article noted that "Wal-Mart's advance on India is barely moving" and one of the "biggest reasons has been a compliance crackdown at Wal-Mart" following its FCPA scrutiny.[117] The article stated that "developing and operating stores in India is complicated, even for locals" because "dozens of permits and licenses are required from various agencies down to the municipal level."[118]

(Aug. 19, 2013), http://www.fcpaprofessor.com/jpmorgans-hiring-practices-in-china-under-scrutiny.

113. Prudence Ho & Yvonne Lee, *J.P. Morgan Exits China IPO*, WALL ST. J. Nov. 19, 2013, http://online.wsj.com/news/articles/SB10001424052702303531204579207192426039728.

114. *Id.*

115. Prudence Ho, *J.P. Morgan Avoids Some Deals in China, Fearing U.S. Investigations*, WALL ST. J., Jan. 21, 2014, http://online.wsj.com/news/articles/SB10001424052702304757004579334393664105198.

116. Ho & Lee, *supra* note 113.

117. Megha Bahree, *Wal-Mart's Path to Power in India Hits Its Limits: The Lawyers*, WALL ST. J., Apr. 1, 2013, http://online.wsj.com/news/articles/SB10001424127887324373204578373830411211410.

118. *Id.*

In response to its FCPA scrutiny, the article noted that Wal-Mart has "enlisted a phalanx of lawyers from a U.S. firm to develop compliance procedures and train employees in India," and that "the company also has begun requiring its Indian landlords to attest that they haven't greased any government palms."[119] In short, "[r]unning people through those hoops has slowed" Wal-Mart's expansion plans in India.[120]

E. Other Effects

FCPA scrutiny can also be distracting for company management forced to focus on FCPA issues instead of other core business issues. For instance, Wal-Mart has disclosed that its FCPA issues "may require the involvement of certain members of the Company's senior management that could impinge on the time they have available to devote to other matters relating to the business."[121] In addition, Wal-Mart disclosed that its FCPA investigation "resulted in a significant increase in the workload" of its Audit Committee members and during 2014 the Audit Committee "conducted 13 additional meetings related to the investigation and compliance matters . . .".[122]

Another instructive example involved gas detection company RAE Systems. As previously highlighted, the company resolved related DOJ and SEC enforcement actions by agreeing to pay a combined $2.95 million in settlement amounts. In a revealing interview, the CFO at the time of the investigation and enforcement action discussed how the company's FCPA scrutiny came to derail his other job duties and caused him to have a falling out with the company's CEO.[123]

FCPA scrutiny can also negatively impact an executive's compensation. For instance, in the midst of Diebold's FCPA scrutiny the company's Compensation Committee reduced the cash bonus of the President and CEO concluding that "given the CEO's ultimate responsibility for the oversight of the company, as a result of the impact to the company of the global FCPA investigation it was appropriate that [his] cash bonus be reduced."[124]

Whether it's a negative impact on market capitalization or cost of

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119. *Id.*

120. *Id.*

121. *Scrutiny Alerts and Updates*, FCPA PROFESSOR (April 3, 2013), http://www.fcpaprofessor.com/scrutiny-alerts-and-updates.

122. *Friday Roundup*, FCPA PROFESSOR (Apr. 25, 2014), http://www.fcpaprofessor .com/friday-roundup-118.

123. *The Former CFO of RAE Systems Speaks*, FCPA PROFESSOR (Aug. 14, 2012), http://www.fcpaprofessor.com/the-former-cfo-of-rae-systems-speaks.

124. *Business Effects*, FCPA PROFESSOR (Mar. 21, 2012), http://www.fcpaprofessor .com/business-effects.

capital, a variety of negative effects on merger and acquisition activity, causing a company to lose or delay business opportunities, or impeding or distracting a company from achieving other business objectives, as highlighted in this Section, FCPA scrutiny and enforcement can negatively impact a business in a variety of ways separate and distinct from any actual enforcement action.

Because of these many ripples of FCPA scrutiny and enforcement, FCPA compliance needs to be on the radar screen of business managers operating in the global marketplace. By highlighting the many ripples of FCPA scrutiny and enforcement, the FCPA conversation should shift away from a purely legal issue to its more proper designation as a general business issue and more business managers should view the importance of FCPA compliance more holistically and not merely through the narrow lens of actual enforcement actions.

Indeed, the business effects of FCPA scrutiny and enforcement in this new era have become so pronounced that FCPA and associated risks have come to be included in the generic risks (such as loss of key personnel, global economic conditions, and currency fluctuations) companies disclose to investors as required in most SEC filings. The annual report of manufacturer Gardner Denver, Inc. provides a representative example. In its annual report filed with the SEC, the company disclosed, among other risk factors, the following:

> The risk of non-compliance with U.S. and foreign laws and regulations applicable to our international operations could have a significant impact on our results of operations, financial condition or strategic objectives. Our global operations subject us to regulation by U.S. federal and state laws and multiple foreign laws, regulations and policies, which could result in conflicting legal requirements. These laws and regulations are complex, change frequently, have tended to become more stringent over time and increase our cost of doing business. These laws and regulations include . . . anti-corruption and bribery laws such as the [FCPA] . . . and local laws prohibiting corrupt payments to government officials. We are subject to the risk that we, our employees, our affiliated entities, contractors, agents or their respective officers, directors, employees and agents may take actions determined to be in violation of any of these laws, particularly as we expand our operations geographically through organic growth and acquisitions. An actual or alleged violation could result in substantial fines, sanctions, civil or criminal penalties, debarment from government contracts, curtailment of operations in certain jurisdictions, competitive or reputational harm, litigation or regulatory action and other consequences that might adversely affect our

results of operations, financial condition or strategic objectives.[125]

Regardless of the FCPA's many ripples, business managers can at least find solace in the following: while FCPA scrutiny and enforcement does indeed have several direct and indirect negative effects on a company and is distracting to management, there is often a silver lining that results from FCPA scrutiny or enforcement.

Business managers involved in an FCPA investigation often learn detailed information about a variety of meaningful corporate issues including: the company's business in foreign countries; how the company operates in foreign countries; the personnel who run the business units and make the key decisions in foreign countries; and whether the company has effective internal controls.

During the stress and strain of FCPA scrutiny, company management (assuming they themselves are not culpable) often grow closer and develop a deeper trust of each other. In addition, the company's commitment to FCPA compliance (and compliance in general) often grows stronger. Given the motivation to improve, a company may try new things, such as aligning management compensation more closely to compliance metrics, and/or rewarding employees for compliance-related achievements. Nothing, of course, prevents company management from learning of these issues or taking these actions in the absence of FCPA scrutiny. However, the realities of the business world often put these proactive issues on the backburner.

Even Wal-Mart's FCPA scrutiny, likely the most high-profile and expensive instance of FCPA scrutiny in history, has a silver lining. For instance, during an investor conference call the following exchange occurred between an investment analyst and Wal-Mart's CEO.

> Analyst: ". . . I'm going to step into the FCPA issue, if I can . . . I think the investment community's already voted that it's not really an issue from our standpoint, in terms of financial issues, but it's obviously a big one reputationally and a big one that you had to deal with from a standpoint of the media and all of that . . . Which really, we think, are probably unfair because of a lot of good things that Wal-Mart has been involved in over the last decade and continues to be involved in. How do you use this opportunity? How do you think about it? I know [Wal-Mart executive vice president, general counsel] has got to think about it from protecting the Company and that's what that outside investigation is. But [CEO], you have to think about it from a standpoint of transparency, and how do you lift this up and then show the entire world how you handle

125. Gardner Denver, Inc., Annual Report (Form 10-K) (Feb. 27, 2013).

this situation and crisis, which has come to the Company and not at your desire, but from just those events that have transpired?
CEO: "One thing that's clear is that we will be a better company because of this. Sometimes when there's a situation, like this, you can treat it as a challenge or create an opportunity. And frankly, you can see we're already taking this as an opportunity to be a better company. And so even the focus on doing business the right way, and the initiatives of outreach to communities is something we're just going to be — you might say just doubling the efforts to be a better company in everything that we do. And frankly, I think it will just lead to long-term being a better company serving communities and serving customers. So yes, a short-term challenge; long-term, it creates us a greater opportunity to be even better.[126]

F. Shareholder Litigation

Although courts have held that the FCPA does not provide a private right of action,[127] plaintiffs' lawyers representing shareholders often target directors and executive officers of companies subject to FCPA scrutiny with civil suits alleging, among other things, breach of fiduciary duty or securities fraud. In other words, as this Section highlights, the FCPA's ripples can also reach individuals and not just business organizations.

Two types of FCPA-related shareholder lawsuits are discussed: derivative claims alleging director and officer breach of fiduciary duty and securities fraud class action claims. Before analyzing these two types of claims, it is instructive to understand how such claims often follow a predictable pattern. In the days and weeks following an FCPA enforcement action, or even a company disclosing or otherwise being the subject of FCPA scrutiny, purported investigations are launched by plaintiffs' firms representing shareholders and lawsuits often begin to rain down on the company, its board of directors or executive officers.

For instance, as discussed earlier in connection with market capitalization issues, shares of SciClone Pharmaceuticals plunged approximately 40% and closed down approximately 32% from its previous trading day based on the company's disclosure that it had received an SEC subpoena and a letter of inquiry from the DOJ as part of an industry-wide FCPA investigation of the pharmaceutical industry. A feeding frenzy followed, and on the *same day,* four separate plaintiffs' firms announced investigations of SciClone on behalf of shareholders to determine whether securities laws were violated. The *next day* four additional plaintiffs' firm announced similar investigations. The following days saw numerous other

126. *The Silver Lining*, FCPA PROFESSOR (June 7, 2012), http://www.fcpaprofessor.com/the-silver-lining.

127. Lamb v. Phillip Morris, Inc., 915 F.2d 1024, 1029 (6th Cir. 1990).

investigations and within *three days* of the disclosure, the first securities class action lawsuit was filed on behalf of certain SciClone shareholders. The plaintiffs' lawyers stated:

> The Complaint alleges that throughout the Class Period, defendants were engaged in illegal and improper sales and marketing activities in China and abroad regarding its products. This ultimately caused the Company to become the focus of a joint investigation by the [SEC and DOJ] for possible violations of the [FCPA]. It was only at the end of the Class Period, however, that investors ultimately learned the truth about the Company's operations after it was reported that the SEC and DOJ were investigating the Company for violations of the FCPA. At that time, shares of the Company declined almost 40% in the single trading day, on abnormally large trading volume.[128]

In the following days and weeks, numerous other plaintiffs' firms announced investigations and/or filed lawsuits against the company, its board of directors or executive officers.[129]

A similar feeding frenzy also followed the *New York Times* article regarding Wal-Mart's alleged conduct in Mexico. Within 48 hours, several plaintiffs' firms announced investigations on behalf of shareholders and within ten days shareholder civil suits tracking the *Times* article began to pour in against the company and its directors and executive officers. Approximately one month after the *Times* article, Wal-Mart disclosed:

> The Company is a defendant in several recently-filed lawsuits in which the complaints closely track the allegations set forth in a news story that appeared in the *New York Times*. One of these is a securities lawsuit . . . in which the plaintiff alleges various violations of the [FCPA] beginning in 2005, and asserts violations of [the securities laws] relating to certain prior disclosures of the Company. . . . In addition, eleven derivative complaints were filed . . . also tracking the allegations of the *Times* story, and naming various current and former officers and directors as additional defendants. The plaintiffs in the derivative suits . . . allege, among other things, that the defendants who are or were directors or officers of the Company breached their fiduciary duties in connection

128. *In the Blink of an Eye ... Along Comes a Securities Fraud Suit*, FCPA PROFESSOR (Aug. 19, 2010), http://www.fcpaprofessor.com/in-the-blink-of-an-eye-along-comes-a-securities-fraud-suit.

129. *See SciClone - An FCPA Feeding Frenzy*, FCPA PROFESSOR (Oct. 13, 2010), http://www.fcpaprofessor.com/sciclone-an-fcpa-feeding-frenzy (listing 18 firms who released statements concerning SciClone in the two weeks after the FCPA disclosure).

with oversight of FCPA compliance.[130]

1. Derivative Actions

The internal affairs of a corporation, such as the rights and responsibilities of corporate directors, are governed by state law. State law, including most prominently Delaware law, provides directors broad discretion to manage the corporation subject to their fiduciary duties to the corporation and its shareholders. A director's fiduciary duties include the duty of care and the duty of loyalty, including its subsidiary component the duty of good faith.

In a notable case in the corporate director context, a court observed:

> The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect . . . Shareholders have a right to expect that directors will exercise reasonable supervision and control over the policies and practices of a corporation. The institutional integrity of a corporation depends upon the proper discharge by directors of those duties.[131]

A corporate director's duty of good faith has evolved over time to include an obligation to attempt in good faith to assure that an adequate corporate information and reporting system exists. In the notable *Caremark* decision by the influential Delaware Court of Chancery, the court held that a director's failure to do so, in certain circumstances, may give rise to individual director liability for breach of fiduciary duty.[132]

In *Stone v. Ritter*, the Delaware Supreme Court provided the following necessary conditions for director oversight liability under the so-called *Caremark* standard: (i) a director utterly failed to implement any reporting or information system or controls; or (ii) having implemented such systems or controls, a director failed to monitor or oversee the corporation's operations.[133] The court held that both situations require a showing that a director knew that they were not discharging their fiduciary obligations and courts have widely recognize that a director's good faith exercise of oversight responsibility may not necessarily prevent employees from violating criminal laws or from causing the corporation to incur significant financial liability or both.[134]

Derivative claims in the FCPA context "are often based on one or more

130. *Friday Roundup*, FCPA PROFESSOR (June 8, 2012), http://www.fcpaprofessor.com/friday-roundup-43.

131. Francis v. United Jersey Bank, 432 A.2d 814, 822-24 (N.J. 1981).

132. *In re* Caremark Int'l Inc., 698 A.2d 959, 967 (Del. Ch. 1996).

133. Stone v. Ritter, 911 A.2d 362, 364 (Del. 2006).

134. *Id.* (quoting Guttman v. Huang, 823 A.2d 492, 506 n. 34 (Del. Ch. 2003)).

of the following alleged actions or failures of directors and/or officers:

- participation in, concealment of, or failure to prevent the FCPA violations;
- preparation, review, and/or signing of false and misleading public statements;
- failure to comply with the company's code of business conduct or similar policy requiring FCPA compliance;
- failure to require the company to implement internal controls in compliance with the FCPA's antibribery provisions or books, records, and internal accounting provisions;
- failure to monitor the company's compliance with, or implement mechanisms for enforcement of, the company's anti-corruption policies and procedures;
- failure to implement information and reporting systems to ensure senior management and the board of directors have adequate information about the company's business and operations, material events, and compliance;
- failure to fulfill the responsibilities and duties of membership on committees of the company's board of directors;
- failure to remedy any illegal conduct or direct the company to institute suit against current or former board members and officers for permitting FCPA violations; and
- failure to oversee, manage, and operate the company in a lawful and ethical manner."[135]

A derivative claim against directors and officers of oil and gas services company Tidewater Inc. after the company resolved an FCPA enforcement is representative of the type of derivative claims frequently brought in the FCPA context.[136] In dismissing the complaint against the individual

135. Jeffrey S. Johnston & Erika A. Tristán, *The Next FCPA Battleground:Private Civil Lawsuits Following Foreign Corrupt Practices Act Settlements with U.S. Government Authorities*, VINSON & ELKINS LITIG. NEWS, Winter 2011 at 8, *available at* http://www.velaw.com/uploadedFiles/VEsite/Resources/VELitigationNewsWinter2011.pdf.

136. Press Release, U.S. Dep't. of Justice, Oil Services Companies and a Freight Forwarding Company Agree to Resolve Foreign Bribery Investigations and to Pay More than $156 Million in Criminal Penalties (Nov. 4, 2010), *available at* http://www.justice.gov/opa/pr/2010/November/10-crm-1251.html. There are unique pleading requirements associated with derivative claims. Ordinarily, a company's board of directors has the exclusive authority to institute corporate action such as filing a lawsuit on behalf of the corporation when it has been harmed. However, when the harm to the corporation is the result of an alleged breach of fiduciary duty by the directors, the law recognizes that the board of directors is unlikely to sue itself in such a situation. Thus, the law provides a mechanism for shareholders to bring a lawsuit, not in their individual capacity, but on behalf of the corporation to recover monetary damages for the corporation. Because this derivative action usurps a traditional board of directors function and can be subject to harassment and abuse, state law often requires shareholders to first make a demand on the corporation to file suit or to plead with particularity so-called demand futility, meaning that demand on the board would be futile because the board is incapable of making an independent judgment concerning

defendants, the court concluded:

> The Complaint merely recites instances whereby certain Individual Defendants, notably not a majority of them, signed financial forms and that audit committee meetings took place. Even taking these as true, nowhere in these allegations is there any indication of a knowing discharge of their fiduciary duties or a conscious disregard of those duties. To have a substantial likelihood of director liability on an oversight claim, a plaintiff must plead the existence of facts suggesting that the board knew that internal controls were inadequate, that the inadequacies could leave room for illegal or materially harmful behavior, and that the board chose to do nothing about the control deficiencies that it knew existed. The Plaintiff has not alleged any acts to suggest that Tidewater's internal controls were deficient, much the less that the board or the Audit Committee had any reason to suspect that they were so. The conclusory allegation that because illegal behavior occurred, internal controls must have been deficient and the board must have known so has been routinely rejected. Ultimately, the Complaint falls woefully short of pleading facts that are sufficient to show that there was any knowledge or conscious disregard on behalf of the directors. As a result, the Plaintiff has failed to plead its claim with particularity and demand is not excused. . . . While Plaintiff's allegations are sufficient to show that Tidewater was evidently violating both the FCPA and the Exchange Act, nowhere in the Complaint do Plaintiff's allegations meet the specificity to show that the Individual Defendants were acting with the intent to violate these laws. The mere fact that a violation occurred does not demonstrate that the board acted in bad faith. Alleging that 'upon information and belief' the 'Headquarters' made the decision to avoid tax assessments in violation of the FCPA falls woefully short of the pleading requirements. Nowhere can this Court find who made this decision, how this decision was made or that there was an intent to violate any law. Moreover, the Court finds it significant that Tidewater's directors voted and voluntarily initiated an FCPA investigation and advised the federal government of their violations before the government even suspected any violations.[137]

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the conduct at issue. Most derivative actions, including those in the FCPA context, are brought as demand futility cases because if a shareholder makes a demand on the board of directors to bring the claim it will be assumed that the shareholder views the board of directors as sufficiently independent to analyze the claim and the board's decision will be analyzed under the board-friendly business judgment rule. To survive a motion to dismiss, a shareholder pleading demand futility must allege more than conclusory allegations regarding a breach of fiduciary duty. Rather, the shareholder must allege with particularly facts suggesting that the majority of directors were interested; that the directors failed to inform themselves; or that the directors failed to exercise due care as to the conduct at issue.

137. Strong v. Taylor, 877 F.Supp.2d 433 (E.D. La. 2012).

Not only was the Tidewater derivative claim representative of the type of derivative claims frequently brought in the FCPA context, it was also representative of the outcome. According to an analysis by Professor Amy Westbrook, "the majority of the recent shareholder derivative suits filed in the wake of FCPA actions have been dismissed, a handful have settled, and none have been fully litigated on the merits."[138]

2. Securities Fraud Actions

As previously highlighted, FCPA scrutiny can impact a company's share price. Thus, it is not surprising that securities fraud class actions are another frequent form of shareholder litigation following an instance of FCPA scrutiny.

The securities laws are based on the general premise that issuers must make full and complete disclosure of all material facts relevant to its business. Although materiality is a murky concept, courts have construed this key concept to mean all information, whether positive or negative, that might be relevant to an investor's decision to buy, sell, or hold a security.[139]

The securities laws' foundation of full and complete disclosure of all material facts is enforced through, among other provisions, Section 10(b) of the Exchange Act and its associated Rule 10b-5. Section 10(b) generally prohibits the use of "any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the SEC may prescribe as necessary or appropriate in the public interest or for the protection of investors." Rule 10b-5 supplements Section 10(b) by making it unlawful for any person, directly or indirectly – (i) to employ any device, scheme or artifice to defraud; (ii) to make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements not misleading; or (iii) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person – in connection with the purchase or sale of any security.

Securities fraud claims in the FCPA context generally "allege that a company's public disclosures regarding potential FCPA violations and/or the potential settlement with the DOJ or the SEC were misleading in themselves or were proof of material misstatements in the company's prior public statements regarding one or more of the following topics:

- the nonexistence of FCPA violations and improper accounting of funds

138. Amy Westbrook, *Double Trouble: Collateral Shareholder Litigation Following Foreign Corrupt Practices Act Investigations*, 73 OHIO ST. L.J. 1217, 1228 (2012).

139. *See, e.g.*, Basic Inc. v. Levinson, 485 U.S. 224, 231 (1988).

used in illegal activity;
• the quality of the company's internal controls;
• the company's general compliance with corporate policies, the FCPA, and other applicable laws;
• the risks and costs associated with an FCPA investigation, including legal and consulting fees and disruptions to the company's operations;
• predictions regarding the results, effects, or ultimate materiality of a FCPA-related investigation;
• the company's profitability or financial performance following the cessation of illegal activity and/or any decision to suspend certain operations due to illegal conduct; and
• the financial impact of increased monitoring expenses."[140]

In such cases plaintiffs typically allege that because of the issuer's false statements or omissions "(1) the market price of the company's securities was artificially inflated and maintained, and (2) shareholders suffered losses when the stock price fell following the issuance of corrective disclosures and the materialization of risks previously concealed by the defendants (i.e., then the "truth" was revealed)."[141]

If an FCPA-related securities fraud class action is fully litigated, plaintiffs face a heightened pleading standard that is often difficult to satisfy.[142] For instance, an institutional investor alleged that InVision Technologies, along with its CEO and CFO, violated section 10(b) of the Exchange Act and Rule 10b–5 in connection with alleged misstatements in its merger agreement.[143] The civil action followed InVision's settlement of an FCPA enforcement action based on payments to foreign sales agents in China, the Philippines, and Thailand.[144] The enforcement agencies alleged that InVision knew of the "high probability" that the payments to the agents would be used to make improper payments to foreign officials and also alleged that InVision failed to maintain proper internal controls and failed to adequately train its foreign third parties.[145]

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140. Johnston & Tristan, *supra* note 135, at 8.

141. *Id.*

142. Under the heightened pleading standard in the Private Securities Litigation Reform Act ("PSLRA") complaints alleging misrepresentations or omissions under Rule 10b-5 must specify each statement alleged to have been misleading, the reason or reasons why the statement is misleading, and, if an allegation regarding the statement or omission is made on information and belief, the complaint shall state with particularlity all facts on which that belief is formed.

143. Glazer Capital Mgmt., LP v. Magistri, 549 F.3d 736, 739 (9th Cir. 2008).

144. *See generally*, Agreement Between the U.S. Dep't of Justice, Criminal Div., Fraud Section & InVisionTechs., Inc. (Dec. 3, 2004), *available at* http://www.justice .gov/criminal/fraud/fcpa/cases/invision-tech/12-03-04invisiontech-agree.pdf.

145. *See id.* at App. A at 2.

In the civil action, plaintiff alleged that the merger agreement contained the following misstatements:

> First, . . . the agreement broadly warrants that InVision is 'in compliance in all material respects with all lawsFalse' Second, . . . the agreement provides that InVision was in compliance with the [FCPA's] books and records provisions. Finally, . . . the agreement provides: 'neither the Company . . . nor, to the knowledge of the Company, any director, officer, agent, employee or other person acting on behalf of the Company' has violated the [FCPA's] anti-bribery provisions[.][146]

The court noted the heightened pleading requirements applicable to the securities fraud claim and the requirement that, among other things, the plaintiff state with particularly facts giving rise to a strong inference that the defendants acted with intent to deceive, manipulate or defraud. A disputed issue was whether the plaintiff "was required to plead scienter as [to specific individuals], or whether it can rely on a theory of 'collective scienter,' which would hold the company as a whole responsible for the statements contained in the merger agreement."

