



# ZETLIN & DE CHIARA LLP

## ZETLIN & DE CHIARA LLP REVIEW

CURRENT LEGAL AND BUSINESS DEVELOPMENTS AFFECTING  
THE DESIGN, CONSTRUCTION AND REAL ESTATE INDUSTRIES

2010 VOL. 16 NO. 3

### FEATURED ARTICLE

## THE ABCs | Abu Dhabi, Brazil, China OF INTERNATIONAL PRACTICE DEVELOPMENT



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**B**efore the recession, an international portfolio was touted as a necessity to the future growth of American design firms. Then the global economy stumbled and, with it, opportunities for international design work slowed. As our worldwide economic outlook improves, however, the emphasis on international business has returned. If the time is right for your firm to expand into the international market, how, exactly, do you begin taking on assignments in foreign jurisdictions?

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### CONDUCTING BUSINESS ABROAD

Design professionals, contractors, and developers contemplating international construction work must first prepare for the truly unfamiliar territory they are about to enter. This issue demonstrates how global approaches – from employment laws to banking and taxation concerns, avoiding corruption to identifying new possibilities – bear little resemblance to their domestic counterparts.

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# FOREIGN EMPLOYMENT ISSUES FOR THE UNWARY



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The expertise and services of U.S. design and engineering firms remain in great demand around the world. The number of U.S.-based engineering and design firms with overseas

offices grew dramatically during the last ten years – a diversification that allowed many firms to mitigate the economic effects of the current severe recession. As they continue to develop necessary strategies to survive the economic malaise following this great recession, U.S. engineering and design firms face unique challenges when considering streamlining operations in their international offices.

Often, firms consult local advisors, expeditors, and lawyers who help set up their international branch offices and, in many cases, the firms receive some initial advice on hiring and employment practices. Such issues typically discussed include local holidays, sick leave and vacation, working hours, and advice on overtime. It is alarming how little research addresses a U.S. firm's legal obligation to its internationally-based employees. This becomes critical when dealing with two common employment issues – disability and discharge.

In the area of disability, depending on the country, the obligations that employers owe to employees who become sick or disabled while working for a professional firm of engineers or architects can be both long-term (the remaining working life of the employee) and significant (the employee's full annual compensation for the duration of the disability). In some countries, this obligation can exist whether or not the disability is work-related; it merely has to occur while the employee is in your employ. Obviously, this is a potential employee-related cost which most U.S. firms are not familiar with and therefore are unprepared to address.

## What then does the U.S. firm do to protect itself against this exposure?

It is important to know the disability rules of the country where you are

opening your office and hiring nationals. If it's a country with onerous disability policies, then make sure you are able to obtain an appropriate disability policy to cover your exposure.

Many firms have been or will be faced with the painful necessity of reducing their workforce abroad. This can be a very difficult and expensive undertaking for American firms not well-versed in the intricacies of employment practices indigenous to the countries hosting their extended offices. Are you aware of the financial obligations you might incur when deciding to reduce your workforce in any international location? It is unfortunate that many firms receive the answer to that question in the form of a double whammy - reducing workforce because business in a given region is down, only to discover at that point the full extent of the obligations you assumed when you staffed your foreign office.

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*It is alarming how little research addresses a U.S. firm's legal obligation to its internationally-based employees.*

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It could be said that the basic issue with employee discharge, regardless of reason, is lost in translation. In the U.S., employees are deemed to be “hired at will,” meaning the term of their employment is at the discretion of both the employer and the employee. In many foreign countries, however, employees are assumed to have an employment contract with specific rules, whether one was actually entered into or not.

While there are some limits in the U.S. on the ability of an employer to discharge an employee, they are restricted to areas of protection due to perceived past inequities. Thus, in the U.S. you can't discharge an employee simply because of, among other things, his or her ethnic background, religious beliefs, or age (if the employee is over 40). In many foreign jurisdictions, however, these familiar rules regarding discharge do not apply. As previously mentioned, many foreign jurisdictions do not recognize the employer/employee concept of “employment at will.” This concept is

not the law. What actually applies is the concept of “all employees have a contract.”

What does that mean if you haven't actually entered into a contract? It means that there are statutory (written legislation) or common law (prior decisions in litigated cases) standards regarding severance notices, payments, and other obligations (insurance and health benefits) for which you will be held liable as if you had signed a contract with the employee. Also, there may be a protocol that you need to follow before you can even give notice that you are going to discharge an employee. Depending on an employee's seniority within your organization, the combination of protocols, such as required meetings, notice period, and actual severance payments can exceed a year's compensation. Then, of course, you get into the labyrinth of extended healthcare and other benefits.