The appellate court held that the plaintiff was required to "plead scienter with respect to the individuals who actually made the false statements in the merger agreement." In so holding, the court also observed:

> [Plaintiff] argues that the settlement agreements InVision entered into with the DOJ and SEC are sufficient to create a strong inference of scienter. In those agreements, InVision accepted responsibility for misconduct and admitted that the company 'was aware of the high probability that its foreign sales agents or distributors paid or offered to pay something of value to government officials in order to obtain or retain business for InVision.' The company further admitted that it 'improperly accounted for certain payments . . . in its books and records in violation of the FCPA.' The district court correctly held that these agreements were not sufficient to meet the pleading requirements of the PSLRA. First, the admissions in these settlement agreements were largely legal conclusions, rather than particularized facts giving rise to a strong inference of scienter. More importantly, even if InVision accepted the SEC's and DOJ's statements of fact, there is nothing in either settlement agreement that would support the conclusion that [any specific individuals] had actual knowledge of the violations. As discussed earlier, the mere fact that someone at InVision had knowledge of the illegal transactions is not sufficient to satisfy the scienter pleading requirements of the PSLRA, given the context and limited nature of the

146. *Glazer Capital*, 549 F.3d at 741–42.

misrepresentations at issue.[147]

Although plaintiffs face a heightened pleading requirement in an FCPA-related securities fraud action that is often difficult to satisfy, few such cases are actually litigated. Rather, most cases settle and according to an analysis by Professor Westbrook, "a number of FCPA-related securities fraud suits have settled for amounts in excess of the penalty assessed by the DOJ and/or SEC" in the underlying FCPA enforcement action.[148]

However, just because certain FCPA-related securities fraud class actions have settled does not mean that such actions would have succeeded on the merits. Companies often make the business decision to settle shareholder litigation (whether derivative actions or securities fraud class actions in the FCPA context or otherwise) for nuisance value and backed by insurance coverage.

A typical corporate position concerning settlement of FCPA-related shareholder litigation was articulated by the Chief Financial Officer of Maxwell Technologies, a company that resolved an FCPA enforcement action in 2011.[149] During an investor call, the CFO stated:

> As we have disclosed in past public filings in 2010, two shareholders had alleged that certain of our past and current officers and directors failed to prevent us from violating the [FCPA]. . . . [M]ediation was held and a proposed settlement was reached wherein $3 million would be paid to plaintiff's counsels, with $2.7 million to be paid by our insurance carrier, and $290,000 would be paid by the Company. In addition, we would be required to insure that certain corporate governance measures are in place and in force. The agreement is subject to among other things, court approval and notice to our shareholders. Without admitting any wrongdoing, the defendants to this suit are willing to enter into this settlement in order to expedite resolution of the matter, and to relieve the defendants and the Company from further financial burden. We are pleased that this suit is near final settlement, and look forward to putting this matter behind us.[150]

As highlighted in this Section, another of the FCPA's many ripples in this new era is plaintiffs' civil suits against directors and executive officers

147. *Id.* at 748–49.

148. Westbrook, *supra* note 138, at 1246.

149. Press Release, U.S. Dep't. of Justice, Maxwell Technologies Inc. Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay $8 Million Criminal Penalty (Jan. 31, 2011), http://www.justice.gov/opa/pr/2011/January/11-crm-129.html.

150. *Friday Roundup,* FCPA PROFESSOR (Mar. 2, 2012), http://www.fcpaprofessor.com/friday-roundup-33.

of companies subject to FCPA scrutiny or enforcement. This is a fact. However, just as with many other FCPA ripples discussed in this Article, probing questions need to be asked whether the majority of shareholder litigation in the FCPA context serves a purpose or is merely a parasitic attempt to feed-off of FCPA scrutiny and enforcement in this new era.

Indeed, in this new era of FCPA enforcement a component of FCPA Inc. includes plaintiffs' firms who frequently pounce on FCPA enforcement actions or instances of FCPA scrutiny. Commenting on this trend, a Forbes columnist wrote under the title "Plaintiff Lawyers Join The Bribery Racket" as follows:

> The Justice Department's unprecedented campaign to enforce a once-backwater statute called the [FCPA] has made corporate lawyers and accountants rich as big companies pay big law and accounting firms to investigate and defend potential violations. Plaintiff lawyers have noticed the enormous fees, which are often reaching into the hundreds of millions of dollars, enhanced FCPA enforcement is generating and are moving to extract their own cut. . . . The unintended consequences of the Justice Department's FCPA policy simply continue to mount. . . . Now the plaintiff lawyers are trying to join the fun. . . . What is clear is that the cost of enhanced FCPA enforcement on U.S. corporations keeps going up. And that more lawyers are finding ways to get rich off of it.[151]

When a company's FCPA violations are the result of board of director or executive officer conduct, or the condoning or encouraging of such conduct by those with fiduciary duties, such civil suits or investigations would seem to be warranted and in the public interest. While there have been a few FCPA enforcement actions alleging such conduct[152], in the vast majority of FCPA enforcement actions the enforcement agencies do not allege any knowledge, participation, or acquiescence in the conduct at issue by the board of directors or executive officers.[153]

Rather, based on respondeat superior, a company faces FCPA exposure because of the actions of a single or small group of employees whose conduct was often in violation of the company's pre-existing FCPA

151. Nathan Vardi, *Plaintiff Lawyers Join The Bribery Racket*, FORBES (Aug. 16, 2010 9:04 AM), http://www.forbes.com/sites/nathanvardi/2010/08/16/plaintiff-lawyers-fcpa-bribery-racket/.

152 Information, United States v. Siemens Aktiengesellschaft (D.D.C filed Dec. 12, 2008), *available at* http://www.justice.gov/criminal/fraud/fcpa/cases/siemens/12-12-08siemensakt-info.pdf.

153. *See, e.g.*, Alcoa Inc, Exchange Act Release No. 3525, 2014 WL 69457 at *9 (Jan. 9 2014) (stating that there were "no findings that an officer, director or employee of Alcoa knowingly engaged in the bribe scheme.").

compliance policies and procedures and the company's good faith efforts to comply with the law. In this typical scenario, shareholder litigation would seem to be merely an attempt by plaintiffs' lawyers to feed-off this new era of FCPA enforcement.

Testimony at a 2011 House Judiciary Committee hearing by a witness appearing on behalf of the Chamber of Commerce highlighted the parasitic nature of much shareholder litigation in the FCPA context and its negative effects. At the hearing, the witness highlighted specific areas of "substantial litigation abuse," including "private lawsuits that piggyback on government investigations."[154] The majority of the testimony focused on the FCPA and the witness stated:

> More recently, the piggyback-litigation phenomenon has been most noticeable with respect to [FCPA] enforcement proceedings brought by the [DOJ and SEC]. These piggyback cases tend to fall into two categories: (1) shareholder class actions alleging that a company did not adequately disclose its FCPA exposure; and (2) derivative actions against officers and directors alleging that they failed to prevent a company from bribing foreign officials.
>
> Follow-on FCPA cases target companies at a difficult time. Companies going through DOJ or SEC FCPA enforcement proceedings often spend tens of millions of dollars, if not more, on attorneys and forensic accountants – on top of potentially multimillion-dollar criminal and civil fines and disgorgement – in order to determine whether their employees (often at a relatively low level) acted improperly. Enforcement proceedings also interrupt normal business operations, as companies make employees and documents available to lawyers, and take action against truly culpable employees. The investigations themselves are disclosable events and are almost always 'bad news,' resulting in negative publicity. Shareholder suits against companies involved in enforcement proceedings threaten to further delay the companies' ability to return to normal operations and to further damage shareholder value. These suits serve no purpose but to take money from current shareholders and transfer it to former (or other) shareholders – with a hefty slice cut out for the plaintiffs' lawyers.
>
> Derivative shareholder suits are equally problematic in this arena. These suits tend to target senior officers and directors, not the employees who actually paid any bribes or condoned others paying them. The reason is simple enough: directors and officers are backed by the deep pockets of

154. *Can We Sue Our Way to Prosperity?: Litigation's Effect on America's Global Competitiveness: Hearing Before the Subcomm. on the Constitution of the H. Comm. on the Judiciary*, 112th Cong. 29 (2011) (statement of John H. Beisner, Partner, Skadden, Arps, Slate, Meagher & Flom LLP).

> the company's [Director and Officer's] insurer; culpable employees have little money to pay in private civil damages, especially if they themselves have been the target of an individual enforcement proceeding.
>
> Often, lawyers filing shareholder class actions against companies under investigation or derivative actions against directors and officers of a company under investigation do not even wait until the government investigation is complete. Such tactics are particularly egregious, because they necessarily involve the company and senior management in defending against a private civil suit – and in making strategic judgments regarding such defense – when their focus should be on resolving the government's investigation. Both the DOJ and the SEC have developed leniency policies for companies that actively assist in government investigations. These policies acknowledge that U.S. government resources are limited, and that cooperating companies can materially assist the government in enforcing the law and protecting shareholders. As part of cooperating with the government, companies in FCPA investigations frequently investigate their own potential wrongdoing and self-report misconduct to the government. When companies and their senior officers and directors face personal civil liability in addition to any exposure to the DOJ and SEC, their judgments regarding what issues to investigate and what results to report to the DOJ and SEC necessarily will be affected, possibly to the detriment of the integrity of the government's investigation.[155]

As with many issues in this new era of FCPA enforcement, FCPA-related shareholder litigation seems to have spiraled out of control and an FCPA practitioner rightly observed:

> Setbacks in court do not appear to have slowed the pace of new cases filed against corporations and their directors after FCPA disclosures. As the DOJ and SEC bring more cases, and as more companies voluntarily disclose potential FCPA violations, the trend of related civil litigation is likely to continue. In attempting to satisfy the expectations of the DOJ and SEC, a company's thorough internal investigation may also serve as the roadmap for a civil litigant. Companies negotiating with the DOJ and SEC must therefore balance the government's requests for the results of internal investigations with the risk of waiver of privilege and subsequent production to civil litigants. As a result of these practical considerations, reputational risk, and expenses involved in litigation, companies targeted by civil suits will feel pressure to settle, potentially even before the DOJ or SEC takes action.[156]

155. *Id.*

156. James G. Tillen and Lauren H. Torbett, *Multiplying the Risks: Parallel Civil*

Regardless of the substantive merits of much FCPA-related shareholder litigation, the fact remains that such civil litigation following an FCPA enforcement action or instance of FCPA scrutiny represents yet another instance of the FCPA's many ripples.

G. Offensive Use of the FCPA

Whether it's a DOJ or SEC FCPA enforcement action or an FCPA-related civil suit by plaintiffs' lawyers representing shareholders, companies are ordinarily in a defensive posture when it comes to the FCPA. Even if a company is not involved in an FCPA investigation or related litigation, the FCPA still usually frustrates a business objective such as not acquiring a foreign target or not engaging a foreign agent because of FCPA risk. While such defensive positions continue to dominate, this Section highlights how the FCPA is increasingly being used offensively by companies to achieve a business objective or to further advance a litigating position.

For instance, in 2013, Dish Network and Tokyo-based SoftBank were battling for control of wireless carrier Sprint Nextel. Among the regulatory approvals needed for SoftBank to complete the transaction was Federal Communications Commission's ("FCC") approval of a license transfer from Sprint Nextel to SoftBank. In opposing the transfer, Dish Network cited a 2009 FCPA enforcement action against UTStarcom in which the company agreed to pay $3 million via a DOJ NPA and SEC civil settlement "for the actions of UTS-China (its wholly-owned subsidiary) and its employees and agents, who arranged and paid for employees of Chinese state-owned telecommunications companies to travel to popular tourist destinations in the United States, including Hawaii, Las Vegas and New York City."[157]

The link Dish Network made between the FCPA enforcement action and its battle with SoftBank for Sprint Nextel was that Softbank's founder Masayoshi Son was on the board of UTStarcom during certain time periods relevant to the conduct at issue in the FCPA enforcement action. Dish Network asserted that the UTStarcom enforcement action was "relevant to the public interest analysis of the proposed transaction."[158] In reply,

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Litigation in FCPA Investigations, 2 BLOOMBERG L. REPS. – White Collar Crime, no. 10, 2010, *available at* http://www.millerchevalier.com/portalresource/lookup/poid/Zl tOl9NP10LTYnMQZ56TfzcRVPMQiLsSwG3Em83!/document.name=/miller_chevalier_tillen_torbett_article.pdf.

157. *"Offensive" Use of the FCPA*, FCPA PROFESSOR (June 6, 2013), http://www.fcpaprofessor.com/offensive-use-of-the-fcpa.

158. *Id.*

Softbank stated that the UTStarcom enforcement action was not relevant to its attempt to gain control of Sprint Nextel and asserted:

> [The enforcement action did] not involve SoftBank or Mr. Masayoshi Son, Chairman and CEO of SoftBank. The settlement documents do not name, implicate, or otherwise relate to SoftBank or Mr. Son, and are legally and factually irrelevant to this proceeding."
> "DISH suggests that these settlements raise a potential issue in this proceeding because Mr. Son at one time served as the Chairman of the Board of UTSI. Neither the DOJ or SEC settlement documents, however, even mention SoftBank or Mr. Son. This is hardly surprising. Mr. Son was not an operating officer of UTStarcom at any time and the alleged violations came to light years after Mr. Son left the Board, which he did in 2004. The FCPA-related misconduct, according to the settlement documents, involved an executive of the company's Chinese subsidiary, UTStarcom China Co., Ltd.[159]

Another example of offensive use of the FCPA in a battle for corporate control involved Central European Distribution Corporation ("CEDC"), a large vodka producer headquartered in the U.S. In 2012, CEDC disclosed:

> There has been a breach of the books and records provisions of the [FCPA] and potentially other breaches of the FCPA. It was determined that payments or gifts were made in a foreign jurisdiction in which the Company operates, and that there was a failure to maintain documentation in respect of certain of these payments or gifts adequate to establish whether there was a valid business purpose in making the payments or gifts. Furthermore, our management also identified a material weakness in our internal control over financial reporting regarding the implementation of our policy on compliance with applicable laws. . . . Our conclusion that this deficiency is a material weakness in our internal control over financial reporting is not based on misstatements in our historical consolidated financial statements or our consolidated financial statements, . . . but instead on the determination that we did not design or maintain sufficient policies, procedures, controls, communications or training to deter or prevent the risk of violations of law, including the [FCPA].[160]

Shortly thereafter, Russian billionaire Roustam Tariko, the founder of CEDC's rival Russian Standard and CEDC's largest shareholder, claimed

159. *Id.*

160. *Friday Roundup*, FCPA PROFESSOR (Oct. 12, 2012), http://www.fcpaprofessor.com/friday-roundup-61.

that CEDC executives themselves were the subject of an FCPA investigation. The claims of CEDC's largest shareholder caused the company to issue a letter to shareholders that stated:

> As you may be aware . . . Mr. Roustam Tariko, Chairman of Russian Standard, published a letter to CEDC investors that has created anxiety and confusion in the marketplace. What you may not be aware of is that Mr. Tariko's letter was published less than 48 hours after the CEDC Board voted 5 to 3 (the 3 being Mr. Tariko and his Board designees) against Mr. Tariko's request that he be given total control over CEDC's operations and finance. This request follows repeated attempts by Russian Standard to remove the interim CEO. The purpose of this letter is to provide you with [among other things] correct information regarding FCPA matters.[161]

The letter then stated that "despite suggestions in the Russian Standard letter to the contrary, the company is NOT on notice that any of its current executives are under investigation with respect to FCPA violations or otherwise."[162]

Perhaps the most high-profile instance of offensive use of the FCPA involved the boardroom battle between Wynn Resorts and its board member Kazuo Okada. In early 2012, Wynn Resorts disclosed:

> In May 2011, Wynn Macau, a majority owned subsidiary of Wynn Resorts, Limited (the "Company"), made a commitment to the University of Macau Development Foundation in support of the new Asia-Pacific Academy of Economics and Management. This contribution consists of a $25 million payment made in May 2011 and a commitment for additional donations of $10 million each year for the calendar years 2012 through 2022 inclusive. The pledge was consistent with the Company's longstanding practice of providing philanthropic support for deserving institutions in the markets in which it operates. The pledge was made following an extensive analysis which concluded that the gift was made in accordance with all applicable laws. The pledge was considered by the Boards of Directors of both the Company and Wynn Macau and approved by 15 of the 16 directors who serve on those boards. The sole dissenting vote was Mr. Kazuo Okada whose stated objection was to the length of time over which the donation would occur, not its propriety. Also as previously disclosed, Mr. Okada commenced litigation . . . in Nevada seeking to compel the Company to produce information relating

161 *See id.*
162. *Id.*

> to the donation to the University of Macau, among other things. . . . Following Mr. Okada's lawsuit, the Company received a letter from the [SEC] requesting that, in connection with an informal inquiry by the SEC, the Company preserve information relating to the donation to the University of Macau, any donations by the Company to any other educational charitable institutions, including the University of Macau Development Foundation, and the Company's casino or concession gaming licenses or renewals in Macau. The Company intends to fully comply with the SEC's request.[163]

While Wynn's disclosure did not specifically mention the FCPA, given that the company's disclosure of the SEC inquiry appeared to link the donation to the "Company's casino or concession gaming licenses or renewals in Macau," the disclosure implicated the FCPA. As Okada alleged in his complaint "Wynn Macau's gaming concession expires in June 2022 – the last year of Wynn's donation commitment." According to Okada's complaint, he objected to the donation, called it unprecedented in University history, and claimed that the Chinese government owned the land on which the University is located.

Shortly thereafter, Wynn accused Okada of separate and distinct conduct that could implicate the FCPA. In a press release, Wynn announced that its "Compliance Committee has concluded a year-long investigation after receiving an independent report detailing numerous apparent violations of the [FCPA] by Aruze USA, Inc., its parent company Universal Entertainment Corporation, and its principal shareholder, Kazuo Okada."[164]

In the release, Wynn noted that its Compliance Committee engaged a variety of experts, including Louis Freeh (the former Director of the FBI), who conducted "a thorough independent investigation" which "uncovered and documented more than three dozen instances over a three-year period in which Mr. Okada and his associates engaged in improper activities for their own benefit in apparent violation of U.S. anti-corruption laws and gross disregard for the Company's Code of Conduct."[165] According to the release, "Mr. Okada and his associates and companies appear to have engaged in a longstanding practice of making payments and gifts to his two chief gaming regulators at the Philippines Amusement and Gaming Corporation, who directly oversaw and regulated Mr. Okada's Provisional

163. *Wynn Resorts $135 Million University of Macau Donation the Subject of SEC Scrutiny*, FCPA PROFESSOR (Feb. 14, 2012), http://www.fcpaprofessor.com/wynn-resorts-whopping-135-million-university-of-macau-donation-the-subject-of-sec-scrutiny.

164. *Wynn's Boardroom Battle Royale*, FCPA PROFESSOR (Feb. 20, 2012), http://www.fcpaprofessor.com/wynns-boardroom-battle-royale.

165. *Id.*

Licensing Agreement to operate in that country."[166]

The Wynn releases further stated:

> The Board has requested that Mr. Okada resign as a Director of Wynn Resorts. The Company will immediately inform the Board of Directors of its Hong Kong listed subsidiary, Wynn Macau, Limited, of its actions and will recommend that Mr. Okada be removed from the Wynn Macau Board. ... The Freeh Report is the culmination of a year-long investigation by the Compliance Committee based on increasing concerns the Board had relating to the activities of Mr. Okada and Aruze USA, Inc. in the Philippines and statements made by Mr. Okada to Wynn Resorts' Directors that gifts to regulators are permissible in Asia. Mr. Okada is the only Director of Wynn Resorts who has continued to refuse to sign the Company's Code of Conduct or participate in mandatory Foreign Corrupt Practices Act training for Directors."[167]

Wynn's FCPA allegations against Okada were used by the company to support its finding that Okada was an "unsuitable person" under Nevada gaming regulations thus justifying Okada's removal from Wynn's board.[168] Moreover, the boardroom battle occurred in the context of Wynn's attempt to purchase Okada's 20% stake in Wynn at an approximate 30% discount. Okada ultimately resigned from Wynn's board and in doing so stated: "I no longer believe it is appropriate for me to serve on the Board of Directors

[redacted]

largest aluminum smelters in the world owned by, among others, the

[redacted]

Virginia Business Conspiracy Act.[174] Innospec agreed to resolve the case by agreeing to pay NewMarket approximately $45 million.[175]

The trend of offensive use of the FCPA to advance litigating positions is not just limited to business organizations. Individuals are also increasingly former President of the company's Macau operations, filed a civil complaint against the company alleging breach of contract and tort-based causes of action.[178] Jacobs alleged, among other things, that the company's "notoriously bellicose" CEO and majority shareholder made several "outrageous demands" upon him, including "demands that Sands China continue to use the legal services of a Macau attorney . . . despite concerns

civil lawsuit has led to enforcement agency scrutiny of Las Vegas Sands under the FCPA and other laws.

While the FCPA is a law exclusively enforced by the DOJ and SEC, the take-away point from Part II of this Article is that the FCPA has many other ripples as well. Whether it is the many negative business effects of FCPA scrutiny, FCPA-related civil litigation against corporate directors or executives, or offensive use of the FCPA to achieve a business objective or advance litigating positions, actual FCPA enforcement actions by the enforcement agencies are often only a relatively minor component of the overall business consequences that can result from FCPA scrutiny or

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RESPONSE

RESPONSE TO: "PAY-TO-PLAY: THE IMPACT OF GROUP PURCHASING ORGANIZATIONS ON DRUG SHORTAGES"

CURTIS ROONEY*

The Note authored by Christian DeRoo in Vol. 3.1 of the American University Business Law Review[1] fails to cite important and persuasive legal precedent related to the subject matter. For example, the U.S. 8th Circuit Court of Appeals in *Southeast Missouri Hospital v. C.R. Bard, Inc.* summarily dismissed the argument that GPO compensation through vendor payments gives incentive to hospitals and GPOs to overpay for medical devices to the detriment of Medicare and Medicaid, forcing competitors out of the market.[2] In fact, in the previous hearing by the 8th Circuit, the court described one of the expert reports in this case (authored by the same experts that DeRoo cites) as "fatally flawed".[3] A similar report by two of the same authors was also rejected as "unbelievable" by practitioners in the field, including the Mayo Clinic, New York-Presbyterian, BJC Healthcare, Memorial Hermann, and other large hospitals.[4]

Mr. DeRoo argues that "many of the agreements entered into between GPOs and pharmaceutical manufacturers amount to exclusionary

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1. Christian DeRoo, *Pay-to-Play: The Impact of Group Purchasing Organizations on Drug Shortages*, 3 Am. U. Bus. L. Rev. 227 (2014).

2. Se. Mo. Hosp. v. C.R. Bard, Inc., 642 F.3d 608, 616-17 (8th Cir. 2011).

3. Se. Mo. Hosp. v. C.R. Bard, Inc., 616 F.3d 888, 893 (8th Cir. 2010), *vacated, reh'g granted*, 642 F.3d 608 (2011).

4. Letter from fourteen of the nation's largest hospitals (including Mayo Clinic, New York-Presbyterian Hosp., Mem'l Hermann, et al.) to Eamonn P. Hobbs, Chairman of the Board, Med. Device Mfr. Ass'n (Dec. 13, 2010) (on file with author).

agreements, either explicitly through contractual arrangements, or implicitly through arrangements between the GPO and member hospitals."[5] Unfortunately, he fails to mention that the United States District Court for the District of New Jersey recently rejected this argument when an antitrust plaintiff challenged "loyalty-discount" contracts.[6] The Court held that such contracts are not anticompetitive, as a matter of law, as long as the prices they offer are above-cost.[7]

Eisai and its expert witnesses (Einer Elhauge and Nicholas Economides) argued, *inter alia*, that Sanofi's contracts prevented customers from buying less expensive rival products, raised rivals' costs, and imposed "disloyalty penalties" on customers who failed to satisfy Sanofi's purchase requirements.[8] The court rejected these arguments.[9] Contrary to Eisai's allegations, the evidence showed that customers can and did buy from Sanofi's rivals, and nothing in Sanofi's contracts prevented them from doing so, other than a low price.[10] The contention that Sanofi's practices raised rivals' costs was, the court found, nothing more than another observation about the effects of Sanofi's pricing.[11] The court noted that Eisai's argument that Sanofi's prices were not really discounts, but rather "disloyalty penalties," was "a matter of semantics."[12] (Op. at 65.)

The argument put forward here is that GPOs "create decreased pharmaceutical manufacturer diversity and a fragile supply chain" and therefore, a drug shortage.[13] Aside from the fact that GPOs existed long before the current drug shortage, these identical arguments have already been put forward by Phillip Zweig, Executive Director, Physicians Against Drug Shortages, a long-time paid consultant for the medical device industry.[14] Mr. Zweig has argued that GPOs inflate the cost of medical prices and used reports by Robert Litan and Hal Singer to support his

5. DeRoo, *supra* note 1, at 232-33.

6. *See* Eisai, Inc. v. Sanoft-Aventis U.S., LLC, No. 08-4168 (MLC), 2014 WL 1343254 (D.N.J. Mar. 28, 2014).

7. *Id.* at *30.

8. *Id.* at *26.

9. *Id.* at *29.

10. *Id.* at *26.

11. *Id.* at *27-28.

12. *Id.* at *28.

13. DeRoo, *supra* note 1, at 227.

14. Patricia Earl & Phillip L. Zweig, *Connecting the Dots: How Anticompetitive Contracting Practices, Kickbacks, and Self-dealing by Hospital Group Purchasing Organizations (GPOs) Caused the U.S. Drug Shortage*, PHYSICIANS AGAINST DRUG SHORTAGES 2-4 (Jan. 4, 2012), *available at* http://www. http://nebula.wsimg.com/c10f39efefbebd4f6475c3c890e98b8b?AccessKeyId=62BC662C928C06F7384C&disposition=0&alloworigin=1.

statements.[15] Unfortunately, for both Mr. Zweig and Mr. DeRoo, it is impossible to argue that GPOs drive out competition in the generic pharmaceutical market while citing reports that say GPOs inflate health care costs in the medical device market. One must choose a side and stick with it. Fortunately, the General Accountability Office (GAO) and the Food and Drug Administration (FDA) recently reaffirmed that the root causes of drug shortages are manufacturing problems, quality issues and barriers to getting new suppliers on line when supply is disrupted.[16] Drug shortages are a complex challenge with no overnight fix. In summary, the courts are likely to continue to summarily dismiss specious arguments like the one's Mr. DeRoo promotes.[17] In the meantime, GPOs will continue their commitment to being a part of the solution.

15. *Id.* at 3.

16. United States Government Accountability Office, *Drug Shortages: Public Health Threat Continues, Despite Efforts to Help Ensure Product Availability*, GAO.GOV 21-24 (Feb. 2014), *available at* http://www.gao.gov/assets/670/660785.pdf.

17. *See generally* DeRoo, *supra* note 1.

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COMMENT

CLEAN WATER ACT, SECTION 404 APPLICANTS: MAY THE ODDS BE EVER IN YOUR FAVOR

JASON BAILEY*

Businesses that engage in projects requiring the disposal of dredged or fill material in waters or wetlands of the United States must apply for a permit from the U.S. Army Corps of Engineers. The permit process, regulated by section 404 of the Clean Water Act, provides the Environmental Protection Agency a distinct role to deny or restrict the use of defined areas as disposal sites when it detects unacceptable adverse effects on the environment. The EPA Administrator may exercise this power "whenever he determines." Until recently, the EPA never used its so-called "veto power" after a permit's issuance; however, the EPA did exactly that in 2011, leading to Mingo Logan Coal Co. v. EPA. *Ultimately, the U.S. Court of Appeals for the District of Columbia held that the word "whenever" within section 404(c) gave the EPA the ability to use its veto power retrospectively. This Comment argues that the U.S. Court of Appeals' recent decision will have an extremely toxic effect on industries across the country. It examines the history behind section 404 and the recent federal cases: analyzing the courts' decisions, Congressional intent regarding section 404, and the harmful effects and vast uncertainty businesses across the country will*

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now face. It sets forth a recommendation to Congress and the courts about how to fix the problem before it becomes detrimental to both individual industries and the U.S. economy as a whole.

"In the business world, the rearview mirror is always clearer than the windshield."

– Warren Buffett

INTRODUCTION

If Washington, D.C. needed to build a new bridge across the Potomac River when a current one becomes outdated, then it would need to obtain a Clean Water Act ("CWA"), section 404 permit.[1] If Honolulu International

1. *See* Clean Water Act (CWA) § 404, 33 U.S.C. § 1344 (2012) (detailing the requirements to obtain a permit for dredged or fill material under the Clean Water Act); *see also* EPA OFFICE OF COMPLIANCE, MANAGING YOUR ENVIRONMENTAL RESPONSIBILITIES: A PLANNING GUIDE FOR CONSTRUCTION AND DEVELOPMENT 27 (2005) [hereinafter EPA PLANNING GUIDE], *available at* http://www.epa.gov/

Airport needed to extend its runways into Māmala Bay to accommodate larger planes, then it would also need to obtain a section 404 permit.[2] If the United States government follows through with the Keystone XL pipeline and builds it in areas where water or wetlands exist, then it, too, would require a section 404 permit.[3] What would have been a routine task a few years ago now involves abundant uncertainty at the behest of the Environmental Protection Agency.

Business activities such as development, water resource projects, infrastructure expansion, and mining ventures require a CWA, section 404 permit before discharging dredged or fill material into U.S. waters.[4] Although the permit is issued by the U.S. Army Corps of Engineers ("Army Corps"), the EPA has veto power over parts of the application.[5] For the first time, in *Mingo Logan Coal Co. v. EPA* ("*Mingo Logan*"), federal courts examined whether the EPA could use its section 404(c) power to retrospectively withdraw disposal site specifications after a permit has been issued by the Army Corps.[6]

The U.S. Court of Appeals for the District of Columbia held in *Mingo Logan* that the text of section 404(c) does not put a time limit on the EPA Administrator's authority to withdraw a permit's specification, but instead, empowers him to "prohibit, restrict or withdraw the specification '*whenever*' . . . ."[7] In March 2014, the Supreme Court chose not to hear the case and denied Mingo Logan Coal Co.'s petition for writ of certiorari.[8] This case of first impression, decided forty-one years after Congress passed the CWA, will have a destructive effect on industries that rely on a CWA,

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compliance/resources/publications/assistance/sectors/constructmyer/myerguide.pdf (explaining that the building of any structure in waters of the United States requiring rock, sand, dirt, or other material for its construction requires a § 404 permit).

2. *See* § 1344 (noting that guidelines for each disposal site shall be based upon criteria comparable to the criteria applicable to the territorial seas, the contiguous zone, and the ocean); *see also* EPA PLANNING GUIDE, *supra* note 1, at 25 ("You need a section 404 permit if your construction project will result in the discharge of dredged material . . . . ").

3. *See* § 1344 (requiring permits for discharge into navigable waters); *see also* EPA PLANNING GUIDE, *supra* note 1, at 25 (distinguishing that a § 404 permit is required not only for the discharge of dredged material, but also for fill material).

4. *See* § 1344 (establishing a program to issue and regulate permits for dredged or fill material).

5. *See* § 1344(c) (establishing the EPA Administrator's authorization to prohibit the specification of any defined area as a disposal site).

6. *See generally* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133 (D.D.C. 2012), *rev'd*, 714 F.3d 608 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014).

7. Mingo Logan Coal Co. v. EPA, 714 F.3d at 613, *cert. denied*, 134 S. Ct. 1540 (2014) (emphasis added).

8. Mingo Logan Coal Co. v. EPA, 134 S. Ct. 1540 (2014).

section 404 permit if the EPA is able to revoke permits whenever it chooses, including years after issuance.[9] Even avid supports of the federal regulatory regime may be skeptical about the uncertainty of the EPA's power and how it will loom over businesses and their investors.[10]

This Comment argues that the court of appeals' recent decision in *Mingo Logan* will have an extremely toxic effect on industries across the country, and Congress is responsible for remedying the situation before it spirals out of control. Part II discusses the background and evolution of the pertinent section of the CWA and why it has been controversial. It gives a detailed factual and procedural history of the recent cases that brought this issue to light. Part III then analyzes the plain meaning of the statute at issue and its legislative history to determine whether the Court of Appeals' decision deviates from the legislation's original intent and how it, nevertheless, leaves industries in a position of insecurity and instability. Part IV sets forth recommendations to Congress and to courts that will inevitably decide similar cases in the future. Finally, this Comment concludes that the U.S. Court of Appeals' recent unprecedented ruling will have a destructive effect on a vast array of industries and that the courts and Congress should take action to provide additional guidance as to how and when the EPA can invoke its section 404(c) veto power.

I. THE ORIGIN AND EVOLUTION OF THE EPA'S SECTION 404(C) POWER

This Section supplies pertinent background information on CWA, section 404, including its original purpose. Specifically, it provides an in-depth discussion of the EPA's veto power[11] as set forth by section 404(c) of the CWA. After discussing past instances when the EPA used its power and the subsequent court battles, it addresses the recent rulings in *Mingo*

9. *See* 714 F.3d at 613 (construing the EPA's power set forth in § 404 to be infinite and without a time limit).

10. *See generally* JOHN KENNETH GALBRAITH, THE AGE OF UNCERTAINTY (1st ed. 1977).

11. The term "veto power" is used throughout this Comment because even though the statute describes the EPA Administrator's authority as the ability to prohibit specifications and deny or restrict the use of those areas, *id.*; *cf.* Am. Forest & Paper Ass'n v. EPA, 137 F.3d 291, 294 (5th Cir. 1998) (citing Save the Bay, Inc. v. EPA, 556 F.2d 1282, 1285 (5th Cir. 1977)) (reviewing the EPA's ability to veto a proposed permit to discharge pollutants if it concludes that the permit violates the CWA § 402 criteria protecting endangered species and holding that the EPA does not enjoy wide latitude in deciding whether to approve or reject a state's proposed permit program because "unless the Administrator of the EPA determines that the proposed state program does not meet [the specified] requirements, he must approve the proposal"), this essentially provides the EPA with veto power over any and all disposal site specifications considered by the Army Corps. *See, e.g.*, Coeur Alaska, Inc. v. Se. Alaska Conservation Council, 557 U.S. 261, 274 (2009) ("We, and the parties, refer to [CWA § 404(c)] as the EPA's power to veto a permit.").

Logan and why this case of first impression has the potential to inflict unnecessary risk and confusion on the business community.

A. Clean Water Act, Section 404 and its Provision Allowing the EPA Veto Power over an Application's Site Specifications

Section 404 of the CWA provides the required steps an entity must take before discharging dredged or fill material into the waters or wetlands of the United States.[12] It is an umbrella statute covering many U.S. business activities.[13] Regardless of the entity applying for a permit, each project is analyzed independently, and every industry is expected to take certain precautions to protect the environment from unnecessary harm.[14] Dredged and fill material are treated the same for the purposes of the statute.[15]

Section 404 regulates activities through a permit review process that addresses the application, specification, and denial or restriction of disposal sites at which an entity may discharge dredged or fill material.[16] The Army Corps, limited by public interest and environmental criteria, reviews and issues individual permits.[17] Although the Secretary of the Army, acting

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12. *See* 33 U.S.C. § 1344(c) (2012) (delineating the process from application and specification of disposal sites to required public hearings and issuance from the Army Corps).

13. *See Water: Discharge of Dredged or Fill Materials (404)*, U.S. EPA, http://water.epa.gov/lawsregs/guidance/cwa/dredgdis/ (last visited July 2, 2014) ("Activities in waters of the United States regulated under this program include fill for development, water resource projects (such as dams and levees), infrastructure development (such as highways and airports) and mining projects.").

14. *See id.* ("The basic premise of the program is that no discharge of dredged or fill material may be permitted if: (1) a practicable alternative exists that is less damaging to the aquatic environment or (2) the nation's waters would be significantly degraded. In other words, when you apply for a permit, you must first show that steps have been taken to avoid impacts to wetlands, streams and other aquatic resources; that potential impacts have been minimized; and that compensation will be provided for all remaining unavoidable impacts."); *see also* § 1344 (granting the EPA veto power in instances when the discharge of such materials will have "an unacceptable adverse effect on municipal water supplies, shellfish beds and fishery areas . . . wildlife, or recreational areas").

15. *Compare* EPA PLANNING GUIDE, *supra* note 1, at 25 (defining "dredged material" as material that is excavated or dredged from waters in the U.S. and "fill material" as material placed in the waters of the U.S. where the material has the effect of "either replacing any portion of water of the United States with dry land or changing the bottom elevation of any portion of a water of the United States"), *with Water: Discharge of Dredged or Fill Materials (404)*, *supra* note 13 (providing additional definitions of the terms but also examples of projects that categorically fit within each).

16. *See* § 1344(a)–(c) (describing the discharge of dredged or fill materials permit process).

17. *See id.* (setting forth criteria to be taken into consideration throughout the permit application and review process); *cf.* EPA PLANNING GUIDE, *supra* note 1, at 30 (proffering that applicants must demonstrate compliance with mitigation provisions by

through the Chief of Engineers, solely handles this aspect of the permit process, subsection (c) of section 404 provides a distinct role for the EPA:

> (c) The [EPA] Administrator is authorized to prohibit the specification (including the withdrawal of specification) of any defined area as a disposal site, and he is authorized to deny or restrict the use of any defined area for specification (including the withdrawal of specification) as a disposal site, *whenever* he determines, after notice and opportunity for public hearings, that the discharge of such materials into such area will have an unacceptable adverse effect on municipal water supplies, shellfish beds and fishery areas . . . , wildlife, or recreational areas. Before making such determination, the Administrator shall consult with the Secretary. The Administrator shall set forth in writing and make public his findings and his reasons for making any determination under this subsection.
>
> (d) "Secretary" defined. The term "Secretary" as used in this section means the Secretary of the Army, acting through the Chief of Engineers.[18]

B. While the EPA has Exercised its Veto Power in the Past, it has Never Done so Retroactively After a Permit's Issuance

The EPA has used its veto power on numerous occasions in the past, and several instances led to suits against the EPA.[19] In the latest case, *Hoosier Environmental Council*, a riverboat casino needed to acquire a section 404 permit to dredge material from the Ohio River bottom, excavate from the river bank, and moor piles both in the water and on the bank, among other activities, to carry out its proposed riverboat gambling project.[20] The plaintiff environmental organizations filed suit claiming that the permit's issuance was in violation of the CWA and other statutes because neither an Environmental Impact Statement nor an adequate public interest review were conducted.[21] Although the court noted the effects of a letter from the

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showing it will "avoid wetland and water impacts where practicable, minimize potential impacts to wetlands and waters, and compensate for any remaining, unavoidable impacts to wetlands or waters through activities to enhance or create wetlands and/or waters").

18. § 1344(c)–(d) (emphasis added).

19. *See generally* Hoosier Envtl. Council, Inc. v. U.S. Army Corps of Eng'rs, 105 F. Supp. 2d 953 (S.D. Ind. 2000); City of Alma v. United States, 744 F. Supp. 1546 (S.D. Ga. 1990); Russo Dev. Corp. v. Reilly, No. 87-3916, 1990 U.S. Dist. LEXIS 15859 (D.N.J. Mar. 16, 1990).

20. *See Hoosier Envtl. Council, Inc.*, 105 F. Supp. 2d at 963 (emphasizing that the Army Corps added numerous special conditions to the permit to limit, prevent, or mitigate the environmental impacts identified in an initial environmental assessment).

21. *See id.* at 964 (stating that one of the plaintiff environmental groups' mission, among others, opposed "any attempt to locate a gambling casino on the Ohio River"

EPA to the Army Corps two months after the section 404(b) permit was issued that raised the Army Corps' failure to examine the project's environmental effects, it failed to consider whether the EPA could have exercised its section 404(c) veto power after the permit was issued.[22]

Two other cases brought to light the controversy surrounding the EPA's veto power, but in both instances, the EPA used its authority prior to a permit's issuance.[23] In *City of Alma*, the EPA obtained an injunction preventing the city from constructing a lake.[24] The Army Corps notified the EPA of its intent to issue a section 404 permit, and the EPA Regional Administrator informed the Army Corps and public officials that he would begin section 404(c) proceedings, proposing to prohibit or restrict the planned dredging or fill of material at the project site.[25] Although the court determined that the EPA acted within its CWA authority, the EPA acted before the Army Corps issued the final permit.[26]

Furthermore, in *Russo Development Corp.*, although the court did not analyze the EPA's ability to use its section 404(c) power against a permit already issued, the court did address whether the EPA could use its section 404(c) veto power in regard to an after-the-fact permit.[27] The plaintiff sought a permit for an area in which filling already began, and the court determined that the regulations "unquestionably" allowed the EPA to prevent the Army Corps from issuing a permit to a landowner seeking to fill wetlands.[28] Thus, the court allowed the EPA to rely on its section 404(c) veto power even after the landowner filled a portion of the land in

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within their county).

22. *See id.* at 971–72 (discussing the cooperative tone of the EPA's letter and finding it unlikely that if the EPA knew the permit had already been granted, it would have accused the Army Corps' environmental assessment of being legally deficient).

23. *See City of Alma*, 744 F. Supp. at 1553 (recognizing that the EPA's § 404(c) proceedings took place after the Corps notified the EPA of its intent to issue a § 404 permit but before the permit was formally issued); *see also Russo Dev. Corp.*, 1990 U.S. Dist. LEXIS 15859, at *2–3 (reviewing an after-the-fact permit as legally equivalent to a new permit).

24. *See City of Alma*, 744 F. Supp. at 1567 (denying the plaintiffs' motion for lifting the injunction).

25. *See id.* at 1553 (providing that the Army Corps notified the EPA of its intent to issue a § 404 permit in 1988 and that the EPA issued its recommendation on October 5, 1988, prior to the permit's issuance).

26. *See id.* at 1560 (citing 44 Fed. Reg. 58,077 (1979)) ("As noted above, the EPA stated, in the preamble to its regulations, that it would avoid initiating section 404(c) proceedings after a permit has been issued.").

27. *See Russo Dev. Corp.*, 1990 U.S. Dist. LEXIS 15859, at *2 (detailing the plaintiff's after-the-fact permit as to the remaining acreage of an area already with a permit and an additional parcel).

28. *See id.* at *8–9 (emphasizing the difference between vetoing an issued permit and vetoing an after-the-fact permit not issued).

question prior to seeking an after-the-fact permit.[29]

The above cases provide a sense of how federal courts have handled the EPA's statutory authority in controversial situations, but never before had a court directly examined whether the EPA could use its section 404(c) power to withdraw disposal site specifications after the Army Corps lawfully issues a section 404 permit until *Mingo Logan*.[30]

C. For the First Time in Mingo Logan Coal Co. v. EPA, *a West Virginia Company Challenged the EPA's Unprecedented Decision to Retroactively Veto a Section 404 Permit*

In *Mingo Logan*, the Army Corps issued a CWA, section 404(b) permit to Mingo Logan Coal Company in 2007, allowing it to discharge fill material from its Spruce No. 1 coal mine into nearby streams and their tributaries.[31] Before the permit was issued, the EPA commented on a preliminary draft of an Environmental Impact Statement, as well as on another draft a year later, expressing its concerns about each version and also noting the application did not include information that fully assessed potential adverse environmental impact associated with the project.[32] After working with the Army Corps, the EPA granted state certification for the individual permit in December 2005 because it determined the project would not violate state water quality standards or anti-degradation regulations.[33] Before the Army Corps issued the final permit to Mingo Logan Coal, the Director of the Office of Environmental Programs, Environmental Assessment and Innovation Division, of the EPA wrote that the EPA had no intention of seeking section 404(c) proceedings regarding the Spruce Mine project.[34]

In September 2009, almost two years after the Army Corps issued the section 404 permit, the EPA sent a letter to the Office of the Army Corps,

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29. *See id.* (noting that the original permit authorized the fill that occurred up to that point but that the after-the-fact permit had yet to be issued).

30. *See* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133, 134 (D.D.C. 2012), *rev'd*, 714 F.3d 608 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) (articulating that the EPA's attempt to withdraw the specification of discharge sites after a permit has been issued is unprecedented in the history of the CWA).

31. *See id.* at 133–34 (specifying the sites as the Pigeonroost and Oldhouse Branches).

32. *See id.* at 135–36 (detailing the EPA's comment dates as August 2001 and August 2002, respectively).

33. *Id.* at 136.

34. *See id.* (explaining that this statement occurred via email on November 2, 2006, from William J. Hoffman, Director of the Office of Environmental Programs, Environmental Assessment and Innovation Division of the EPA, to Teresa Spagna of the Army Corps).

requesting that it suspend, revoke, or modify Mingo Logan Coal's issued permit.[35] Finding no grounds to suspend, revoke, or modify the permit because no new information had surfaced related to water quality impacts, the Army Corps rejected the EPA's request.[36] The EPA then invoked its section 404(c) veto power in January 2011, withdrawing the specification of two waterways and their tributaries as disposal sites for materials in connection with the construction of the Spruce No. 1 Surface Mine.[37] This fundamentally rendered the permit ineffective by taking away eighty-eight percent of the total discharge area the permit authorized,[38] and it eventually led to the dispute in *Mingo Logan*, which is whether the EPA still possesses its veto power after a permit has been issued.

The U.S. District Court for the District of Columbia initially granted the coal company's Motion for Summary Judgment on multiple bases.[39] First, the court decided that a retrospective veto power is not discussed in Section 404(c) and that an interpretation of such is contrary to the language, structure, and legislative history of section 404 as a whole.[40] The decision asked whether the EPA could withdraw a decision it has not made.[41] Using *Chevron U.S.A., Inc. v. NRDC, Inc.* and *Collins v. National Transportation Safety Board* in its analysis, the court concluded that de novo review was appropriate and that the EPA was not entitled to any deference.[42]

35. *See id.* at 136–37 (emphasizing that the Army Corps' permit issued on January 22, 2007, contained an express notification that the regional Army Corps office may reevaluate its decision on the permit at any time the circumstances warranted without saying anything about the EPA's authority to withdraw the specification of a discharge site or to modify or revoke the permit).

36. *See id.* at 137 (articulating that the EPA's letter specifically asserted that "recent data and analyses had revealed downstream water quality impacts that were not adequately addressed by the permit").

37. *See id.* (providing the timeline after the Army Corps rejected the EPA's initial request as follows: "Six months later, on March 26, 2010, EPA published a notice of its proposed determination to withdraw or restrict the specification of Seng Camp Creek, Oldhouse Branch, Pigeonroost Branch, and certain of their tributaries as disposal sites for fill material. On September 24, 2010 it published a 'Recommended Determination' to withdraw the specification of Oldhouse Branch, Pigeonroost Branch, and certain of its tributaries. And [sic] on January 13, 2011, EPA issued its Final Determination . . . .").

38. *Id.*

39. *See id.* at 153 (holding that the EPA exceeded its authority under the CWA when it attempted to invalidate an existing permit for disposal sites because the statute did not give the EPA the power to render a permit invalid once it had been issued by the Army Corps).

40. *See id.* at 139 (asserting that it would be a "stunning power for an agency to arrogate to itself when there is absolutely no mention of it in the statute").

41. *See id.* (focusing on the words "prohibit" and "deny" within the statute as actions that naturally take place before the end result).

42. *See id.* at 148–49 (citing Collins v. Nat'l Transp. Safety Bd., 351 F.3d 1246

On appeal, the U.S. Court of Appeals for the D.C. Circuit examined the expansive conjunction "whenever" in its plain meaning.[43] By using the term "whenever," the court decided that Congress plainly intended to grant the EPA authority to prohibit, deny, restrict, or withdraw a specification at any time.[44] Moreover, it discussed the usage of the word "withdrawal," stating that the word itself conveys a meaning that the EPA's power could only be exercised post-permit.[45] Finding the District Court for the District of Columbia's argument on legislative history unpersuasive, the D.C. Circuit reversed and remanded this case of first impression back to the district court to decide the case on the second claim.[46] The specific effects of this decision will be discussed in Part III, but its strong deviation from past precedent and sound public policy will have detrimental consequences for businesses and investors.

II. THE POWER OF ONE WORD: SECTION 404'S AMBIGUOUS USE OF "WHENEVER" IS AT THE CENTER OF THE DEBATE IN *MINGO LOGAN*

This Section discusses both courts' decisions and rationales in *Mingo Logan*. It explains how the U.S. Court of Appeals' decision ultimately leaves certain businesses at a disadvantage in the marketplace amidst an unquantifiable state of uncertainty.

A. Analyzing the Two Federal Courts' Interpretation Disparity Regarding the Word "Whenever"

This entire issue hinges on the existence and interpretation of the word

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(D.C. Cir. 2003)) (noting that the CWA's regulatory regime fits squarely within the second *Collins* category of statutes where agencies have specialized enforcement responsibilities but their authority potentially overlaps); *see also* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984) (setting forth a two-part test for courts to use when reviewing an agency's construction of a statute which it administers and stating that if a statute is silent or ambiguous with respect to the specific issue, then the question for a court is whether the agency's action was based on a permissible construction of the statute).

43. *See* Mingo Logan Coal Co. v. EPA, 714 F.3d 608, 613 (D.C. Cir. 2013), *cert denied*, 134 S. Ct. 1540 (2014) (pulling the Oxford English Dictionary definition of "whenever" for support: "At whatever time, no matter when.").

44. *See id.* (referring to the language of subsection 404(c) as "unambiguous").

45. *See id.* (citing OXFORD ENGLISH DICTIONARY 449 (2d ed. 1989)) (defining "withdraw" as "[t]o take back or away (something that has been given, granted, allowed, possess, enjoyed, or experienced)").

46. *See id.* at 616 (holding that the text of § 404(c) clearly and unambiguously gave the EPA the power to act post-permit and leaving the District Court for the District of Columbia to decide whether EPA's decision to withdraw site specifications after a permit's issuance was arbitrary and capricious in violation of the Administrative Procedure Act).

"whenever" in section 404(c) of the CWA.[47] Without the word "whenever," the subsection reads plainly that the EPA Administrator may act during the application process to prohibit, deny, or restrict disposal sites from applications. Adding the single word "whenever" blurs the acceptable time frame in which the EPA can use its veto power. For decades, courts never dealt with the interpretation of the word "whenever" as possibly referring to a post-permit veto power because the EPA never exercised its power in this manner.[48] Throughout the proceedings of *Mingo Logan*, however, the interpretation of that single word became the debate's focal point, drawing strong opinions and public discussion from judges, scholars, and business professionals alike.

For the sake of *Mingo Logan*, the only interpretations of the word "whenever" that matter are those used by Judge Amy Jackson and Judge Karen Henderson of the district court and court of appeals, respectively, in their opinions. Judge Jackson examined the legislative history behind the statute and, particularly, section 404(c).[49] In rejecting a strict dictionary definition of the word "whenever," Jackson noted that all parties agreed that the clear intent in using "whenever" was that Congress gave the EPA the ability to veto the use of certain disposal sites at the start and during the application process, thereby blocking the issuance of those permits.[50]

Judge Henderson of the U.S. Court of Appeals for the D.C. Circuit preferred the literal definition of the word "whenever."[51] Citing the Oxford English Dictionary, she defined "whenever" in *Mingo Logan* as "a qualifying (conditional) clause . . . 'At whatever time, no matter when.'"[52]

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47. *See* 33 U.S.C. § 1344(c) (2012) ("The Administrator is authorized to prohibit . . . , and he is authorized to deny or restrict . . . whenever he determines . . . .").

48. *See generally* Hoosier Envtl. Council, Inc. v. U.S. Army Corps of Eng'rs, 105 F. Supp. 2d 953 (S.D. Ind. 2000); City of Alma v. United States, 744 F. Supp. 1546 (S.D. Ga. 1990); Russo Dev. Corp. v. Reilly, No. 87-3916, 1990 U.S. Dist. LEXIS 15859 (D.N.J. Mar. 16, 1990) (providing examples where courts have decided issues related to the word "whenever" without directly addressing the EPA's post-permit authority).

49. *See* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133, 134 (D.D.C. 2012), *rev'd*, 714 F.3d 608 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) (concluding that the EPA exceeded its authority under § 404(c) of the CWA "[b]ased upon a consideration of the provision in question, the language and structure of the entire statutory scheme, and the legislative history . . . ").

50. *See id.* at 140 (citing § 1344(a)) ("Since a permit can only be issued by the Corps for a 'specified' (note the past tense) site, the act of prohibiting a specification, or denying the use of an area for specification, eliminates the necessary foundation for the issuance of a permit.").

51. *See* 714 F.3d at 613 (indicating that the formulation of the statute with the word "whenever" is reinforced by the use of the word "withdrawal").

52. *Id.* (citing OXFORD ENGLISH DICTIONARY 210 (2d ed. 1989)).

To further support this interpretation of "whenever," she argued that subsection 404(c)'s authorization of a "withdrawal" further supported her interpretation because it is a term of retrospective application allowing a person or entity to take back or take away something that has been given.[53]

B. *While Antagonistic to Public Policy, the D.C. Circuit's Interpretation Passes Constitutional Muster and Prevails*

If and when the EPA is able to veto permits retrospectively lies in the existence and statutory interpretation of a single word: "whenever."[54] In *Chevron,* the U.S. Supreme Court set out a two-step analysis for courts to use in reviewing an administrative agency's construction of a statute.[55] A court must first determine whether Congress directly spoke to the precise question at issue.[56] In the midst of unambiguously expressed Congressional intent, the court, as well as the agency, must give effect to it.[57] If, however, Congress has not directly addressed the precise question at issue, then the court does not impose its own interpretation of the statute, but rather, the question becomes whether the agency's answer is based on a permissible construction of the statute.[58]

When determining whether a statute is silent or ambiguous on the agency's interpretation in question, courts should use traditional tools of statutory construction, including the statutory language and legislative history.[59] Congress is not silent, but instead ambiguous, about when the EPA can use its veto power in this case; therefore, the statute and its text can be analyzed one of two ways.[60] Based on canons of construction, it can be evaluated strictly by looking at the language itself, or it can be analyzed

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53. *Id.* (citing OXFORD ENGLISH DICTIONARY 449 (2d ed. 1989)).

54. *See* § 1344(c).

55. Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984) (holding that the EPA's decision to allow states to treat all of the pollution-emitting devices within the same industrial grouping as though they were encased within a single "bubble" was based on a reasonable construction of the statutory term "stationary source").

56. *See id.* at 842–43, 844 (citing Aluminum Co. of Am. v. Cent. Lincoln Peoples' Util. Dist., 467 U.S. 380 (1984) et al.) (supporting the notion that the Court has long recognized the considerable weight that should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer).

57. *See id.*

58. *See id.*

59. *See* Anderson v. U.S. Dep't of Labor, 422 F.3d 1155, 1180 (10th Cir. 2005) (citing *Chevron*, 467 U.S. at 843) (noting that this method helps determine whether Congress had intent on the precise question at issue).

60. *See* Mingo Logan Coal Co. v. EPA, 714 F.3d 608, 614–15, *cert. denied*, 134 S. Ct. 1540 (2014) (finding none of Mingo Logan Coal Co.'s arguments persuasive regarding the ambiguity of the statute's language).

substantively based on the presumptions, values, and intent of Congress at the time of the statute's passage.[61]

Typically, a court will assume that the legislature uses words in their ordinary sense.[62] By ordinary, courts look toward how an "ordinary" or "reasonable" reader would interpret it while bearing in mind that the ordinary meaning should be distinguished from a literal meaning, strict construction, or narrow understanding of the word.[63] For example, the majority in *Babbitt v. Sweet Home Chapter of Communities for a Greater Oregon* used a textual construction analysis in finding three reasons for concluding that the Secretary of the Interior's interpretation of the word "harm" within the Endangered Species Act was reasonable.[64]

Substantive canons look toward the presumptions that Congress intended to incorporate into statutes rather than the plain meaning of the text; however, presumptions will generally not trump a contrary statutory text, legislative history, or purpose.[65] In *NLRB v. Catholic Bishop of Chicago*, the Supreme Court decided whether Congress intended the NLRB to have jurisdiction over teachers in church-operated schools.[66] In holding that it did not, the court recognized that Congress provided no clear expression of an interpretation to include teachers in church-operated schools, and it placed weight on the presumption that Congress would not intend for a

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61. *See, e.g.*, New York v. U.S. Dep't of Health & Human Servs. Admin. for Children & Families, 556 F.3d 90, 97 (2d Cir. 2009) (quoting Gen. Dynamics Land Sys., Inc. v. Cline, 540 U.S. 581, 586 (2004)) ("Only if we determine that Congress has not directly addressed the 'precise question at issue' will we turn to canons of construction and, if that is unsuccessful, to legislative history 'to see if those "interpretative clues" permit us to identify Congress's clear intent.'").

62. *See* WILLIAM N. ESKRIDGE, JR., PHILIP P. FRICKEY, & ELIZABETH GARRETT, CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY 849–50 (4th ed. 2007) (explaining that judges may consult dictionaries, but they will often just rely on their linguistic experience or intuition to decide the most reasonable meaning of the words, given the context in which they are being used and applied).

63. *See id.* (suggesting that the interpretation starts with the "prototypical" meaning of statutory words or the core idea associated with the word or phrase).

64. *See* Babbitt v. Sweet Home Chapter of Cmtys. for a Greater Or., 515 U.S. 687, 697–703 (1995) (concluding that Congress did not unambiguously manifest its intent to adopt the plaintiff's view and that the Secretary of Interior's interpretation was reasonable).

65. *See* ESKRIDGE, ET AL., *supra* note 62, at 883 (citing Astoria Fed. Sav. & Loan Assoc. v. Solimino, 501 U.S. 104, 108 (1991)) (stating that a presumption or rule of thumb can be treated as a starting point for discussion, a tiebreaker at the end of discussion, or just a balancing factor).

66. *See* NLRB v. Catholic Bishop of Chi., 440 U.S. 490, 491 (1979) (raising the additional question that if the Act does in fact authorize such jurisdiction, it must be determined whether its exercise violates the guarantees of the Religion Clauses of the First Amendment).

statute to violate the Constitution.[67] The Court, therefore, declined to construe the Act in a way that could require the Court to resolve difficult and sensitive First Amendment questions.[68]

In observing the plain, textual meaning of the word "whenever" within the context of section 404, a definite intention or interpretation is not obvious. "Whenever" usually carries with it a connotation of "at any time; on whatever occasion" while emphasizing a lack of restriction.[69] The word does have limitations, however, that are apparent and important in its everyday usage.[70] For example, when someone tells their neighbor to "come over whenever," they do not literally mean "at any time." An understanding exists that the neighbor should not visit during unreasonable hours or when the home is empty. Did Congress also assume similar limitations in its use of the word "whenever?" Is it reasonable to "deny or restrict" the use of certain sites after the application process is over and a permit has been formally issued? The textual construction is not absolutely clear. In an instance like this, where the language of a statute is susceptible to more than one reasonable construction, courts should review the legislative history of the measure to ascertain its meaning.[71]

The legislative history of section 404 does not provide enough insight on Congress' intention of the word "whenever" to overcome the burden needed to interpret the word differently than its narrower, ordinary meaning.[72] Although no clues exist in the printed *U.S. Code Congressional*

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67. *See id.* at 504 ("There is no clear expression of an affirmative intention of Congress that teachers in church-operated schools should be covered by the Act. Admittedly, Congress defined the Board's jurisdiction in very broad terms; we must therefore examine the legislative history of the Act to determine whether Congress contemplated that the grant of jurisdiction would include teachers in such schools.").

68. *See id.* at 507 (affirming the decision of the 7th Circuit).

69. *See* Mingo Logan Coal Co. v. EPA, 714 F.3d 608, 613 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) (believing that this lack of restriction is why the Congress intentionally included the word "whenever" within that part of the statute).

70. *Cf.* Richard A. Epstein, *Plain Meaning in Context: Can Law Survive Its Own Language?*, 6 N.Y.U. J.L. & LIBERTY 359, 366 (2011) ("First, the consequences matter; these words are often designed to structure the social and legal relations between two or more persons or groups, with the result that any small error can lead to a large amount of injustice or inefficiency. Second, error correction is not just a matter of asking the correct question or backspacing on a word processer. The words in question are not generated by a single person who can alter and change them at will, so their costs of correction are far greater than before.").

71. *See, e.g.*, Nelson v. Pearson Ford Co., 112 Cal. Rptr. 3d 607, 626 (Dist. Ct. App. 2010) (citing Diamond Multimedia Sys., Inc. v. Superior Court, 968 P.2d 539 (Cal. 1999)) (analyzing the Automobile Sales Finance Act, legislation enacted to increase protection for the unsophisticated motor vehicle consumer and provide additional incentives to dealers to comply with the law).

72. *See* 1972 U.S.C.C.A.N. vol. 2, 3815–20. (providing Congressional and administrative history for permits and licenses addressed by the CWA but not offering

and Administrative News with respect to section 404,[73] certain pieces of the CWA's legislative history exist that may help shed light on what exactly Congress meant by giving the EPA the power to deny or restrict disposal site specifications "whenever."

When Congress first enacted the CWA, it recognized that a massive percentage of coal reserves in the United States can only be extracted by underground mining methods, and so it was vital to national interests to ensure the existence of an expanding and economically healthy underground coal mining industry.[74] Is it possible Congress can simultaneously insure an expanding and economically healthy industry[75] if the EPA can use its veto power months or years after the Army Corps issues a section 404 permit?

Additionally, Senator Edmund Muskie played the most significant role in the legislation's passage, and he made it clear during a speech to his Senatorial colleagues that a limitation applies to the EPA's section 404(c) power. He stated, during consideration of the bill, that the EPA had to determine that the disposal material would not adversely affect municipal water supplies "prior to the issuance of any permit."[76] Should the Administrator so determine, then the Army Corps could not issue a permit.[77] Senator Muskie made it apparent in his speech that the EPA may only deny a permit based on site specifications before it is issued by the Army Corps.[78] Later in those same comments, however, Muskie said that the legislation's drafters tried to write Congress' intent into the CWA as clearly as possible so that the final evaluation of the bill would not be left to legislative history.[79] Why, then, did Congress use the word "whenever"

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any information in regards to § 404).

73. *See generally* 1972 U.S.C.C.A.N. vol. 2–3 (omitting any reference to CWA, § 404).

74. *Compare* 30 U.S.C. § 1201(b) (1977) ("The Congress finds and declares that . . . coal mining operations presently contribute significantly to the Nation's energy requirements; surface coal mining constitutes one method of extraction of the resource; the overwhelming percentage of the Nation's coal reserves can only be extracted by underground mining methods, and it is, therefore, essential to the national interest to insure the existence of an expanding and economically healthy underground coal mining industry . . . ."), *with* § 1201(j) (noting also that "surface and underground coal mining operations affect interstate commerce, contribute to the economic well-being, security, and general welfare of the Nation and *should be conducted in an environmentally sound manner*" (emphasis added)).

75. § 1201(b).

76. *Senate Consideration of the Report of the Conference Committee*, s. 2770, 93rd Cong. 1st Sess. (Oct. 4, 1972), *reprinted in* A LEGISLATIVE HISTORY OF WATER POLLUTION CONTROL ACT AMENDMENTS OF 1972 177 (1973) (emphasis added).

77. *Id.*

78. *See id.*

79. *Id.*

when that seems contrary to Muskie's earlier statement? A court will subjectively determine how much weight to afford a single Senator's comments such as those made by Muskie.[80]

Additional history regarding the CWA section at issue exists to further aid the analysis. During a public comment period regarding section 404 of the CWA, the EPA publicly stated that it should not invoke its veto power after a permit is issued except in very rare occurrences.[81] On top of the above legislative history, the EPA signed a Memorandum of Agreement with the Department of the Army regarding the EPA's section 404(c) power.[82] Each time the veto power is mentioned in the agreement, supporting language indicates the power is to be used before a permit is issued.[83] The agreement's language supports the notion that the EPA's authority is to be used prior to a permit's issuance.[84] Thus, although some legislative history exists, the available information is questionable at best as to whether it supports a precise Congressional interpretation and intention of the word "whenever."[85]

If the text or the legislative history does not provide the court with the

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80. *See, e.g.*, Ellen J. Sokol, Note, *Environmental Law—Joint and Several Liability Under CERCLA*—United States v. Chem-Dyne Corp., 57 TEMP. L.Q. 885, 889–90 (1984) (citing Fed. Energy Admin. v. Algonquin SNG, Inc., 426 U.S. 548, 564 (1976)); United States v. Chem-Dyne Corp., 572 F. Supp. 802, 807 (S.D. Ohio 1983)) ("The court then noted that, while a single legislator's remarks are not controlling, the statements of legislative sponsors should be given substantial weight.").

81. *See* Denial or Restriction of Disposal Sites; Section 404(c) Procedures, 44 Fed. Reg. 196 (proposed Oct. 9, 1979) (to be codified at 40 C.F.R. pt. 231) ("[I]t would be inappropriate to use 404(c) after issuance of a permit where the matters at issue were reviewed by EPA without objections during the permit proceeding, or where the matters at issue were resolved to EPA's satisfaction during the permit proceeding, unless *substantial* new information is first brought to the Agency's attention after issuance." (emphasis added)).

82. *See generally* Memorandum of Agreement Between the EPA and the Dep't of the Army (Aug. 11, 1992), *available at* http://water.epa.gov/lawsregs/guidance/wetlands/upload/1992_MOA_404q.pdf.

83. *See id.* ("[T]he District Engineer will provide EPA a copy of the Statement of Findings/Record of Decision prepared in support of a permit decision after the [Assistant Secretary of the Army for Civil Works'] review. The permit shall not be issued during a period of 10 calendar days after such notice unless it contains a condition that no activity may take place pursuant to the permit until such 10th day, or if the EPA has initiated a Section 404(c) proceeding during such 10 day period, until the Section 404(c) proceeding is concluded and subject to the final determination in such a proceeding.").

84. *See id.* (indicating that absent exigent circumstances, retrospectively invoking § 404(c) would be inappropriate).

85. *Cf.* Lockhart v. United States, 546 U.S. 142, 146 (2005) (quoting Union Bank v. Wolas, 502 U.S. 151, 158 (1991)) ("The fact that Congress may not have foreseen all of the consequences of a statutory enactment is not a sufficient reason for refusing to give effect to its plain meaning.").

necessary interpretation, then under *Chevron* the second question for the court is whether the agency's interpretation is based on a permissible construction of the statute.[86] The EPA argued in *Mingo Logan* that section 404(c) grants it unlimited power to modify or revoke a permit that the Army Corps lawfully issues.[87] The district court was not persuaded, even if considerable deference was given to the EPA's interpretation.[88]

The EPA specifically addressed the concept of taking no action post-permit during Mingo Logan Coal's permit application process.[89] When the EPA issued state certification for Mingo Logan Coal's individual permit, it stated via an email from William Hoffman, Director of the Office of Environmental Programs, Environmental Assessment and Innovation Division, of the EPA, to Teresa Spagna of the Army Corps, that the EPA had no intention of taking its concerns any further from a section 404 standpoint.[90] Hoffman sent that email one year before the Army Corps issued Mingo Logan Coal its final permit and five years before the EPA invoked its veto power to retrospectively revoke certain disposal sites.[91]

The permit issued to Mingo Logan Coal contained an express notification that the Huntington District Office of the Army Corps had the right to reevaluate its decision at any time circumstances warranted.[92] In 2009, almost two years after the Army Corps issued the section 404 permit, the EPA sent a letter to the Huntington District Office recommending that the Army Corps use its discretionary authority to suspend, revoke, or modify Mingo Logan Coal's permit.[93] The Army Corps rejected the EPA's

86. *See* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984) ("If . . . the court determines Congress has not directly addressed the precise question at issue, the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation.").

87. *See* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133, 139 (D.D.C. 2012), *rev'd*, 714 F.3d 608, 614 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) ("[T]he EPA is permitted to withdraw its assent to a disposal site *at any time*, even if the agency did not exercise its authority to prohibit or deny the specification at the outset, and a permit has already been issued.").

88. *See id.* (reasoning that the EPA's "reading does not exactly leap off the page").

89. *See id.* at 136 (referring to William Hoffman's email to Teresa Spagna).

90. *See id.* (citing Administrative Record 23085) (emphasizing that the EPA intended to work alongside the Army Corps throughout the application process rather than invoke § 404(c)'s veto power).

91. *See id.* at 136–37 (explaining that the original email was sent November 2, 2006; the permit was delivered on January 22, 2007; and the EPA's Final Determination to "withdraw the . . . disposal site[s]" was issued January 13, 2011).

92. *See id.* at 137 (implying that the permit did not mention the EPA's ability to withdraw the specification of a disposal site or to modify or revoke the permit after its issuance).

93. *See id.* (stating that the letter was sent on September 3, 2009); *see also* 33 C.F.R. § 325.7(c)–(d) (2013) ("The district engineer may suspend a permit after

request, finding no grounds to do so.[94]

Contract law provides one potential basis for the illegality of the EPA's ability to revoke permits after issuance as it did in Mingo Logan Coal's case. The section 404 permit to mine at Spruce No. 1 was the result of a contract under which Mingo Logan Coal had a reasonable expectation that it would be able to dispose of material for the permit's duration. Mingo Logan Coal's acceptance of the permit was based on the EPA's statements that expressed intent not to exercise § 404(c) power retrospectively.[95] On multiple occasions, noted above, the EPA indicated its intention to exercise section 404(c) power only prior to a permit's issuance by the Army Corps.[96] The Fifth Amendment's "takings clause"[97] provides a second potential basis for the illegality of retrospectively vetoing section 404 permits. By revoking disposal sites post-issuance, the EPA deprives the business enterprise of the entire economic value of the land, and the business deserves, at the least, just compensation.[98]

As stated in various cases since *Chevron*, in construing a statute, the court should consider the history and consistent purpose of the legislation and discover the policy of the legislature as disclosed by the course of the legislation and not the agency or third parties after its passage.[99] Although

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preparing a written determination and finding that immediate suspension would be in the public interest. The district engineer will notify the permittee in writing by the most expeditious means available that the permit has been suspended with the reasons therefore, and order the permittee to stop those activities previously authorized by the suspended permit.... Following completion of the suspension procedures in paragraph (c) of this section, if revocation of the permit is found to be in the public interest, the authority who made the decision on the original permit may revoke it.").

94. *See* 850 F. Supp. 2d at 137 (disagreeing with the EPA's assertion that recent data and analyses had revealed downstream water quality impacts that were not adequately addressed by the permit).

95. *See, e.g.*, GREGORY KLASS, CONTRACT LAW IN THE USA 63–87 (2010) (defining contract formation as offer, acceptance, consideration, and intent to create legal relations).

96. *See* 850 F. Supp. 2d at 136 (email from Mr. Hoffman to Teresa Spagna). *See generally* Denial or Restriction of Disposal Sites; Section 404(c) Procedures, 44 Fed. Reg. 196 (proposed Oct. 9, 1979) (to be codified at 40 C.F.R. pt. 231); Memorandum of Agreement Between the EPA and the Dep't of the Army, *supra* note 82.

97. *See* U.S. CONST. amend. V ("[N]or shall private property be taken for public use, without just compensation.").

98. *But see* Lost Tree Vill. Corp. v. United States, 707 F.3d 1286, 1290–92 (Fed. Cir. 2013) (quoting Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1029 (1992)) (finding that the plaintiff's § 404 permit met the only exception to compensation for such categorical takings: "where the regulations prohibit a use that was not part of the landowner's title to being with; that is, a limitation that inheres 'in the restrictions that background principles of the State's law of property and nuisance already place upon land ownership'").

99. *See, e.g.*, United States v. Awadallah, 349 F.3d 42, 53–55 (2d Cir. 2003) (citing 18 U.S.C. § 3144 (1986)) (holding that the legislative history of § 3144 made

the Court of Appeal's decision in *Mingo Logan* at first seems to be inconsistent with how the EPA has historically portrayed its authority, the correct interpretation can be found in the legislative process. According to *Chevron*,[100] the textual meaning of the statute along with the legislative history is the deciding factor, and based on those two canons, there is simply not enough information to deem the EPA's interpretation of the statute unreasonable after providing due deference.[101]

The next Section of this Comment delves into the risk, uncertainty, and negative outcomes that accompany affirming the EPA's interpretation of its section 404(c) power, but based on the above analysis, the U.S. Court of Appeals appears to have correctly analyzed the EPA's authority strictly under *Chevron*. The court failed, however, by not addressing that the EPA's interpretation of its power, as explained in the next Section, will lead to an absurd result that businesses and investors will inevitably find disconcerting. When this is the case, the courts have a duty to consider common sense and public welfare.[102]

C. The D.C. Circuit's Interpretation Nonetheless will have a Deleterious Effect on Businesses Across the United States because of the Vast Uncertainty and Risk they now Face

At the micro level, the EPA's decision to withdraw two of Mingo Logan Coal's disposal sites and their tributaries from its permit was detrimental.[103]

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clear Congress' intent to include grand jury proceedings within the definition of "criminal proceeding" while indicating that although committee reports are not always reliable interpretive tools, courts may look to them in discerning Congressional intent).

100. *See* Chevron, U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837, 842–43 (1984) (setting out the two-step test discussed throughout this Comment).

101. *See id.* at 844 ("We have long recognized that considerable weight should be accorded to an executive department's construction of a statutory scheme it is entrusted to administer . . . .").

102. *See, e.g.*, Tenn. Valley Auth. v. Hill, 437 U.S. 153, 195 (1978) (Powell, J., dissenting) ("In my view § 7 cannot reasonably be interpreted as applying to a project that is completed or substantially completed when its threat to an endangered species is discovered. Nor can I believe that Congress could have intended this Act to produce the 'absurd result' — in the words of the District Court — of this case. If it were clear from the language of the Act and its legislative history that Congress intended to authorize this result, this Court would be compelled to enforce it. It is not our province to rectify policy or political judgments by the Legislative Branch, however egregiously they may disserve the public interest. But where the statutory language and legislative history, as in this case, need not be construed to reach such a result, I view it as the duty of this Court to adopt a permissible construction that accords with some modicum of common sense and the public weal.").

103. *See* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133, 137 (D.D.C. 2012), *rev'd*, 714 F.3d 608, 614 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) (acknowledging that the EPA seized "eighty-eight percent of the total discharge area authorized by the permit").

If Mingo Logan Coal was able to predict the outcome of this case, it could have applied for after-the-fact permits at other locations,[104] cut back on human capital or other expenses, or simply begun to minimize its production numbers. The unpredictability of the EPA's move left Mingo Logan Coal with its metaphorical hands tied tightly behind its back. The Spruce No. 1 Mine was one of the Appalachian Mountains' largest surface mining operations ever.[105] Recognizing that the EPA's decision would force Mingo Logan Coal and other companies to cut production and lay off employees at an incredibly damaging rate, leading to financial difficulty, members of Congress immediately responded with legislation that would prevent the EPA from vetoing section 404 permits after the permits have been issued by the Army Corps.[106]

At a macro level, thousands of companies in the U.S., including those companies' investors, might now find themselves in Mingo Logan Coal's position. Not only do they now face an unthinkable amount of complication to every investment and business decision, but also, they face one of an unquantifiable type.[107]

In *Risk, Uncertainty, and Profit*, economist Frank Knight thoroughly discusses the difference between risk and uncertainty.[108] Put simply, risk involves outcomes delimited by a known probability distribution, while uncertainty means that the probability distribution of outcomes is unknown.[109] When Alan Greenspan chaired the Federal Reserve Board, he

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104. *See, e.g.*, Russo Dev. Corp. v. Reilly, No. 87-3916, 1990 U.S. Dist. LEXIS 15859, *6–7 (D.N.J. Mar. 16, 1990) (citing 33 U.S.C. § 1344(p) (2012)) (recognizing that once a party obtains an after-the-fact permit from the Army Corps of Engineers, the EPA cannot commence an enforcement action and stating that "[i]f EPA cannot proceed under its authority under Section 404(c), then [it] is absolutely precluded from seeking restoration or mitigation to halt or offset the adverse effects of the discharge").

105. Amy Oxley, Comment, *No Longer Mine: An Extensive Look at the Environmental Protection Agency's Veto of the Section 404 Permit Held by the Spruce No. 1 Mine*, 36 S. ILL. U. L.J. 139, 148 (2011).

106. *Compare* H.R. 457, 112th Cong. (2011) (introduced on January 26, 2011, but not enacted), *with* S. 272, 112th Cong. (2011) (introduced on February 3, 2011, but not enacted).

107. *See* Daniel A. Farber, *Uncertainty*, 99 GEO. L.J. 901, 916–17 (2011) (noting that even though the precautionary principle attempts to provide for a safety net against uncertainty, "government intervention creates risks of its own, [which] are also uncertain and present unforeseen risks to health and environment," thereby turning the precautionary principle against itself).

108. *See generally* FRANK KNIGHT, RISK, UNCERTAINTY, AND PROFIT 367 (1921) (explaining that while risk presents itself when a company faces possibilities whose odds are discernible, uncertainty, on the other hand, deals with possibilities whose odds are unknown, or where "the possible outcomes themselves are a matter of speculation").

109. Alan Greenspan, *Innovation and Issues in Monetary Policy: the Last Fifteen Years*, 94 AM. ECON. REV. 33, 36–37 (2004) ("In practice, one is never quite sure what

stated that reducing uncertainty, deemed Knightian uncertainty, was one of his primary objectives with regard to the overall marketplace.[110] Knightian uncertainty, because of its unpredictability, can cause both high inflation rates and stock market crashes, and too much can have profound effects on economic development, as it stifles investment and generates unnecessary losses.[111] Professor Dru Stevenson noted that uncertainty is a trait businesses attempt to avoid, and the possible consequences of uncertainty are often negative.[112] Knight, Greenspan, and Stevenson would likely agree that allowing the EPA to retrospectively veto section 404 site specifications introduces a dangerous amount of uncertainty into the marketplace that will cause investors to take their resources out of industries that are regulated by section 404 of the CWA.[113]

Businesses today have enough uncertainty and risk to consider; an unpredictable regulatory framework is an unnecessary, additional burden.[114] Industries must consider where they stand in the midst of a globalized market that relies heavily on cutting-edge technology and political divisions.[115] At a time when businesses need to be able to rely on

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type of uncertainty one is dealing with in real time, and it may be best to think of a continuum ranging from well-defined risks to the truly unknown.").

110. *See id.* at 37–40 ("In pursuing a risk-management approach to policy, we must confront the fact that only a limited number of risks can be quantified with any confidence. And even these risks are generally quantifiable only if we accept the assumption that the future will, at least in some important respects, resemble the past. Policy-makers often have to act, or choose not to act, even though we may not fully understand the full range of possible outcomes, let alone each possible outcome's likelihood. As a result, risk management often involves significant judgment as we evaluate the risks of different events and the probability that our actions will alter those risks.").

111. *See id.* at 38 ("When confronted with uncertainty, especially Knightian uncertainty, human beings invariably attempt to disengage from medium- to long-term commitments in favor of safety and liquidity.").

112. *See* Dru Stevenson, *Special Solicitude for State Standing:* Massachusetts v. EPA, 112 PENN ST. L. REV. 1, 66 (2007) ("People are intuitively averse to uncertainty, even more than they are averse to risk. They will steer their resources away from it when possible. The possibility of sudden, radical moves by any governmental branch introduces genuine uncertainty into many facets of society.").

113. *See generally* Knight, *supra* note 108; Greenspan, *supra* note 109; Stevenson, *supra* note 112.

114. *See* Christian Engau & Volker H. Hoffmann, *Strategizing in an Unpredictable Climate: Exploring Corporate Strategies to Cope with Regulatory Uncertainty*, 44 LONG RANGE PLANNING 42, 43 (2011) (explaining that policymakers' decisions to establish new regulation aimed at intervening into firms' traditional business operations pose a considerable risk for firms and expose them to high regulatory uncertainty).

115. *See* Chris Arnold, *Business Leaders Decry the Economic Cost of Uncertainty*, NPR, Oct. 19, 2013, http://www.kqed.org/news/story/2013/10/19/127321/business_leaders_decry_the_economic_cost_of_uncertainty?category=economy ("Running a company is like driving a car. You need to be able to see what's coming down the

government and its agencies to provide them with a sense of stability and foundation upon which to build, they are left in the dark, adding regulatory distrust to their list of uncertainties when making all business-related decisions.[116]

Professor Rebecca Bratspies recognized this problem and offered a solution; one that, although readily applied, may not be able to fix the unpredictability left by the U.S. Court of Appeals' decision in *Mingo Logan*.[117] She describes the risks and uncertainties that already exist in today's business world, and she explains how the growing distrust between business and government unproductively taints an otherwise stable relationship.[118] Regulatory uncertainty both erodes the public's trust and alienates citizens from decision-making institutions, like the EPA.[119] To regain social resiliency, institutions must make decisions amidst uncertainty to create a more inclusive and transparent regulatory scheme. Without definitive decision-making, however, businesses and citizens begin to distrust those institutions that are meant to help them. This distrust is detrimental to regulatory value in the present and in the future.[120]

For industries and agencies where an amicable relationship is possible, Bratspies offers a simple yet underrated solution: trust.[121] She explains that trust is a crucial resource for responding to uncertainty and lays out the ideal version of that trust narrative in a mutual understanding between the Food and Drug Administration ("FDA") and those who take medicines that could be deadly but are monitored closely by the FDA.[122] As it applies to

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road. The dysfunction in Washington has created a fog, and when driving in the fog, you have to slow down.").

116. *See id.* (providing examples of both small and large businesses that are strongly affected by decisions in Washington); *cf.* Engau & Hoffman, *supra* note 114, at 43 ("[I]ncreasing international regulation for trade, social, and natural environmental purposes exposes firms to continuous uncertainty, so that, more than ever, coping with this uncertainty constituted a fundamental challenge for them.").

117. *See* Rebecca Bratspies, *Perspectives on the New Regulatory Era: Regulatory Trust*, 51 ARIZ. L. REV. 575, 603 (2009) (laying the foundation for "regulatory trust").

118. *See id.* at 577 (noting that "[n]ot only are particular regulatory decisions woven together from strands of uncertainty, but so, too, are the scope and direction of the regulatory endeavor itself").

119. *See id.*

120. *See id.* ("Loss of trust undermines regulatory effectiveness and diminishes society's overall capacity to persevere and even thrive in the face of multiple, unpredictable risks.").

121. *See id.* at 584 ("A reservoir of social trust helps societies remain stable even as administrators make decisions against this overwhelming net of uncertainty.").

122. *See id.* ("The [FDA]'s perceived rigor creates a mantle of trustworthiness that can vouch for the conduct of third parties, thereby facilitating desirable social outcomes. Social trust can thus stabilize ambiguous situations by increasing society's ability to tolerate uncertainty.").

CWA, section 404, Bratspies' solution of regulatory trust is invoked every time the EPA makes a decision not to interfere in a business' permit in spite of some conditions of uncertainty as to how a project may ultimately affect the environment, both natural and wildlife.[123] She would argue that a loss of trust between the EPA and business entities that must apply for a section 404 permit undermines the regulatory effectiveness of the CWA as well as these businesses' ability to succeed in the face of other unpredictable risks inherent in carrying out business operations.[124] In a world full of perfectly rational actors, Bratspies' solution may carry more weight than it does in reality.

Contrary to Bratspies' solution, Mingo Logan Coal cannot be blamed for any distrust toward the EPA from this point forward. Other companies and businesses applying for a section 404 permit will not trust the EPA either due to its unprecedented move in retrospectively revoking Mingo Logan Coal's permit.[125] As long as the EPA has this unlimited veto power, not only is regulatory trust unviable as a possible solution, but also, a growing distrust will further smear an already rocky relationship between the federal agency and industries across the country.[126]

Ironically, the EPA has acknowledged and addressed the role that uncertainty and risk play in creating and reforming its own public policy.[127] The EPA, however, enjoys the advantage of data analysis not available for those business entities that its veto power can potentially destroy.[128] Only the EPA itself can provide any data or improved information to potentially help businesses predict if and when the EPA will use its veto power. Its decision to invoke section 404(c) is not a scientific equation businesses can readily crack; the uncertainty involved can only be resolved by the EPA

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123. *See id.* at 575.

124. *See id.*

125. *See generally* Brief for The Chamber of Commerce of the U.S. et al. as Amici Curiae Supporting Appellee, Mingo Logan Coal Co. v. U.S. EPA, 714 F.3d 608 (2013) (No. 12-5150), 2012 WL 4960379.

126. *See* Bratspies, *supra* note 117, at 577 (indicating that a loss of trust diminishes businesses' ability to persevere).

127. *See generally* NATIONAL RESEARCH COUNCIL, COMMITTEE ON IMPROVING RISK ANALYSIS APPROACH USED BY THE U.S. EPA (2009), *available at* http://www.epa.gov/region9/science/seminars/2012/advancing-risk-assessment.pdf (listing a number of substantial challenges it faces similar to industries affected by § 404, "including long delays in completing complex risk assessments, some of which take decades to complete; lack of data, which leads to important uncertainty in risk assessments; and the need for risk assessment of many unevaluated chemicals in the marketplace and emerging agents").

128. *See id.* (considering uncertainty and variability throughout the risk-assessment process but dismissing their irreparable effect because "uncertainty can be reduced by the use of more or better data . . . [and v]ariability cannot be reduced, but it can be better characterized with improved information").

absent the intervention of Congress or future court decisions.

Other authors have also written about the negative consequences of uncertainty, particularly within the realm of government regulation.[129] Under the auspices of contract law, Professor Alex Seita points out that the bargain theory provides for a mutually exclusive exchange between two parties.[130] Once a party omits certain calculated risks, he finds an estimate of his expected gain from the bargain, but it will be "very much in error when unfavorable outcomes actually occur."[131] If one party breaches the contract, the law will enforce the contract by awarding a remedy despite unanticipated circumstances.[132] Even if a CWA section 404 permit is considered a contract between a company and the federal government via the Army Corps and the EPA, the agreement lacks a similar remedy to provide insurance for businesses in the case of unanticipated circumstances.[133]

Businesses and investors are left with no safety net if they find themselves in a *Mingo Logan* situation. When government or an affiliated agency suddenly changes a policy, as the EPA did by exerting its power in an unprecedented way, it creates a new uncertainty businesses never encountered.[134] The EPA and the U.S. Court of Appeals have placed an undue burden on businesses of not only hedging uncertainty from the market, but also, the uncertainty that accompanies the EPA's capricious authority.

The analysis provided above regarding uncertainty, risk, and its

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129. *See* Farber, *supra* note 107, at 909 (describing a policy of ignoring all nonquantifiable harms as "literally a recipe for disaster"); *see also* Alex Y. Seita, *Uncertainty and Contract Law*, 46 U. PITT. L. REV. 75, 90–91 (1984) (noting that in contract law the more relevant information a party acquires before making a contract, the better able he is to protect himself against or to prevent dangerous outcomes); *cf.* Louis Kaplow, *An Economic Analysis of Legal Transitions*, 99 HARV. L. REV. 509, 527 (1986) (focusing on two consequences of changes in government policy, including the imposition of risk and modification of incentives to engage in affected activities).

130. *See* Seita, *supra* note 129, at 84–85 ("The bargain theory of contracts assumes that in a voluntary exchange, each party to a contract will seek to maximize his own welfare, for no rational individual will ever voluntarily place himself into a position in which he is worse off.").

131. *See id.* at 87 (explaining that unfavorable outcomes transform a contract that once promised an attractive profit into something that burdens the profit with a loss).

132. *See id.* (negating the losses felt by the party suffering unanticipated circumstances).

133. *See* 33 U.S.C. § 1344 (2012) (including no language regarding remedy, reparation, restitution, or compensation).

134. *See* Kaplow, *supra* note 129, at 532 (observing that businesses are unfamiliar with having to juggle both market-created risks and government-created risks and noting that "[m]ost risks in society are not attributable to uncertainty concerning future government action").

detrimental effects to a business' investments will be recognized and feared by businesses everywhere now that the U.S. Court of Appeals for the District of Columbia's decision stands.[135] In a Brief of Amici Curiae in support of Mingo Logan Coal, business groups ranging from the Chamber of Commerce and American Farm Bureau Federation to the Associated General Contractors of America and the National Mining Association joined together to persuade the Court of Appeals to rule against the EPA.[136] The brief analyzed the practical consequences of an adverse ruling, including its effects on activities as diverse as the entities that signed onto the brief, ranging from construction and transportation to agriculture and manufacturing; these industries invest hundreds of billions of dollars in the U.S. economy.[137] It declared that the EPA's action injected a new and untenable level of uncertainty into thousands of project proponents' investment planning processes.[138] Regarding the investment risk, the brief provides hard-number examples supporting its claims.[139] Ultimately, it concluded that an interpretation of section 404(c) that fundamentally contradicts the concept of permit finality dramatically changes the way project proponents view their investments and should not be considered reasonable under step two of the Supreme Court's *Chevron* framework.[140]

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135. Mingo Logan Coal Co. v. EPA, 134 S. Ct. 1540 (2014) ("Petition for writ of certiorari to the United States Court of Appeals for the District of Columbia Circuit denied.").

136. *See* Brief for The Chamber of Commerce of the U.S. et al. as Amici Curiae Supporting Appellee, Mingo Logan Coal Co. v. U.S. EPA, 714 F.3d 608 (2013) (No. 12-5150), 2012 WL 4960379, *2 ("Decreased investment in Section 404 permit-dependent projects will not only directly harm the vast array of industries whose operations require Section 404 permits, but will also result in less growth in numerous other sectors of the economy, since projects that require a Section 404 permit frequently provide substantial downstream economic benefits.").

137. *See id.* at *1, 3 (using as an example the American Road and Transportation Builders Association's (ARTBA) statement that "[i]f the Clean Water Act processes ARTBA members have come to rely upon are disturbed by EPA's unprecedented modification of a previously issued Section 404 permit, it will be difficult, if not impossible, for ARTBA members to rely upon Clean Water Act permits to both build transportation improvements and accomplish environmental objectives through mitigation").

138. *Id.* at *1.

139. *See id.* at *17 ("[I]f a project proponent faces a one percent chance that EPA would act under Section 404(c) after the permit issues, it would decrease the expected cost-benefit ratio for the project by 17.5%. A two percent chance that EPA would take adverse action – not an unrealistic assumption for a large or controversial project – would decrease the project's cost-benefit ratio by 30%.").

140. *See id.* at *22 ("Every project proponent that is contemplating an investment contingent on a Section 404 permit would have to recalculate the costs and benefits of investing, and many would undoubtedly decide that the inability to ever fully rely on a Section 404 permit tips the scales against investing.").

III. COURTS CAN PROVIDE A TEMPORARY SOLUTION, BUT ONLY CONGRESS CAN ELIMINATE UNCERTAINTY BY REMOVING AMBIGUITY FROM THE STATUTE'S PROVISION

One of the most difficult aspects of enforcing and abiding by legislation is its lack of clarity and the broad application of the language. The CWA, for example, applies to many types of industries that engage in different practices, so it becomes extremely difficult to take the language of one statute and apply it across the board to every entity. A statute like section 404 that contains some ambiguity becomes even more complicated when it is applied to many businesses, enforced by agencies with changing leadership, and interpreted by courts with ideologies that shift as often as the membership.

Beyond the clarity and broad application, it is difficult to interpret and apply language written in the 1970s to such a globalized, twenty-first century world. In terms of research alone, it becomes problematic to decipher Congress' intent when documents, transcripts, and reports are not readily available online or printed and available in law libraries. When section 404 was originally enacted in 1972, it affected how businesses moved forward with projects, but in no way did it affect such an array of industries to the degree that it does today. The businesses that must apply for a section 404 permit, those that now must worry about the EPA's volatile veto power, pump hundreds of billions of dollars into the U.S. economy,[141] and that money and those jobs hinge on a single word written somewhat haphazardly over forty years ago.

It is time for Congress, the body who created the issue in the first place, to fix the problem. It constantly amends sections of the CWA, the most recent of which is still pending in our slow and politically fractured legislative branch. The time it would take to propose an amendment and push it through Congress will be immensely rewarding to those businesses who are simply trying to do what they do best: employ workers, stimulate the market-driven economy, and advance society.

This Comment recommends that Congress amend section 404(c) of the CWA to remove any ambiguous language relating to the EPA's power to deny or restrict certain disposal site specifications.[142] By amending the

141. *See id.* at *1 (listing not only the types of activities and industries involved but also the amount of investments they facilitate).

142. *See* 33 U.S.C. § 1344(c) (2012) ("Denial or restriction of use of defined areas as disposal sites. The Administrator is authorized to prohibit the specification (including the withdrawal of specification) of any defined area as a disposal site, and he is authorized to deny or restrict the use of any defined area for specification (including the withdrawal of specification) as a disposal site, whenever he determines, after notice and opportunity for public hearings, that the discharge of such materials into such area will have an unacceptable adverse effect on municipal water supplies, shellfish beds

statute to remedy the unpredictable interpretation of the EPA's power, this Comment recommends amending section 404(c) so that the affected and pertinent language reads as follows:

> The Administrator is authorized to prohibit the specification (including the withdrawal of specification) of any defined area as a disposal site, and he is authorized to deny or restrict the use of any defined area for specification (including the withdrawal of specification) as a disposal site, [if] he determines, after notice and opportunity for public hearings, [but before the issuance of a permit by the Secretary in accordance with Section 404(b),] that the discharge of such materials into such area will have an unacceptable adverse effect on municipal water supplies, shellfish beds and fishery areas . . . , wildlife, or recreational areas. Before making such determination, the Administrator shall consult with the Secretary.[143]

As evidenced by the proposed language, the EPA's approval of the application should be a condition precedent to the Army Corps' approval rather than an arbitrary, and possibly infinite, veto power. The statute originally created a working relationship between the Army Corps and the EPA, and this proposal may heighten tension between the two agencies while placing yet another check on the EPA's authority.

The recent U.S. Court of Appeals decision,[144] a case of first impression, may not have purported the EPA's interpretation of section 404(c) as unconstitutional, but it certainly sets an uncomfortable precedent for business industries all over the U.S. If another case similar to *Mingo Logan* reaches the federal system before the legislative branch acts, this Comment recommends that courts rule similar to the U.S. District Court for the District of Columbia in *Mingo Logan* with a heavy emphasis and discussion on policy.[145] The policy behind a decision like this involves eliminating the complete uncertainty businesses will face if the EPA eternally carries veto power over any section 404 permit. It involves promoting business activity and economic stimulation while diminishing the disillusionment experienced by companies like Mingo Logan Coal Co.

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and fishery areas (including spawning and breeding areas), wildlife, or recreational areas. Before making such determination, the Administrator shall consult with the Secretary. The Administrator shall set forth in writing and make public his findings and his reasons for making any determination under this subsection.").

143. *See id.* (emphasis added) (proposed text in brackets).

144. *See* Mingo Logan Coal Co. v. EPA, 714 F.3d 608, 614 (D.C. Cir. 2013), *cert. denied* 134 S. Ct. 1540 (2014) (holding that the text of § 404(c) clearly and unambiguously gave the EPA the power to act post-permit).

145. *See* Mingo Logan Coal Co. v. EPA, 850 F. Supp. 2d 133, 134 (D.D.C. 2012), *rev'd*, 714 F.3d 608, 614 (D.C. Cir. 2013), *cert. denied*, 134 S. Ct. 1540 (2014) (holding that the CWA does not give EPA the power to render a permit invalid once it has been issued by the Army Corps).

It is about ensuring that the American Dream cannot be held hostage by federal agencies such as the EPA. While the analysis used by the district court may not hold constitutional muster, especially given the *Chevron* analysis, courts should use the abovementioned obvious public policy and equity analyses available to further support a conclusion that the EPA should not have this type of power and that section 404 did not intend to give it such overarching influence.[146]

Businesses who are egregiously affected by an EPA action can find remedy in a civil case against the EPA, one that the Supreme Court has recently found not barred by the CWA.[147] Although the plaintiffs in *Sackett v. EPA* were harmed by the EPA's issuance of a CWA section 309 administrative compliance, they used the courts for a remedy similar to what businesses harmed by a section 404(c) issuance could seek.[148] If a court allows a similar civil remedy with respect to section 404, then businesses harmed by the EPA and its section 404(c) power could file a new wave of cases.

Courts cannot be relied upon forever to provide remedies in the potentially infinite number of lawsuits arising from section 404. It is up to Congress to ultimately alleviate ambiguity and amend the statute to comport with the original intent of section 404(c). It must ensure the economic vitality of business industries while keeping a keen eye on possible detrimental effects to the environment prior to the issuance of § 404 permits.

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146. Business industries recently found themselves on the losing side of a legal battle with the EPA once again in National Mining Ass'n v. McCarthy, Nos. 12-5310, 12-5311, 2014 WL 3377245, at *1 (D.C. Cir. July 11, 2014). This case analyzed the 2009 Enhanced Coordination Process adopted by the Army Corps and the EPA to facilitate their consideration of certain CWA permits, including those regulated by section 404. The District Court for the District of Columbia granted summary judgment for the plaintiffs, the States of West Virginia and Kentucky along with coal mining companies and trade associations, that challenged this procedure and the EPA's Final Guidance. 880 F. Supp. 2d 119, 141–42 (D.D.C. 2012). The same federal court of appeals that ruled in favor of the EPA in Mingo Logan, however, reversed and remanded the decision of the district court in *National Mining Ass'n* as well, holding that the CWA did not prohibit the interagency plan for enhanced consultation and coordination with respect to applications and permits and that the EPA's Final Guidance was not legislative rule subject to judicial review. 2014 WL 3377245, at *8.

147. *See* Sackett v. EPA, 132 S. Ct. 1367, 1374 (2012) (concluding that the compliance order is final agency action for which there is no adequate remedy other than APA review and that the CWA does not preclude that review).

148. *See id.* at 1372 (agreeing with the plaintiffs that the order was "'arbitrary [and] capricious' under the Administrative Procedure Act . . . and that it deprived them of 'life, liberty, or property, without due process of law,' in violation of the Fifth Amendment.").

CONCLUSION

For decades, the CWA section 404 was just another red tape permit businesses needed to obtain before beginning projects that involved the disposal of dredged or fill materials in any U.S. waters or wetlands. The EPA never used its power governed by section 404(c) to revoke a permit that had already been issued by the Army Corps until recently. This retrospective permit revocation had deleterious effects on one particular company, but the frightening and unpredictable potential effects will be felt by businesses across the U.S.

Section 404(c) sets forth the ability of the EPA to deny certain disposal sites within a business' application. It tasks the EPA Administrator with notifying and working alongside the Secretary of the Army, acting through the Chief of Engineers, before that authority is used. If Congress could have predicted *Mingo Logan* on a federal court's docket, then it may have decided differently when constructing the language found within the statute. The U.S. Court of Appeals' recent unprecedented ruling will have a destructive effect on certain business industries that pump hundreds of billions of dollars into the United States economy.

The courts and, ultimately, Congress should provide additional guidance as to how and when the EPA can invoke its section 404(c) veto power. The ability of Congress to slightly amend the language as recommended earlier in this Comment could make all the difference. Its action, which is needed immediately, would be a simple solution to a complex and dangerous problem, a problem with a potential for havoc that has yet to be fully realized.

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NOTES

IT'S NOT JUST ABOUT THE MONEY: A COMPARATIVE ANALYSIS OF THE REGULATORY STATUS OF BITCOIN UNDER VARIOUS DOMESTIC SECURITIES LAWS

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INTRODUCTION

The Internet revolutionized the world like nothing before. It allowed for various forms of communication and connectivity, yet produced a number of social, legal, and economic challenges. Evidently, scholars began to theorize that the Internet would lead to the development of new forms of digital currency.[1] And, they were right.

This Note focuses on the regulatory status of a digital "currency" called Bitcoin.[2] Specifically, it explores whether Bitcoin may be regulated as a "security" under various domestic securities laws. Part II summarizes the unique characteristics of Bitcoin and its current regulatory classification. Part III analyzes the securities laws of the United States, the United Kingdom ("U.K."), Brazil, and Japan— four regional leaders in financial regulation. Part III also applies these laws to Bitcoin, arguing that Bitcoin does not fit squarely within the securities definitions of any country. Lastly, Part IV suggests a possible solution to regulating Bitcoin in the United States under a "quasi-security" framework. It recommends that the Securities and Exchange Commission ("SEC") define Bitcoin as a "quasi-security" and pass regulations aimed solely at Bitcoin regulation, rather than trying to incorporate it into existing legislation. By promulgating new rules, the SEC can effectively spearhead the effort towards global Bitcoin regulation.

I. BITCOIN'S UNIQUE CHARACTERISTICS AND CURRENT REGULATORY CLASSIFICATION

This Section explains what Bitcoin is and how it works. It discusses the unique characteristics of Bitcoin, and gives a brief overview of its varying legal status around the world.

A. Entering the Bitcoin Market

Bitcoin is the first digital currency that allows two parties to directly exchange single monetary units without going through a central payment

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1. *See, e.g.*, Kerry Lynn Macintosh, *How to Encourage Global Electronic Commerce: The Case for Private Currencies on the Internet*, 11 HARV J.L. & TECH 733, 734 (1998) (noting that in the late 1990s, President Clinton stressed the importance of digital currencies and identified electronic payment systems as a key component of "a vigorous electronic marketplace").

2. *See generally* Matt Clinch, *Bitcoin Recognized by Germany as 'Private Money'*, CNBC (Aug. 19, 2013 10:25 AM), http://www.cnbc.com/id/100971898 (stating that some countries also refer to Bitcoin as a form of "private money").

system.[3] The Bitcoin system is regulated entirely by computer software.[4] It awards bitcoins to users through a "mining" program that solves various mathematical proofs and takes increasing amounts of computational power.[5] Once users take time to download this program and use their computers to generate solutions, new bitcoins are issued.[6] However, as the number of users in the system increases, the mathematical proofs become more difficult, which eventually slows down the production of bitcoins over time.[7] Today, due to Bitcoin's popularity, few users acquire bitcoins through the mining process; rather, they acquire bitcoins in exchange for goods and services,[8] or they purchase them directly through online exchanges.[9]

B. Bitcoin Transfers

Once a user enters the Bitcoin market, he or she may choose to engage in Bitcoin transfers. Transfers occur through a network operated by thousands of computers, similar to a music-sharing system like iTunes or Spotify.[10] Bitcoins are sent from one computer to another through

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3. *See* Derek A. Dion, *I'll Gladly Trade You Two Bits On Tuesday For A Byte Today: Bitcoin, Regulating Fraud In The Economy Of Hacker-Cash*, 2013 U. ILL. J.L. TECH. & POL'Y 165, 168–69 (2013) (describing different ways that one can begin trading in Bitcoin and various forums that are used for this trading).

4. *See generally* BITCOIN PROJECT, http://bitcoin.org/ (last visited Jun. 19, 2014) (outlining the basics of the Bitcoin system for new users).

5. Reuben Grinberg, *Bitcoin: An Innovative Alternative Digital Currency*, 4 HASTINGS SCI. & TECH. L.J. 159, 162–63 (2012).

6. *See* Nikolei M. Kaplanov, *Nerdy Money: Bitcoin, The Private Digital Currency, And The Case Against Its Regulation*, 25 LOY. CONSUMER L. REV. 111, 119-20 (2012) (describing the entire mining process and the system of awarding miners with bitcoins).

7. *See* Grinberg, *supra* note 5, at 163 ("As the number of miners in the network changes, the problem difficulty adjusts to ensure that bitcoins are created at a predetermined rate and not faster or slower. Currently, about 50 bitcoins are issued every ten minutes, although the rate will halve to 25 bitcoins in about two years and will halve every four years after that. At those rates, 10.5 million bitcoins will be created in the first four years, half that amount in the next four years, and so on, approaching but never reaching a total supply of 21 million bitcoins."); *see also* Steve Forbes, *Bitcoin: Whatever It Is, It's Not Money!*, FORBES (Apr. 16, 2013 10:50 AM), http://www.forbes.com/sites/steveforbes/2013/04/16/bitcoin-whatever-it-is-its-not-money/ (explaining that, unlike typical currencies, bitcoins have no intrinsic value and their real value is based entirely on supply and demand).

8. *See* Dion, *supra* note 3, at 169 (explaining that both legitimate and illegitimate organizations accept bitcoins in addition to traditional currencies).

9. Dion, *supra* note 3, at 168; *see* PLANET BITCOIN, http://planetbtc.com/complete-list-of-bitcoin-exchanges/ (last visited Jun. 19, 2014) (listing all of the Bitcoin exchanges).

10. *See* Nicholas A. Plassaras, *Regulating Digital Currencies: Bringing Bitcoin within the Reach of the IMF*, 14 CHI. J. INT'L L. 377, 384 (2013) (analogizing bitcoins

individual messages.[11] Each message has a personal identifier called an "address,"[12] and each address has an associated pair of public and private keys, consisting of a string of numbers and letters.[13] When an individual transfers bitcoins to a recipient, the recipient sends his or her address to the transferor.[14] The transferor then adds the address and the amount of bitcoins to the transfer message.[15] Finally, the transferor signs the message with his or her private key, and announces the public key to the recipient for signature verification.[16]

In addition, the Bitcoin system provides a built-in mechanism to prevent individuals from copying and pasting the same digital addresses over and over again—a process that is often referred to as "double spending."[17] The traditional answer to the double-spending problem was a central clearinghouse, such as a bank, to keep a database of all transfers made in an account. However, Bitcoin found a way to alter this approach.[18] After a transfer is completed, the system automatically broadcasts the time of the transfer and adds it to the Bitcoin "block chain."[19] The "block chain" is a computer-generated, public record of all Bitcoin transactions, back to the very first transaction.[20] Every computer on the Bitcoin network has a copy of the entire block chain.[21] After an hour or two, each transfer is locked in time by the massive amount of user transfers added to the block chain.[22] The use of this time-stamping process ensures that the same bitcoin is not used in more than one transfer.[23] Therefore, each individual bitcoin has an

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to music files).

11. COINDESK, http://www.coindesk.com/information/how-do-bitcoin-transactions-work/ (last visited Jun. 19, 2014) (walking through the steps of a bitcoin transaction using hypothetical individuals).

12. *Id.*

13. *Id.*

14. *Id.*

15. *Id.*

16. *Id.*; *see* Kaplanov, *supra* note 6, at 117 (describing the public key as an e-mail address, and the private key as the password needed to authorize the email).

17. Kaplanov, *supra* note 6, at 116–17.

18. *Cf.* Satoshi Nakamoto, *Bitcoin: A Peer-to-Peer Electronic Cash System* (unpublished white paper), http://bitcoin.org/bitcoin.pdf (claiming that the Bitcoin system was able to circumvent the concept of a clearinghouse because bitcoins do not require any backing or "trust").

19. *See* Kaplanov, *supra* note 6, at 11–18.

20. *See* Plassaras, *supra* note 10, at 385–86 (giving an in-depth description of time-stamping and block chain procedures).

21. *See id.*

22. *See id.*

23. *See* Kelsey L. Penrose, *Banking on Bitcoin: Applying Anti-Money Laundering and Money Transmitter Laws*, 18 N.C. Banking Inst. 529, 532–33 (2014) (explaining

irreversible history of transfers, tracing its movement from one computer to the next.[24]

C. Bitcoin's Legal Uncertainty

Due to these unique characteristics, Bitcoin's legal classification remains uncertain. On the one hand, the United States has made significant efforts to regulate Bitcoin as a currency, subject to federal anti-money laundering regulations.[25] On the other hand, the IRS recently announced that it would consider Bitcoin a form of property, subjecting every Bitcoin transaction to capital gains tax.[26]

Other countries have taken similar inconsistent approaches. Brazil has refrained from labeling Bitcoin a currency, requiring Bitcoin holders to file capital gains like any other security. The U.K. has stated that an official legal classification is premature until regulators fully understand how Bitcoin works;[27] yet, it has also treated Bitcoin as a "taxable voucher."[28] Finally, Japan has openly acknowledged that Bitcoin is neither a currency nor a financial product, but that digital currencies may be subject to new trade rules in the future.[29]

Despite these differing views, one commonality remains: no country has engaged in an analysis regarding Bitcoin's classification under existing securities laws.

II. A COMPARATIVE ANALYSIS OF BITCOIN'S CLASSIFICATION AS A

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that the block chain stops others from "double-spending" their bitcoins and that if someone tried to do this, the system would recognize the deficiency and reject the transaction).

24. *See id.*

25. Angelo Young, *US Treasury Department: Virtual Currencies (Read: Bitcoins) Need Real Rules To Curb Money Laundering*, INTERNATIONAL BUSINESS TIMES (March 22, 2013), http://www.ibtimes.com/us-treasury-department-virtual-currencies-read-bitcoins-need-real-rules-curb-money-laundering.

26. Richard Rubin & Carter Dougherty, *Bitcoin is Property, Not Currency in Tax System: IRS*, BLOOMBERG (March 25, 2014 4:25 PM), http://www.bloomberg.com/news/2014-03-25/bitcoin-is-property-not-currency-in-tax-system-irs-says.html.

27. Emily Spaven, *HMRC: UK Bitcoin Exchanges Don't Have to Register Under Money Laundering Regulations*, COINDESK (Jul. 8, 2013 2:39 PM), http://www.coindesk.com/hmrc-uk-bitcoin-exchanges-dont-have-to-register-under-money-laundering-regulations.

28. David Gilson, *Bitcoin in the UK: HMRC suggests bitcoins are 'taxable vouchers'*, COINDESK (Nov. 14, 2013 4:30 PM), http://www.coindesk.com/bitcoin-uk-hmrc-suggests-bitcoins-taxable-vouchers/.

29. *Tokyo Leaves Bitcoin Outside Financial Product Regulatory Framework*, ASIAN REVIEW (Mar. 10, 2014 7:00 PM), http://asia.nikkei.com/Politics-Economy/Policy-Politics/Tokyo-leaves-Bitcoin-outside-financial-product-regulatory-framework.

SECURITY IN THE UNITED STATES, THE U.K., BRAZIL, AND JAPAN

The regulation of new, cross-border financial instruments, such as Bitcoin, is impeded by a lack of regulatory harmonization. Although the trend is shifting towards international harmonization of securities laws and standards, the existence of inconsistent national rules is a challenge for regulators around the world. Some jurisdictions, such as the United States and Brazil, have developed broad, inclusive definitions for securities in order to address new, unorthodox instruments, while other jurisdictions have not. This Part summarizes the securities laws of the United States, the U.K., Brazil, and Japan, and applies those laws to Bitcoin. These countries are not only considered leaders of securities regulation in their respective geo-political spheres, but also, have similar economic and financial structures.[30] Taken together, they provide a representative sample of securities regulation around the world.

A. Although the United States Adopts a Broad Approach to Securities Regulation Compared to Other Countries, Bitcoin Does Not Fit Squarely Within its Securities Laws.

Securities regulation in the United States is broad due to its flexible definition of "securities." According to the Securities Act of 1933,[31] a security includes common financial instruments like stocks and bonds, as well as "investment contracts."[32] The Supreme Court has defined the broad, "investment contract" category through a four-part test—commonly known as the *Howey* test.[33] According to this test, an investment contract

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30. *See* INTERNATIONAL MONETARY FUND, UNITED KINGDOM: IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION: DETAILED ASSESSMENT OF IMPLEMENTATION (2011), *available at* https://openknowledge.worldbank.org/bitstream/handle/10986/15973/807280ESW0Braz00Box379814B00Public0.pdf?sequence=1 (finding that the U.K. is the leading equity marketplace in Europe) appear to be in place"); *see also* INTERNATIONAL MONETARY FUND, BRAZIL: IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION: DETAILED ASSESSMENT OF IMPLEMENTATION (2013), *available at* https://openknowledge.worldbank.org/bitstream/handle/10986/15973/807280ESW0Braz00Box379814B00Public0.pdf?sequence=1 (concluding that "the Brazilian equity market made impressive gains in market capitalization and liquidity over the past decade" compared to other Latin American countries); INTERNATIONAL MONETARY FUND, JAPAN: IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES REGULATION: DETAILED ASSESSMENT OF IMPLEMENTATION (2012), *available at* http://www.imf.org/external/pubs/ft/scr/2012/cr12230.pdf (stating that the legal and regulatory framework for the securities market in Japan exhibits a high level of implementation of international standards for securities regulation).

31. 15 U.S.C. § 77 (1933).

32. 15 U.S.C. § 77b(a)(1); *see also* § 78c(a)(10) (containing substantially identical language).

33. SEC v. W. J. Howey Co., 328 U.S. 293, 299–300 (1946) (holding that an investment in the cultivation, harvesting, and marketing of fruit from citrus trees is an

is: (1) an investment of money, (2) in a common enterprise, which is (3) expected to produce profits, due to (4) the efforts of others.[34]

The four elements of the *Howey* test have been developed through case law. First, the "common enterprise" element has been subject to two differing jurisdictional approaches.[35] Under a horizontal commonality approach, courts have held that the "common enterprise" element is satisfied if the transaction involves a joint participation of investors sharing in the profits.[36] Therefore, this approach involves a "tying" of each individual investor's fortune to the fortunes of other investors.[37] Under a vertical commonality approach, a court need only find that the fortunes of an investor are tied to the expertise of the promoter, not to the fortunes of other investors.[38]

Second, the "expectation of profits" element is only satisfied in situations where an investor is looking for a financial return, not a commodity or service.[39] Thus, the "expectation of profits" must be the principal motivation for the investment of money.[40] As the Court concluded in *United. Housing Foundation, Inc. v. Forman*, "profits" refer to "either capital appreciation resulting from the development of the initial investment . . . or a participation in earnings resulting from the use of investors' funds . . . ."[41] For this reason, an investor must be "'attracted

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investment contract because it satisfies the four elements of an investment contract).

34. *Id.* at 298–99.

35. *See* John F. Wagner, *"Common enterprise" element of* Howey *test to determine existence of investment contract regulable as "security" within meaning of Federal Securities Act of 1933 (15 U.S.C.A. § 77a et seq.) and Securities Exchange Act of 1934 (15 U.S.C.A. § 78a et seq.)*, 90 A.L.R. FED. 825 (1988) (summarizing all of the case law in relation to the horizontal commonality approach and the vertical commonality approach).

36. *E.g.*, Wals v. Fox Hills Dev. Corp., 24 F.3d 1016, 1018 (7th Cir. 1994) (explaining that the horizontal commonality approach requires that the fortunes of two or more investors be joined in a pooling of interests).

37. Revak v. SEC Realty Corp., 18 F.3d 81, 87 (2d Cir. 1994); *see* Salcer v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 682 F.2d 459, 460 (3rd Cir. 1982) (stating that the investment must be "part of a pooled group of funds"); *see also* Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276 (7th Cir. 1972) (emphasizing that the success or failure of contracts by other investors must have a "direct impact on the profitability of the plaintiffs' contract").

38. *E.g.*, SEC v. Cont'l Commodities Corp., 497 F.2d 516, 522 (5th Cir. 1974) (ruling that the critical inquiry in determining whether the common enterprise element is satisfied is whether the fortuity of the investments made with a particular promoter depend on the promoter's expertise).

39. *See* United Hous. Found., Inc. v. Forman, 421 U.S. 837, 856–57 (1975) (concluding that rental reductions and tax deductions resulting in savings do not qualify as an expectation of profits).

40. *Id.* at 852.

41. *Id.* (quoting SEC v. W. J. Howey Co., 328 U.S. 293, 300 (1946)).

solely by the prospects of a return' on his investment."[42]

Third, the "efforts of others" element of the *Howey* test has also been subject to differing views. Various lower courts have concluded that investor participation in the generation of profits does not automatically foreclose the finding of an investment contract, even though the original *Howey* test required that profits result solely from the efforts of others.[43] Courts have concluded that investors may be able to make small contributions to the generation of profits; yet, such contributions must be passive, and the efforts of others must predominate.[44] Therefore, one important factor in the satisfaction of the "efforts of others" element is the amount of control that investors retain under their investment agreements.[45]

Finally, courts have applied the *Howey* test to a wide range of varying contexts like pyramid schemes.[46] Using the *Howey* test, courts have concluded that investments in pyramid schemes constitute securities because they seek to attract monetary investments in a common enterprise, involving a promoter who organizes the entire scheme with the promise of future returns arising from the efforts of the promoter in attracting new investors.[47] Although it would seem that pyramid schemes defy the horizontal commonality approach to the "common enterprise" element because the continued success of the scheme depends mostly on investors who end up luring more investors through favorable pronouncements regarding the scheme's high returns, courts have applied the "common enterprise" element quite loosely in such circumstances.[48]

Given the broad, "investment contract" category and its liberal application, the remaining question is whether the SEC can regulate Bitcoin under existing securities regulations. So far, it appears that the SEC may regulate instruments based on the value of bitcoins under federal securities laws.[49] But, can a bitcoin *itself* constitute a security? In other words, when

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42. *Id.*

43. *See, e.g.,* Robinson v. Glynn, 349 F.3d 166, 170 (4th Cir. 2003) (stating that, in addition to the Fourth Circuit, the Supreme Court has relaxed the "efforts requirement by omitting the necessity of the word "solely").

44. *See, e.g.,* SEC v. Galaxy Foods, Inc., 417 F. Supp. 1225, 1239 (E.D.N.Y. 1976) (explaining that the existence of an investment contract turns upon an analysis of the nature and extent of an investor's participation and therefore, the efforts of others should be undeniably significant ones which affect failure or success of the enterprise).

45. Albanese v. Fla. Nat.'l Bank of Orlando, 823 F.2d 408, 410 (11th Cir. 1987).

46. *See* ALAN R. PALMITER, EXAMPLES & EXPLANATIONS: SECURITIES REGULATION, 55-56 (Wolters Kluwer, 5th ed. 2011) (explaining why and how the U.S. definition of "securities" specifically applies to pyramid schemes).

47. *See id.* at 55.

48. *See, e.g.,* SEC v. SG Ltd., 265 F.3d 42, 50 (1st Cir. 2001) (finding a security in an online investment game that depended on the ability of players to lure new players).

49. *See* SEC v. Shavers & Bitcoin Trust, No. 4:13–CV–416, 2013 WL 4028182 *2

you buy a bitcoin, are you buying an investment in the hope of acquiring a future return?

Although the "investment of money" prong under the *Howey* test is easily satisfied because users buy bitcoins on exchanges using traditional forms of money,[50] the other three elements require further analysis. First, one could argue that the "common enterprise" element of the *Howey* test is satisfied because users enter a network composed of like-minded users who all have a common desire to continue the block chain and add to Bitcoin's value.[51] Bitcoin may have "horizontal" commonality because the fortunes of all individual users are tied together; each individual user is better off when the value of Bitcoin rises and worse off when the value of Bitcoin drops.[52] Bitcoin may not have "vertical commonality," on the other hand, because the fortune of each individual user is not tied to the expertise of a sole "promoter," especially since no single entity manages the entire Bitcoin community.[53]

The last two prongs of *Howey* are also in dispute. With regards to an "expectation of profits," most Bitcoin movement involves investors, speculators, and traders reacting to price fluctuations, seeking a return on their investment. Yet, despite this fact, the "expectation of profits" element may not be satisfied because the primary purpose for Bitcoin is the facilitation of commercial exchange.[54] Moreover, "the efforts of others" prong may also point in either direction. On the one hand, Bitcoin's profitability does not depend on the efforts of others because private users control every aspect of a transfer;[55] but, on the other hand, Bitcoin users

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(E.D. Tex. Aug. 6, 2013) (establishing that a Bitcoin-based fund is a security, subject to the SEC's rules and regulations).

50. Grinberg, *supra* note 5, at 196–97. *But see* Dion, *supra* note 3, at 183-84 (suggesting that Bitcoins involve investments of CPU power for solving block chains, more so than investments of money).

51. *See* Grinberg, *supra* note 5, at 197 (indicating that Bitcoin has horizontal commonality because everyone is proportionally better off when the value of Bitcoin increases).

52. *Id.*; *see* Kaplanov, *supra* note 6, at 160 (stating that there is a "common enterprise of software developers who maintain bitcoin's value").

53. Grinberg, *supra* note 5, at 197. *But see* Jose Pagliary, *Bitcoin Flaw Could Let Group Take Control of Currency*, CNN MONEY (Nov. 4, 2013), http://money.cnn.com/2013/11/04/technology/bitcoin-flaw/ (reporting that according to a Cornell study, a single group may be able to control Bitcoin).

54. *See, e.g.*, John William Nelson, *Why Bitcoin Isn't a Security Under Federal Securities Law*, LEX TECHNOLOGIAE (June 26, 2011 11:49 PM), http://www.lextechnologiae.com/2011/06/26/why-bitcoin-isnt-a-security-under-federal-securities-law (arguing that securities laws do not apply to Bitcoin because Bitcoin is used for commercial exchange).

55. Grinberg, *supra* note 5, at 162–63.

play no active role in the system's management or overall viability.[56]

Lastly, the SEC may choose to classify Bitcoin as a security due to its similarity to pyramid schemes.[57] Since its inception, Bitcoin has sought to lure new users into a "common enterprise," involving both Bitcoin users and developers. The entire Bitcoin system lacks intrinsic value because its value depends only on the willingness of users to accept it.[58] Therefore, like a pyramid scheme, the more users that are brought into the system, the more likely it is that original users receive greater returns because the demand for bitcoins will rise, leading to an increased value for each individual bitcoin.

B. Compared to the United States, the U.K., Brazil, and Japan Represent Varying Degrees of Flexibility for Securities Regulation.

The U.K.'s approach to securities regulation is quite exclusive, and the "securities" concept under U.S. laws is most akin to the "investment" concept in the U.K.'s Financial Services and Markets Act ("FSMA").[59] Although the FSMA provides a general definition for "investment," whether a particular instrument constitutes an "investment" depends on a two-part analysis.[60] First, the activity must fall into the categories of investments enumerated in Part II of Schedule 2 of the FSMA; and second, the activity associated with the investment must be a "regulated activity."[61]

The first step in the "investment" analysis is whether an instrument falls within the "specified" categories of investment in Part II of Schedule 2 of the FSMA.[62] This section includes "specified" categories including, but

56. Grinberg, *supra* note 5, 197–99 (noting that it is up to the developers of Bitcoin to ultimately keep the system going).

57. *Cf.* VIRTUAL CURRENCY SCHEMES, EUROPEAN CENTRAL BANK (2012), *available at* http://www.ecb.europa.eu/pub/pdf/other/virtualcurrencyschemes201210en.pdf ("Therefore, although the current knowledge base does not make it easy to assess whether or not the Bitcoin system actually works like a pyramid or Ponzi scheme, it can justifiably be stated that Bitcoin is a high-risk system for its users from a financial perspective, and that it could collapse if people try to get out of the system and are not able to do so because of its illiquidity.").

58. *See* Forbes, *supra* note 7 (characterizing Bitcoin as a currency that is different from typical government-backed currencies because it has no intrinsic or "fixed" value and therefore, its real value is based entirely on what others are willing to pay for it).

59. Financial Services and Markets Act, 2000, c. 8 (U.K.) (regulating securities markets in the U.K.); *see* Frederick H. C. Mazando, *Taxonomy of Global Securities: Is the U.S. Definition of a Security too Broad?*, 33 NW. J. INT'L L. & BUS. 121, 150–51 (2012).

60. *See* Mazando, *supra* note 54, at 151.

61. *See id.*

62. § 22(2), sch. 2.

not limited to, stocks, deposits, electronic money, and options.[63] Under the FSMA, "specified" is defined as "specified in an order made by the Treasury."[64] Therefore, a "security" may include any instrument falling within the definitions of these enumerated categories,[65] or any other instrument that the Treasury defines as an investment.[66]

The second step in the "investment" analysis is whether an activity is a "regulated activity."[67] In order to constitute a "regulated activity," two requirements must be satisfied: (1) the activity must be geographically linked to the U.K. "by way of business,"[68] and (2) the activity must relate to an investment of a "specified" kind.[69] Overall, the FSMA considers the following activities to be "regulated activities," among others: dealing in investments, arranging deals or managing investments, and establishing collective investment schemes.[70]

Brazil, on the other hand, adopts a fairly liberal approach compared to both the U.K. and the United States. Essentially, Brazil's definition for "security" is more inclusive because its category for "investment contracts" has fewer requirements than the *Howey* test.[71] In 2001, Brazil codified the *Howey* test language into its Capital Market Law, rather than developing the test through litigation.[72] Article 2 of The Brazilian Capital Market Law provides the following category: "(i) when publicly offered, any other collective investment instrument or contract that creates the right of participation on profits or remuneration, including those resulting from the rendering of services, and whose profits derive from the efforts of the entrepreneur or from the efforts of any third parties."[73]

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63. *Id.*; *see* Mazando, *supra* note 54, at 152 (listing the classes and categories of "specified" investments in Part II Schedule 2 of the FSMA); *see also* Robert C. Rosen & Gordon R. Walker, INTERNATIONAL SECURITIES REGULATION 8: UK-1-18—1-19 (Thomas Reuters/West, 10/2012).

64. § 22(5).

65. *See* Mazando, *supra* note 54, at 152 (explaining that "enumerated category" applies to all those categories in Part II of Schedule 2 of the FSMA or categories specified in secondary legislation).

66. Financial Services and Markets Act, 2000, c. 8, § 22(5) (U.K.).

67. § 22(1).

68. §§ 19, 22(1); *see* Mazando, *supra* note 54, at 151 (describing the first requirement as both a geographic test and a business test).

69. § 22(1)(a)–(b).

70. *See* § 22(2), sch. 2, arts. 2-9(A); *see* Mazando, *supra* note 54, at 151 (providing a list of regulated activities barred without prior FSMA authorization).

71. Law No. 10,303 of 2001 (Braz.).

72. Marcus Best & Jean-Luc Soullier, INTERNATIONAL SECURITIES REGULATION HANDBOOK 93 (Kluwer Law International, 3rd ed. 2010).

73. Law No. 10,303, art. 2.

Like the *Howey* test, this category requires an investment instrument or contract that creates: (1) a *right* to share in the profits from (2) the efforts of an entrepreneur or any third parties.[74] These two elements are similar to the last two elements of the *Howey* test: (1) an expectation of profits from (2) the efforts of others;[75] yet, unlike the *Howey* test, this broad category does not require an investment of money, nor does it require the presence of a "common enterprise."[76]

Lastly, although Japanese financial regulations have been primarily modeled after U.S. laws,[77] the Japanese definition for "security" is the most inclusive.[78] According to the Japanese Financial Instruments and Exchange Act ("FIEA"), the term "security" means any "right" with economic characteristics or features.[79] The FIEA provides a long list of equity and debt instruments, which are commonly known as securities.[80] The FIEA also includes a broad category that may allow for Bitcoin regulation.[81] This category suggests that, when taking into account various factors such as liquidity and the extent to which a particular novel instrument has similar economic characteristics to those securities listed within the FIEA, the Japanese Cabinet may choose to regulate a "right" as a security if it deems that such regulation is "necessary to secure the public interest or the protection of investors."[82]

C. Despite Such Differing Jurisdictional Approaches, Bitcoin Does Not Fit Squarely within the Laws of the U.K., Brazil, or Japan.

Bitcoin is unlikely to fall within the scope of the U.K. definition because

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74. *Id.*; Robert C. Rosen & Gordon R. Walker, *International Securities Regulation* 4: JP-4—JP-5 (Thomas Reuters/West, 10/2012) (explaining that although various Japanese laws in the 19th and 20th century were modeled after European laws, the end of World War II created a shift for securities regulation and now most Japanese financial laws are substantially influenced by Anglo-American law).

75. Sec. & Exch. Comm'n v. W. J. Howey Co., 328 U.S. 293, 299–300 (1946).

76. Law No. 10,303.

77. *See* Rosen & Walker, *supra* note 74, at 4: JP 4–5(explaining that although various Japanese laws in the 19th and 20th century were modeled after European laws, the end of World War II created a shift for securities regulation and now most Japanese financial laws are substantially influenced by Anglo-American law).

78. Financial Instruments and Exchange Act [FIEA], Law No. 25 of 2006, art. 1 (Japan).

79. *Id.* art. 2; *see generally* Rosen & Walker, *supra* note 74 (giving a broad overview of the Japanese statutory definition for securities).

80. FIEA, art. 1; *see* Rosen & Walker, *supra* note 74, at 4: JP-19—JP-20 (listing and discussing all of the enumerated categories of securities that fall under Article 1 of the FIEA).

81. FIEA, art. 1, para. 1, xxi.

82. *Id*,; Rosen & Walker, *supra* note 74, at 4: JP-19—JP-20.

securities are confined to those instruments specifically enumerated within the FSMA, depriving regulators of the opportunity to interpret a broad category, like that of "investment contracts" under the U.S. regulatory regime.[83] The FSMA's list includes instruments that are commonly held to be securities by most jurisdictions, and Bitcoin is so novel that it is not yet commonly recognized as a security. The FSMA does, however, include one potential category under which Bitcoin may fall: the FSMA lists "electronic money" as a specified category within its investment definition.[84] Because Bitcoin has been regarded as a form of digital currency used to buy goods and services online, it may easily fit within this specified category of investments; however, the particular scope of Bitcoin's regulation under the FSMA will ultimately depend on the type of Bitcoin activity that is conducted.

In order to qualify as a "regulated activity" under the FSMA, an activity must be geographically linked to the U.K. "by way of business."[85] Many factors determine whether an activity is carried on "by way of business."[86] Some of these factors include the activity's degree of continuity and the existence of a commercial element.[87] Generally, it is difficult to argue that one's activities do not satisfy the business element of the "regulated activity" test, as most companies dealing with the specified categories of investments discussed in the FSMA are carrying on some sort of business;[88] however, the FSMA specifically lists "issuing electronic money" as the only type of "regulated activity" associated with the "specified" category of electronic money.[89] For this reason, under the FSMA's definition, regulating Bitcoin may be limited *only* to those individuals who partake in the issuance of individual bitcoins, that is, large Bitcoin exchanges.

In contrast, Bitcoin has a better chance of falling within the scope of the Brazilian definition for security. As previously mentioned, in order to fall within the scope of Brazil's definition, Bitcoin must constitute an investment agreement that (1) creates a *right* for its users to share in the profits, depending on (2) the efforts of a third party.[90] This second element

83. Mazando, *supra* note 54, at 156-57 (describing the FSMA's limited scope when defining a "security").

84. Financial Services and Markets Act, 2000, cmt. 8, § 22(2), sch. 2, (U.K.).

85. FSMA, §§ 19, 22(1).

86. Mazando, *supra* note 54, at 151.

87. *Id.*

88. *See* Rosen & Walker, *supra* note 58, at UK-1-17 (arguing that it is generally hard for anyone to argue that their activities relating to specified instruments are not by way of business).

89. FSMA, § 22(2), sch. 2; Rosen & Walker, *supra* note 58, at UK-1-17.

90. Law No. 10,303 of 2001 (Braz.).

is similar to the fourth element of the *Howey* test, and therefore, a similar analysis may be used: although private users control every aspect of a Bitcoin transfer, Bitcoin's management, profitability, and viability depend solely on the program's developers, which ultimately satisfies the "efforts of a third party" element in the Brazilian regulatory system.

Contrastingly, the first element of the Brazilian definition is not easily satisfied with regards to Bitcoin. The Brazilian definition of security requires a *right* to share in the profits, not just an *expectation*, as stated under the *Howey* test.[91] This difference in language suggests that there may be a contractual component involved. As such, the Bitcoin system does not contractually guarantee a right to its users; Bitcoin users enter the system at their own risk without any guarantees from Bitcoin's developers. Despite this disputed element, however, the Brazilian definition still does away with the "common enterprise" element—the hardest element to satisfy under the *Howey* test—which shows that Bitcoin is, nonetheless, more likely to fall within the scope of Brazilian securities regulations, than U.S. securities regulations.

Lastly, Bitcoin regulation may be easiest in Japan. The FIEA ultimately allows the Japanese Cabinet to regulate any "right" as a security if, after taking into account factors such as the liquidity and the extent to which a particular novel instrument has similar economic characteristics to those securities listed within the FIEA, the Cabinet deems such regulation "necessary to secure the public interest or the protection of investors."[92] First, bitcoins have similar economic characteristics to typical securities. Most securities, like stocks and bonds, have no intrinsic value because their value is derived from some other underlying valuable asset. Likewise, bitcoins do not have intrinsic value because their value is based entirely on supply and demand.[93] Second, bitcoins resemble investments because the vast majority of activity in the Bitcoin market involves the movement of bitcoins through investors and traders on Bitcoin exchanges, and this activity is based on speculation regarding Bitcoin's fluctuating market price.[94]

Additionally, Bitcoin liquidity is quite limited because the entire system

91. *Id.*

92. Financial Instruments and Exchange Act, Law No. 25 of 2006, art. 1, para. 1, xxi (Japan).

93. Forbes, *supra* note 7.

94. *See* Carter Dougherty, *Wall Street Bitcoin Fans Try to Make Real Money from Virtual*, BLOOMBERG (Jan. 6, 2014 10:52 AM), http://www.bloomberg.com/news/2014-01-06/wall-street-bitcoin-fans-seek-to-make-real-money-from-virtual.html (stating that most Bitcoin enthusiasts are buying and holding the currency, betting that it will rise in value, while others are engaging in other types of investment activities such as trading, exchanging or storing bitcoins).

is designed so that there will only ever be a total of 21 million bitcoins in circulation.[95] This limited liquidity means that Bitcoin merchants cannot comfortably sell their orders at a known or predictable price, and therefore, a sizable sell order itself could have the potential to drive down the entire market price for bitcoins.[96] Due to Bitcoin's illiquid nature, which may give rise to large price fluctuations, the Japanese Cabinet may deem Bitcoin regulation necessary for the protection of investors.

That being said, if one were to adhere to a strict interpretation of the FIEA, Bitcoin may actually fall outside the scope of the Japanese definition, as well. Like the Brazilian definition of a "security," the FEIA uses the term "right"—not expectation—when defining a "security."[97] This suggests that there is a contractual component involved, and the Bitcoin system does not contractually guarantee any rights to its users, but rather bitcoin users enter the system at their own risk without any guarantees from the system's developers. Therefore, Bitcoin may also fall outside the Japanese definition.

With such uncertainties for Bitcoin, the next Part provides a solution to domestic Bitcoin regulation. It recommends that the SEC regulate Bitcoin as a "quasi-security," subjecting it to some reporting requirements, but not others.

III. SOLUTION: BITCOIN AS A "QUASI-SECURITY"

Despite the varying approaches to securities regulation analyzed in Part III, there is no existing definition that easily incorporates Bitcoin into existing laws. Although the United States has created a broad definition for securities, Brazil's definition eliminates two key requirements. Contrastingly, the U.K. definition is the most exclusive, as it contains no broad category and allows regulation only of those instruments specifically enumerated within the FSMA. Finally, the Japanese definition adopts the most inclusive approach, allowing the regulation of any economic right that the Japanese Cabinet deems necessary to protect the public interest; yet, as previously mentioned, even this inclusive approach may give rise to uncertainties for Bitcoin regulation.

Generally speaking, amending the *Howey* test to mirror any of the definitions analyzed in this Note would prove particularly unhelpful as a proper regulatory solution to Bitcoin regulation, especially since bitcoins

95. *See* Robert MacGregor, *Bitcoin is Money. . . It's Just Terrible At It*, YAHOO FINANCE (Jul. 29, 2013 4:57 PM), http://finance.yahoo.com/blogs/the-exchange/bitcoin-money-just-terrible-205752180.html (explaining that due to Bitcoin's illiquid nature, the very act of disposing or selling Bitcoins may devalue them).

96. *Id.*

97. FIEA, art. 1.

themselves do not fall squarely within any approach. The *Howey* test has become a useful guide for courts when determining whether unorthodox investments fall within the scope of existing federal securities legislation. Therefore, amending *Howey* to facilitate the inclusion of digital financial instruments like Bitcoin may not only retroactively affect the status of other unorthodox instruments, but also, it may burden various agencies that have relied on this test for so long.

If amending existing securities regulations is not the proper approach to Bitcoin regulation, then what is? I argue that the United States and other jurisdictions should create new laws to successfully regulate Bitcoin as a "quasi-security." As an agency whose primary mission is to protect investors from risky investments that are not fully understood by the general public, the SEC should study the various risks associated with Bitcoin and decide whether it should extend certain requirements to bitcoin transactions and bitcoin-based products.

Ideally, the SEC should extend regulations to key actors in the Bitcoin community, requiring such entities to either register themselves or disclose material information. For example, the SEC could require large bitcoin wallet holders to register themselves, especially if they are in the business of buying and selling bitcoins. Similarly, the SEC could compel exchanges to periodically report large transactions, especially those transactions that are large enough to substantially alter the market value of bitcoins and create devastating losses for bitcoin users. It could require exchanges to disclose material facts regarding the amount of Bitcoin traffic in a day as well as any attacks or attempted attacks on the entire network. Lastly, the SEC could also resort to indirect control over Bitcoin by imposing amount limitations on individuals and/or entities that invest using bitcoins, as well as, establishing capital requirements on trading houses, banks, and other entities that hold bitcoins.

CONCLUSION

If not properly regulated, Bitcoin has the potential to create a disruptive and risky new global monetary system. Bitcoin not only poses grave money-laundering dangers, but also, it has the tendency to result in drastic price fluctuations, which may create various risks for users and investors in bitcoin-based financial products. Notably, regulators should seek a solution that will provide proper oversight and investor protection, without discouraging economic growth and investment.

KEEP IT SECRET; KEEP IT SAFE: A PRACTITIONER'S GUIDE TO THE "BRIC" TRADE SECRET REGIMES

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As the global economy recovers from the 2008 financial crisis, it has become paramount for companies to protect their intellectual property assets abroad. This is especially true in countries that are notorious for lackluster statutory protection and inefficient policing and enforcement. This Note seeks to advise practitioners on the domestic trade secret regimes of Brazil, Russia, India, and China – collectively the BRICs. In this difficult economic climate, both the importance of trade secrets and the threat of misappropriation increase. In addition to outlining relevant domestic trade secret statutory provisions, this Note expounds on the most dangerous aspects inside each BRIC country. Finally, this Note explains which of the four BRIC countries is the safest and which represents the largest risk to American multinational enterprises that export their trade secrets and other intellectual property.

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INTRODUCTION

In late 2003, the large investment bank Goldman Sachs released a paper entitled "Dreaming With BRICs: The Path to 2050."[1] The authors forecasted – quite optimistically – the rise of the "BRIC economies," an acronym that refers to Brazil, Russia, India, and China.[2] Using a number of projection factors, such as gross domestic product (GDP), GDP per capita, and GDP averages, the authors predicted that the BRICs would become a much more powerful, if not *the* most powerful, global economic force by 2050.[3]

To an extent, these predictions are on point – as of 2012, all of the BRICs have secured their positions as four of the top ten international economies.[4] Despite this monumental growth, not even the BRIC

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1. Dominic Wilson & Roopa Purushothaman, *Dreaming With BRICs: The Path to 2050*, GOLDMAN SACHS, GLOBAL ECONOMICS PAPER NO. 99 (2003) *available at* http://www.goldmansachs.com/our-thinking/archive/archive-pdfs/brics-dream.pdf.

2. *See id.* at 4 (forecasting that by 2040, the BRIC nations could be worth more in dollar terms than the G6, which is comprised of the United States, the United Kingdom, Italy, France, Germany, and Japan).

3. *See id.* at 9 (predicting collective BRIC GDP to top the economic scales at US$ 84,201 billion in 2050); *see also Six Global Trends Shaping the Business World: Emerging Markets Increase Their Global Power*, ERNST & YOUNG, http://www.ey.com/GL/en/Issues/Business-environment/Six-global-trends-shaping-the-business-world—Emerging-markets-increase-their-global-power (last visited Oct. 6, 2013) ("By 2020, the BRICs are expected to account for nearly 50% of all global GDP growth. Securing a strong base in these countries will be critical for investors seeking growth beyond them.").

4. *See, e.g.*, *Gross Domestic Product 2012*, THE WORLD BANK (Dec. 17, 2013) http://databank.worldbank.org/data/download/GDP.pdf (ranking China second, Brazil seventh, the Russian Federation as eighth, and India as tenth).

economies were shielded from the economic recession of 2008.[5] One resounding effect of the global recession on the BRIC countries was a loss of foreign direct investment (FDI); all four countries saw a dramatic drop from 2008 to 2009.[6] Regardless of this temporary stagnation, FDI into some of the BRICs has picked up since 2009, and the four countries remain prominent targets for companies wishing to take advantage of the emerging markets.[7]

Expansion into these countries can be a risky endeavor on many fronts, and this Note seeks to expound on one of them: the threat of trade secret misappropriation abroad. Companies inside of the United States have grown comfortable utilizing the extensive legal protections afforded to trade secrets by both state and federal law.[8] Unfortunately, this level of protection is not available in the BRIC countries – in fact, each country ranks among the worst for intellectual property protection.[9] American multinational enterprises (MNEs) must tread carefully when exporting their

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5. *See GDP Growth (Annual %)*, THE WORLD BANK, http://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG (last visited Dec. 20, 2013) (presenting the differences in GDP growth rate for the BRICs before and after the global recession).

6. *FDI in Figures*, THE ORGANIZATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT 2 (Apr. 2013) *available at* http://www.oecd.org/daf/inv/FDI%20in%20figures.pdf.

7. *See id.* (showing large increases in FDI for China and Brazil and small decreases for Russia and India); *see also* Merrill Matthews, *Companies "Outsource" Because That's Where the Sales Are*, FORBES (July 20, 2012, 3:20 PM), http://www.forbes.com/sites/merrillmatthews/2012/07/20/companies-outsource-because-thats-where-the-sales-are/ (arguing that the reason why companies like Caterpillar and GE conduct almost fifty percent of their business abroad is because many expanding countries are experiencing a blooming middle class, creating new, profitable markets for U.S. companies).

8. *See, e.g.*, ROBERT P. MERGES ET AL., INTELLECTUAL PROPERTY IN THE NEW TECHNOLOGICAL AGE 35 (Vicki Been et al. eds., 5th ed. 2010) (noting that every state has adopted some form of trade secret protection, most of which were modeled after the Uniform Trade Secrets Act, the origin being common law tort); *see generally* Theft of Trade Secrets 18 U.S.C.A. § 1832 (West 2012) ("Whoever, with intent to convert a trade secret, that is related to a product or service used in or intended for use in interstate or foreign commerce, to the economic benefit of anyone other than the owner thereof, and intending or knowing that the offense will, injure any owner of that trade secret, knowingly . . . steals . . . such information"); UNIF. TRADE SECRETS ACT § 1 (1985).

9. *See Measuring Momentum: Global Intellectual Property Center International IP Index*, UNITED STATES CHAMBER OF COMMERCE 24 (Dec. 2012), *available at* http://www.theglobalipcenter.com/measuring-momentum-the-gipc-international-ip-index/ [hereinafter *GIPC International IP Index*] (ranking the United States as the most effective protector of IP rights, while listing Russia, Brazil, China, and India as the least effective in a report that examined different factors such as patent and related rights, copyright and related rights, and membership to international intellectual property treaties).

trade secrets into these lucrative markets.[10]

This Note acts as a practitioner's guide to navigating the complex, and often times threadbare, trade secret regimes of the BRIC nations. Part II introduces the applicable laws and statutory provisions that provide protection to trade secrets in each country. Part III analyzes the BRIC trade secret regimes by presenting the best and worst aspects of each country's laws. Furthermore, it identifies both signs of improvement in each BRIC country, and diagnoses what each country must do if it wishes to become a safe, viable target for expanding foreign businesses. Part IV provides advice for American MNEs that wish to expand into the BRICs by determining which, out of the four, is the safest in regards to trade secret and intellectual property protection. Finally, this Note concludes that it is an economic reality that the BRIC countries have reached a level of prominence that used to be reserved for Western, capitalist systems – it falls on the shoulders of each BRIC country to establish trade secret protection worthy of their new, preeminent position in the global arena.

I. THE SCOPE OF THE CURRENT DOMESTIC TRADE SECRET LAWS OF BRAZIL, RUSSIA, INDIA, AND CHINA

With the exception of India, each BRIC country has promulgated domestic trade secret protection in one form or another – largely holding to three common factors present in many trade secret definitions: (1) the information is not known to the public, (2) the subject confers economic benefit through its secrecy and confidentiality, and (3) the information is subject to reasonable efforts to maintain secrecy.[11] In Brazil, trade secrets receive minor protection under Article Five, Section XXIX of the Federal Constitution and Article 195 of the country's Industrial Property Law, which was passed in 1996.[12] In Russia, Article 1465 of Part Four of the Russian Civil Code and the Federal Law on Commercial Secrecy protect

10. *See* Robert C. Bird, *Defending Intellectual Property Rights in the BRIC Economies*, 43 AM. BUS. L.J. 317, 317 (2006) (lamenting that in the BRIC economies, intellectual property misappropriation ranges from "rampant to merely widespread").

11. Zafar Mahfooz Nomani and Faizanur Rahman, *Intellection of Trade Secret and Innovation Laws in India*, 16 J. INTELLEC. PROP. RIGHTS 341, 341-42 (July, 2011).

12. CONSTITUTION OF THE FEDERATIVE REPUBLIC OF BRAZIL [C.F.] art. 5, Sec. XXIX (Braz.) *available at* http://www.stf.jus.br/repositorio/cms/portalStfInternacional/portalStfSobreCorte_en_us/anexo/constituicao_ingles_3ed2010.pdf; Law No. 9,279, of May 14, 1996 (Industrial Property Law), DIÁRIO OFICIAL DA UNIÃO [D.O.U.] of May, 14 1996 (Braz.) *available at* http://www.wipo.int/wipolex/en/text.jsp?file_id=125397; *see also* Robert M. Sherwood, *Trade Secret Protection: Help for a Treacherous Journey*, 48 WASHBURN L.J. 67, 73-74 (2008) (giving a detailed history of the development of Brazilian trade secret law, which is rooted in the rules that governed medieval German trade guilds).

trade secrets to an extent.[13] India proves to be the outlier, and does not provide any statutory protection for trade secrets.[14] In China, trade secrets enjoy fairly thorough protection under the Anti-Unfair Competition Law of the People's Republic of China.[15] This Part lays out the applicable statutory provisions for each country, and identifies what kinds of trade secrets are afforded protection.

A. Domestic Trade Secret Law of Brazil

Article Five, Section XXII of Brazil's Federal Constitution guarantees the right to property. Further, Section XXIX of the same Article provides in part that, "the law shall ensure . . . protection of industrial creations . . ."[16] This is augmented by the Industrial Property Law, which criminalizes the misappropriation of trade secrets – the text of Title V, Chapter VI, Article 195, Section XI states, in part, that a crime of unfair competition has been perpetrated by anyone who "divulges, exploits, or utilizes, without authorization . . . confidential knowledge," if that knowledge can be used in industry and is not publically known.[17] Section XII extends this protection to information that is obtained by illicit means or fraud.[18]

Sections XI and XII provide protection to any "knowledge, information, or data" which has a use in industry or commerce, so long as it is not known to the public and would not be readily ascertainable by someone

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13. CIVIL CODE OF THE RUSSIAN FEDERATION art. 1465 (Russ.) *available at* http://www.rupto.ru/rupto/nfile/3b05468f-4b25-11e1-36f8-9c8e9921fb2c/CivilCode .pdf; Federal Law on Commercial Secrecy, RUSSIAN FEDERATION COLLECTION OF LEGISLATION 2004, No. 98-FZ, item 3283 *available at* http://www.wipo.int/ wipolex/en/text.jsp?file_id=202527.

14. *See, e.g.*, Sonia Baldia, *Offshoring to India: Are Your Trade Secrets and Confidential Information Protected?*, MARTINDALE.COM, (Mar. 1, 2010) http://www.martindale.com/business-law/article_Mayer-Brown-LLP_921758.htm (last visited Oct. 15, 2013) (explaining that India, unlike the United States, does not provide protection for trade secrets or other IP rights, and instead relies on tort and contract common law).

15. Anti-Unfair Competition Law of the People's Republic of China (promulgated by the Standing Comm. Nat'l People's Cong., Sept. 2, 1993, effective Dec. 1, 1993), art. 10, 1993 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China) *available at* http://en.chinacourt.org/public/detail.php?id=3306.

16. CONSTITUTION OF THE FEDERATIVE REPUBLIC OF BRAZIL [C.F.] art. 5, Sec. XXIX (Braz.) *available at* http://www.stf.jus.br/repositorio/cms/portalStfInternacional/portalStfSobreCorte_en_us /anexo/constituicao_ingles_3ed2010.pdf.

17. Law No. 9,279, of May 14, 1996 (Industrial Property Law) at Title V, Chapter VI, art. 195, § XI.

18. *Id.* at art. 195, § XII.

well versed in the field, which sets an obviousness standard not seen in the other BRIC countries or the United States.[19] This sweeping definition does not limit the scope of the law by enumerating a list of eligible subjects. In this respect, it is similar to the protection offered in the United States.[20] Brazilian law is implicated in the event of misappropriation through breach of a contractual relationship, illicit means, or fraud, which closely mimics U.S. law.[21]

B. Domestic Trade Secret Law of Russia

In Russia, trade secret protection derives its authority in part from Chapter 75, Part Four of Russia's Civil Code – outlining the subject matter as, "[I]nformation of any type . . . including . . . methods . . . having real or potential commercial value because it is unknown to third persons, to which such persons have no legal open access and with respect to which the owner . . . has introduced a regime of trade secret."[22] Article 1472 of the same chapter defines misappropriation, stating that infringement of the exclusive right to a secret of production occurs when "a person who has illegally received information constituting a secret of production . . . disclose[s] or use[s] this information . . . ."[23] Article 1472 extends liability to those who have breached a commitment to maintain confidentiality, and halfheartedly describes the penalty for a breach.[24] The inclusive definitions of both subject matter and scope of misappropriation are similar to those in the Uniform Trade Secrets Act in the United States.[25]

The Federal Law on Commercial Secrecy expands on the trade secret protection outlined in Part Four of the Russian Civil Code. It regulates the establishment, amendment, and termination of the regime of commercial secrecy – a set of requirements that must be met before a piece of information can qualify as a trade secret.[26] In order for a piece of information to qualify as a trade secret, it must meet the definition included in Chapter 75, Part Four of the Civil Code, and have the regime of

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19. *Id.* at art. 195, § XI.

20. *See, e.g.*, MERGES ET AL., *supra* note 8, at 37 (explaining that the Uniform Trade Secret Act protects any information, so long as that information adds value to its owner and is not publically known).

21. *Compare* Law No. 9,279, of May 14, 1996 (Industrial Property Law) at Title V, Chapter VI, art. 195, §§ XI-XII, *with* 18 U.S.C. § 1832.

22. CIVIL CODE OF THE RUSSIAN FEDERATION art. 1465 (Russ.).

23. *Id.* at art. 1472.

24. *See id.* (requiring those guilty of infringement to pay damages to the owner of the exclusive right to the secret of production, but omitting a method to calculate an amount).

25. *See generally* UNIF. TRADE SECRETS ACT § 1 (1985).

26. Federal Law on Commercial Secrecy, 2004, No. 98-FZ, item 3283.

commercial secrecy introduced, a process described in Article 10 of the Federal Law on Commercial Secrecy.[27] Once the process is complete, the information will fall within the purview of Russian trade secret law and gain protection.

C. Domestic Trade Secret Law of India

India is unique in the BRIC context because it is the only country out of the four that does not provide specific statutory protection for trade secrets, instead, it relies on its British common law tradition of tort and contract law.[28] Understandably, this dearth of trade secret protection presents a dangerous environment for American MNEs, the intricacies of which will be analyzed in Part III of this Note.

D. Domestic Trade Secret Law of China

Unlike India, China has passed an array of laws that protect proprietary information and trade secrets. In 1993, China passed the Anti-Unfair Competition Law of the People's Republic of China, which is the keystone of the country's trade secret protection.[29] While it is accompanied by a number of different laws that touch on trade secrecy to a lesser degree,[30] Article 10 of the Anti-Unfair Competition Law provides definitions for both trade secrets and misappropriation. Referred to as "Business Secrecy" by the Anti-Unfair Competition Law, trade secrets are defined as, "utilized technical information and business information which is unknown by the public, which may create business interests or profit for its legal owners, and also is [kept secret] by its legal owners."[31]

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27. *See id.* (describing that an owner must provide a list of the information, establish a procedure to limit access to the information, keep a record of people allowed access to the commercial secret, regulate employee use, and affix an official "Commercial Secret" stamp upon material media and documents).

28. *See, e.g.*, Baldia, *supra* note 14 (detailing that the absence of statutory protections can place US firm's IP at risk if it does not carefully employ contractual mechanisms or rely on the common law tort of breach of confidence in the absence of a contract); *see also* Nomani and Rahman, *supra* note 11, at 345 ("There are no specific laws in India to protect trade secrets and confidential information. Nevertheless, Indian courts have upheld trade secret protection on [the] basis of principles of equity, and common law action of breach of confidence and contractual obligation").

29. Anti-Unfair Competition Law of the People's Republic of China, art. 10, 1993 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China).

30. *See* J. Benjamin Bai and Guoping Da, *Strategies for Trade Secret Protection in China*, 9 NW J. TECH. & INTELL. PROP. 351, 356–57 (2011) (detailing the relevant provisions of Chinese Contract Law, Company Law, Labor Law, and Labor Contract Law that allow an owner of a trade secret to impose confidentiality agreements upon employees).

31. Anti-Unfair Competition Law of the People's Republic of China, art. 10, 1993 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China).

Article 10 also provides a comprehensive three-part misappropriation provision. The first sentence prohibits theft, coercion, and the use of any other unfair method to obtain another's business secrets; the second sentence makes it illegal to disclose or permit others to use the business secret without authorization; and the third sentence incorporates the breach of contract into China's definition of trade secret misappropriation.[32] Accordingly, in order to prevail in a Chinese trade secret action, the elements that must be proven are extremely similar to those in the United States.[33]

II. ANALYSIS OF THE DOMESTIC BRIC TRADE SECRET REGIMES: THE POSITIVE AND NEGATIVE ELEMENTS

This Part examines the pros and cons of each BRIC country's domestic trade secret regimes, paying especially close attention to the intricacies of each system and the facts that savvy MNEs should consider before exporting their trade secrets abroad.

A. Analysis of Brazilian Trade Secret Law: An Adequate Law with Inadequate Penalties

Despite the fact that the Brazilian Industrial Property Law does not expressly define trade secrets under that name, the law criminalizes the theft of confidential business information.[34] While Brazil's law does provide a large scope of subject matter eligible for protection, there are a number of glaring shortcomings associated with Brazilian intellectual property and trade secret protection, earning the country a poor reputation.[35]

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32. *Id.*

33. *See e.g.*, Bai and Da, *supra* note 30, at 356 (outlining the elements as: (1) the trade secret is not publically known, (2) the trade secret provides economic benefit, (3) the trade secret is subject to reasonable measures to maintain secrecy, and (4) there is misappropriation by a "wrongdoer or third party"); *see also* UNIF. TRADE SECRETS ACT § 1 (1985).

34. George Charles Fischer, *Trade Secret Protection in Brazil*, LATIN AMERICAN LAW & BUSINESS REPORT 7, 8 (June 30, 1998), *available at* http://www.fischerforster.com.br/midia/pdf/20090326161920_TradeSecretProtectioninBrazil.pdf (last visited Dec. 26, 2013) (explaining that even though the law does not use the phrase "trade secret", three elements are discernable: competitive advantage, novelty, and secrecy). *See generally* Law No. 9,279, of May 14, 1996 (Industrial Property Law), at Title V, Chapter VI, art. 195.

35. *See* GIPC International IP Index, *supra* note 9, at 5, 24 (ranking Brazil third from last on overall IP protection); *see also The Two Faces of Intellectual Property in Brazil*, KNOWLEDGE@WHARTON (March 1, 2006) http://knowledge.wharton.upenn.edu/article.cfm?articleid=1339 (last visited Sept. 16, 2013) (quoting Kenneth Adelman, former U.S. Ambassador to the United Nations, saying "Brazil is a prominent member of the IP axis of evil").

The first and most obvious problem associated with Brazilian trade secret law is its statutory penalty. Article 195 of the Industrial Property Law states that one guilty of trade secret misappropriation faces between three months to one year in prison, or a fine of an undisclosed amount.[36] This minor penalty pales in comparison to those mandated under United States law, raising questions of the law's deterrent efficacy.[37] Moreover, the law does not specify the availability of either civil damages or injunctive relief, which adds more uncertainty as to which remedies can be sought.[38]

Another noteworthy factor involves varying reports as to who can be charged with a crime of unfair competition. While the law itself says that anyone who "divulges, exploits, or utilizes, without authorization, confidential knowledge . . ." perpetrates a crime of unfair competition, existing literature claims that Article 195 of the Industrial Property Law simply added parties that can be found liable.[39] If the literature is correct, limiting those who can be held liable for trade secret misappropriation reduces the law's effectiveness.

Finally, the Brazilian judicial system itself can be an impediment to effective trade secret protection. The system is plagued with dysfunction caused by undue delays and the high cost of litigation.[40] Corruption is present in some areas, and decisions regarding trade secret protection can be of poor quality due to the fact that very few cases have been brought.[41]

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36. Law No. 9,279, of May 14, 1996 (Industrial Property Law), at Title V, Chapter VI, art. 195.

37. *See* Theft of Trade Secrets 18 U.S.C. § 1832 (2012) (setting the penalty for trade secret misappropriation at ten years imprisonment or up to $5 million in fines).

38. *See e.g.*, *Trade Secret Theft: Managing the Growing Threat in Supply Chains*, CENTER FOR RESPONSIBLE ENTERPRISE AND TRADE 1, 17 (2012), *available at* http://www.create.org/news-resources/resources/trade-secret-theft-supply-chains [hereinafter CREATE.ORG] (lamenting the uncertain nature of remedies in Brazilian law and reporting that trade secret protection is poorly established).

39. *Compare* Law No. 9,279, of May 14, 1996 (Industrial Property Law), at Title V, Chapter VI, art. 195, *with Protection of trade secrets through IPR and unfair competition law*, INT'L ASS'N FOR THE PROTECTION OF INTELL. PROP. 1 (Mar. 31, 2010) *available at* https://www.aippi.org/download/commitees/215/GR215brazil.pdf (answering that one bringing a case in Brazil may hold the contractual partner, employee or ex-employee, employer, or the partner or administrator of another company who accessed the information through fraud liable for an unfair competition charge).

40. *See, e.g.*, *GIPC International IP Index*, *supra* note 9, at 39 (reporting that it can take up to four years for a case to reach trial and often times a decade before litigation is complete).

41. *See* Robert M. Sherwood, *Intellectual Property Systems and Investment Stimulation: The Rating of Systems in Eighteen Developing Countries*, 37 IDEA 261, 295-99 (1997) (explaining in two parts that judicial integrity has been an issue in many highly-publicized cases and that the lack of trade secret jurisprudence leaves many

So, while Brazil does have an adequate trade secret law in place, the country needs to increase the penalties and remedies available, clarify who can be indicted, and overhaul its slow judiciary.

B. Analysis of Russian Trade Secret Law: A Trade Secret Regime with Questionable Government Intentions

Like Brazil, Russia's trade secret laws appear to be inclusive – Part Four of the Civil Code provides a sweeping scope of covered subject matter and a solid definition of misappropriation.[42] Yet, the country is still notorious for poor trade secret protection.[43]

To begin with, there are a number of statutory issues that should be taken into account by any MNE expanding into Russia. First, is the lack of remedies available – the statute provides for damages, but is silent when it comes to injunctive relief or criminal charges.[44] Unlike other countries, the Federal Law on Commercial Secrecy requires trade secret owners to affirmatively "introduce the regime of commercial secrecy" – a list of steps that must be taken in order to achieve statutory protection.[45] In addition to these steps, the Federal Law on Commercial Secrecy includes another troubling measure – Article 6 gives the Russian government carte blanche authority to demand access to a company's trade secrets, with criminal sanctions and court actions for those who do not comply.[46]

Certain realities outside the country's statutory regime are also extremely troubling. Along with the provision allowing the Russian government to demand a privately held trade secret, it is widely believed that Russia's government is engaged in extensive cyber espionage.[47] The clandestine

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concepts undefined and vague).

42. CIVIL CODE OF THE RUSSIAN FEDERATION art. 1465, 1472 (Russ.) (qualifying "any [type of] information" as a trade secret and illegal use or disclosure as misappropriation).

43. *See, e.g.*, CREATE.ORG, *supra* note 38, at 7 (blaming Russia's high threat level on poor police work, weak data privacy, and cybercrime).

44. CIVIL CODE OF THE RUSSIAN FEDERATION art. 1465, 1472 (Russ.).

45. Federal Law on Commercial Secrecy, RUSSIAN FEDERATION COLLECTION OF LEGISLATION 2004, No. 98-FZ, item 3283 *available at* http://www.wipo.int/wipolex/en/text.jsp?file_id=202527 (listing the steps that must be taken in order to introduce the regime of commercial secrecy).

46. *See id.* at art. 6.

47. *See* Melanie J. Teplinsky, *Fiddling on the Roof: Recent Developments in Cyber Security*, 2 AM. U. BUS. L. REV. 225, 259 (2013) (stating that Russia, along with a number of other countries, is believed to be involved in cyber espionage, though to a lesser degree than China); *see also Foreign Spies Stealing U.S. Economic Secrets in Cyberspace: Report to Congress on Foreign Economic Collection and Industrial Espionage, 2009-2011*, OFFICE OF THE NAT'L COUNTERINTELLIGENCE EXEC. 6 (October, 2011), *available at* http://www.ncix.gov/publications/reports/fecie_all/Foreign_Economic_Collection_2011.pdf [hereinafter *Foreign Spies Stealing U.S.*

attitudes of the Russian government present a risk to American MNEs uncommon in other countries.[48] If this were not enough, the Russian police force is infamous for failing to pursue reports of corporate data theft.[49] Regardless of the seemingly comprehensive law, American MNEs that expand into Russia face the possibility that their valuable trade secrets will fall into the wrong hands or end up the property of the state.

C. Analysis of Indian Trade Secret Law: The Absence of Statutory Regime Leaves Protection Lacking

Out of the four BRIC countries, India is the only one that does not have some form of statutory trade secret protection.[50] This is not to say that one cannot protect trade secrets in India – just that the protection available is limited in so far as the parties who can be held liable.[51] Although there is not a codified definition of trade secrets in India, the Delhi High Court recently recognized the concept in the case *American Express Bank, Ltd. v. Priya Puri.*[52]

The problem in India is not that it lacks a statutory definition; instead the judicially recognized definition can only be used in cases involving the violation of contractual obligations or breach of confidence – both of which require a preexisting relationship between the parties.[53] Herein lies the

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Economic Secrets] (asserting that because the United States is the leading global economic innovator, foreign governments, including Russia, have a large incentive to try and pilfer economic and trade secrets).

48. *See GIPC International IP Index*, *supra* note 9, at 67 (attributing weak trade secret protection, in part, to widespread industrial espionage).

49. *See e.g.*, CREATE.ORG, *supra* note 38, at 19 (revealing corruption and poor skills among law enforcement to be the reasons behind the inefficient enforcement).

50. *See, e.g.*, Baldia, *supra* note 14 (warning US businesses that the non-legal environment for trade secrets in India provides a substantial risk if the proper contractual mechanisms are not employed).

51. *See, e.g.*, Nomani and Rahman, *supra* note 11, at 345 (recognizing that Indian courts will protect trade secrets on the basis of equity, common law breach of confidence, and violation of contractual obligation); *see also* Baldia, *supra* note 14 (explaining that the tort of breach of confidence only applies to fiduciaries and contractual obligation only applies to those who have agreed not to misappropriate trade secrets).

52. *American Express Bank, Ltd. v. Puiya Puri*, (2006) III LLJ 540, at page 2129, *available at* http://indiankanoon.org/doc/445135/ ("A trade secret can be a formulae, technical know-how or a peculiar mode or method of business adopted by an employer which is unknown to others.").

53. *See* Baldia, *supra* note 14 (posing a hypothetical scenario in which an American company has its trade secrets misappropriated by an Indian subcontractor who has not entered into a contractual or fiduciary relationship with the American company as an example of a situation where recovery would be impossible).

danger of India's lack of trade secret regime: if an individual or entity that has no prior relationship to the company misappropriates an American MNE's trade secrets, there may be no route to recovery.[54]

Considering this, it is important to utilize extensive contractual protections when exporting trade secrets into India.[55] But, even if every contract is perfect, the risk of misappropriation by unknown third parties who have no prior relationship still exists, in addition to the burdens associated with a slow and archaic judicial system.[56] These factors make India an inhospitable environment for trade secret exportation.

D. Analysis of Chinese Trade Secret Law: A Demonstrated Effort Despite Government Enforcement Problems

Out of all the BRIC countries, China's trade secret regime may be closest to the protection offered in the United States – both in scope and definition of misappropriation.[57] Despite this comprehensive regime, a recent report found that, "China's growth has far outpaced its ability to create and enforce legislation or – even more importantly – cultural attitudes towards protecting digital privacy . . . ."[58]

China's system, like Russia's, is rife with cyber espionage and questionable government attempts at extracting trade secrets from foreign companies.[59] According to a 2011 US counterintelligence report, China's trade secret theft is motivated by the need for economic growth and a desire to compete with American firms.[60] This is a risk that lies outside of the

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54. *Id.*

55. *See id.* (imploring US companies to insist on contractual provisions that bind both Indian contractors and any subcontractors that are hired by them, making it clear that the US company has a right to enforce any violation of these provisions).

56. *See* CREATE.ORG, *supra* note 38, at 18-19 (attributing Indian judicial inefficiency to backlogged cases, hand kept court records, misplaced filings, and cycling presiding judges); *See generally* Baldia, *supra* note 14.

57. Anti-Unfair Competition Law of the People's Republic of China, art. 10, 1993 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China), *with* UNIF. TRADE SECRETS ACT § 1 (1985).

58. *Unsecured Economies: Protecting Vital Information*, MCAFEE, INC. 14 (2009), *available at* http://resources.mcafee.com/content/NAUnsecuredEconomiesReport.

59. *See* Teplinsky, *supra* note 47, at 263 (explaining that proof has become public that the Chinese government has engaged in cyberespionage against the United States, including *Coca Cola* who owns one of the most famous trade secrets in the world); *see also* CREATE.ORG, *supra* note 38, at 19 (relaying an experience that General Motors had with the Chinese government where, in order to qualify for extensive government subsidies, demands were made that the car maker transfer a number of engineering and electronic trade secrets to Chinese officials; GM refused).

60. *See Foreign Spies Stealing U.S. Economic Secrets*, *supra* note 47, at 4-5 (expounding on the fact that Chinese intelligence services and private entities often use employees of US firms to steal confidential information using portable devices or

country's statutory regime, and unfortunately, is difficult to mitigate.

Government corruption aside, there have been recent signs of hope from the Chinese judiciary regarding the protection of American MNE's trade secrets. Shanghai's No.1 Intermediate Court recently ruled for American pharmaceutical company Eli Lilly in an action against a former employee from one of its Chinese subsidiaries.[61] Judge Liu Junhua ruled in favor of the plaintiff, using newly amended Article 100 of the PRC Civil Procedure Law, which provides injunctive relief for trade secret cases.[62] This anecdotal evidence reinforces the importance of contractual provisions that mandate confidentiality.[63] In addition, the United States and China continue to hold talks regarding cyber espionage practices.[64] One can hope that the *Eli Lilly* case, along with the ongoing diplomacy, are signs of things to come – a China where trade secrets are afforded the protection they are due.

III. GENERAL RECOMMENDATIONS TO AMERICAN MNES INTENT ON EXPANDING INTO THE BRICS

Each BRIC country carries a unique set of risks that must be balanced against potential rewards. Every BRIC trade secret regime leaves much to be desired, although many of the problems fall outside of the substantive boundaries of the statutory structure.[65] After a detailed side-by-side analysis of the four BRIC countries and their respective trade secret laws, it is difficult to say which country provides the best protection to foreign MNEs.[66]

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email).

61. Christine Yiu & Yijun Ge, *Eli Lilly v. Huang: Shanghai Court Issues Interlocutory Injunction Against Breach of Trade Secret*, BIRD & BIRD (Aug. 21, 2013), *available at* http://www.twobirds.com/en/news/articles/2013/china/eli-lilly-v-huang-shanghai-court-issues-interlocutory-injunction-against-breach-of-trade-secret (stating that Eli Lilly was successful in obtaining damages and an injunction against a former employee whose employment contract contained a thorough confidentiality agreement. The former employee, known only as Huang, downloaded 21 confidential documents without permission and refused to delete them when asked to do so).

62. *Id.*

63. *See* Dan Harris, *How to Write a China Contract. Arbitration Versus Litigation. Part II. Trade Secrets.*, CHINA LAW BLOG (Sept. 6, 2013), *available at* http://www.chinalawblog.com/2013/09/how-to-write-a-china-contract-arbitration-versus-litigation-part-ii-trade-secrets-baby.html (detailing the trial's takeaways for foreign companies aiming to do business in China).

64. *See* Teplinsky, *supra* note 47, at 263 (explaining that diplomatic talks were prompted after evidence of cyber espionage became public).

65. *See generally GIPC International IP Index*, *supra* note 9 (noting that each BRIC country has difficulty enforcing the laws that are in place).

66. *See id.* at 5 (using the scoring method adopted by the study to show that because each of the BRICs are ranked so low in IP protection, it is hard to pinpoint an

For example, while China has the most promising and comprehensive trade secret laws, it, nonetheless, suffers from abysmal enforcement methods.[67] Brazil's laws seem to protect trade secrets as well, but the available damages and penalties are insufficient to justify a large risk.[68] Russia's laws are adequate, but available damages are unclear and the intentions of the nation's government are, at times, questionable.[69] India's lack of trade secret law is troublesome, and relying on the traditional contract or tort laws leaves companies vulnerable.[70]

This is an inexact science. Nevertheless, this Note seeks to make a recommendation to practitioners. Even with all of its faults and failures, China seems to be the best choice for overseas expansion. It has enforcement issues, but the availability of civil damages, possible injunctive relief, and even criminal punishment, gives American MNEs a range of options to pursue if their trade secrets are misappropriated.[71] China also extends liability to third parties, even if their actions are tangential to the initial wrongdoer.[72] This increases possible routes to equitable recovery. As China's economy draws closer to the size of the U.S. economy, its legal and judicial system will have to mature as well. Of course, this would be welcome news to any MNE doing business there.

In regards to trade secret protection, India falls behind compared to the other BRIC countries. This is not simply because the nation does not have a codified trade secret regime, as one can attempt to protect oneself using contract and tort law. What makes India a frightening place to export one's

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exact best choice).

67. *See* Anti-Unfair Competition Law of the People's Republic of China, art. 10, 1993 STANDING COMM. NAT'L PEOPLE'S CONG. GAZ. (China). *But see Unsecured Economies: Protecting Vital Information*, *supra* note 58, at 13 (explaining that China, along with Russia, have the worst reputations for pursuing security related incidents).

68. *See* Law No. 9,279, of May 14, 1996 (Industrial Property Law), art. 195 XIV, DIÁRIO OFICIAL DA UNIÃO [D.O.U.] (Braz.) (displaying penalties ranging from three months to a year in prison, or a fine).

69. *See, e.g.*, *Foreign Spies Stealing U.S. Economic Secrets*, *supra* note 47, at 4 (claiming that because Russia views itself as one of the strategic competitors of the United States, it has become one of the most aggressive consumers of U.S. economic information).

70. *See, e.g.*, Baldia, *supra* note 14 (explaining that the traditional "breach of confidence" tort is applicable only to the fiduciaries of the company and that breach of contract can only apply to parties with which the US company is doing business).

71. *See* Bai and Da, *supra* note 30, at 361 (listing the possible damage calculations available in China as either plaintiff's lost profits, defendants realized profits, or reasonable royalty and explaining that once a plaintiff prevails on a claim, permanent injunctions are possible).

72. *See id.* at 364 (noting that criminal liability can be extended to third parties who either acquired or disclosed the protected information when the third party knew or should have known that the information was acquired wrongfully).

trade secrets is the fact that even with contract and tort law, a company can only protect itself from half of the possible threats.[73] Contract law can hold employees accountable,[74] and tort law can punish fiduciaries for breaches of confidence,[75] but consider the anonymous hacker who has no relationship with the company – India's existing system does not provide a clear route to recovery against such a person.[76] For these reasons, India is the riskiest destination when it comes to exporting one's trade secrets.

CONCLUSION

The global economy is here to stay. Business will continue to cross borders, oceans, and hemispheres. Technology will continue to increase efficiency, processes, and unfortunately, risks. MNEs must be wary of the legal systems of countries whose economic growth has outpaced their institutional sophistication – of which the BRICs are the poster children. The trade secret regimes in the BRICs are not adequate and severely need improvement. Until that happens, companies who export their trade secrets in the interest of tapping into new markets must use the utmost caution if they wish to keep them safe and retain their economic edge.

73. *See* Baldia, *supra* note 14 (warning that tort law only applies to fiduciaries of the US company and that contract law only applies to those that the company has a contractual relationship with).

74. *See id.* (emphasizing the need for strong contractual provisions).

75. *See id.* (acknowledging that India does recognize the common law tort "breach of confidence).

76. *See* Nomani and Rahman, *supra* note 11, at 345 (detailing that the Indian courts have upheld protection of trade secrets based on breach of confidence, contractual obligation, and equity, but not explaining the implications of unknown third party thefts).

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