Even more challenging is a foreign distinction between termination for cause and termination for convenience. In fact, in some jurisdictions, even if you have a valid basis for termination for cause, if you don't exercise it promptly (which can be as short as a week or two in some countries), you are deemed to have waived it. What's worse is that in some foreign jurisdictions, the uninformed U.S. employer thinks because it has an employment contract with a senior employee, perhaps a principal in charge of a foreign office, that employee is also required to give the U.S. firm a significant notice (six months to a year) before leaving. In order to get around that requirement, the senior employee, with advice of local counsel, may do something to prompt a harsh response from the U.S. parent firm, whereupon the foreign senior employee may be deemed to be a free agent. Sound bizarre? Better check the law in the United Kingdom.

Thus, when hiring or discharging employees in foreign jurisdictions, or when dealing with all other employee-related issues (sickness, sexual harassment, disability, to name but three), the rules in foreign countries are very likely to be extraordinarily different from those in the U.S. Proceed with extreme caution and sound legal advice. ■

# GREENING THE GLOBE: UNITED NATIONS DEVELOPING WORLDWIDE BUILDING EMISSIONS MONITORING STANDARDS



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Existing buildings contribute more than 40% percent of world-wide energy consumption and one-third of greenhouse gas (GHG) emissions. According to a United Nations Environment Programme (UNEP) report, the 8.6 billion

tons of CO<sup>2</sup> produced each year by buildings is anticipated to balloon to about 15.6 billion tons by 2030. This radical increase can be attributed in large part to the forecasted doubling of building stock in developing countries by 2050.

The Sustainable Buildings and Climate Initiative (SBCI) of UNEP recognizes

that sustainable design is instrumental in reducing overall global energy consumption and greenhouse gas emissions. The SBCI in cooperation with the World Green Building Council, International Initiative for the Sustainable Built Environment, the Sustainable Buildings Alliance, and others, issued a Common Carbon Metric specifically aimed at providing a universal method of measuring a building's carbon footprint. These organizations believe that the building sector "has more potential to deliver quick, deep and cost effective GHG emissions reduction" than any other sector, and building energy consumption can be reduced 30-50% by 2020.

"In countries such as China, where new construction over the next ten years will equal the size of all existing buildings in the United States, realizing this potential from the start is imperative for reaching

any climate mitigation goals," said Under-Secretary General and UNEP's Executive Director Achim Steiner.

The World Green Building Council believes that "a common metric for measuring carbon emissions from buildings will enable the global construction sector to participate in carbon markets and attract investment that may not otherwise have been available, in turn delivering tangible carbon reductions." According to the Council, "the Common Carbon Metric project has the potential to act as a real stimulus and support a range of green building projects in developing nations – from large scale retrofit programs through to new building projects."

UNEP/SBCI is currently in the second phase of developing uniform language to establish a worldwide platform to measure and report building performance. ■

## THE ABCs OF INTERNATIONAL PRACTICE DEVELOPMENT

CONTINUED FROM PG. 1



First and foremost, it is imperative to obtain qualified legal, insurance, and tax information before even offering to provide such services. Are business registrations or professional licenses required? Will your employees be able to visit the foreign jurisdiction to attend project meetings? Will they be allowed to stay in the jurisdiction for any length of time to perform services? In what currencies will you receive payment? Can the funds be readily removed from the jurisdiction? Where and how will they be taxed? And so on. Guidance and assistance from qualified experts can help address these hurdles in a timely manner and avoid complications and legal and financial exposure in the future.

The purpose of this article is to identify

some of the key issues that a U.S.-based design firm should investigate before taking on an assignment in a foreign jurisdiction. They are based upon Zetlin & De Chiara's experiences and the experiences of our clients in pursuing opportunities and establishing offices in Abu Dhabi, Brazil, and the People's Republic of China, including the Hong Kong and Macau special administrative regions, among other countries.\*

### LICENSURE AND REGISTRATION

When considering whether to pursue a project in a foreign country, it is imperative to determine whether (a) business registration is required to do business in that jurisdiction and (b) a professional license is required to provide design services on projects in that jurisdiction. The qualification requirements for licensure can be very stringent and should be confirmed very early in the process of pursuing foreign work.

Foreign jurisdictions can require the design firm, the individual professional, or both to obtain a professional license before performing professional design services for a project in that jurisdiction. In fact, it may be necessary to obtain a license before a firm can even offer to provide such services, as is the case in many American states. In addition, many foreign clients will request verification that such registrations

and licenses are in place before selecting a design professional for a project.

If you are not yet licensed in the jurisdiction, however, you may be able to provide services for the project as a design consultant, rather than as the architect or engineer of record, without having to obtain such licensure. If permissible, this presents an opportunity to gain some experience in the region and build relationships without bearing the expense of obtaining full licensure. Whether or not you can do so may depend on the nature and location of the services being performed. For example, conceptual design, schematic design, and design development phase services performed from your U.S. offices may be permitted without a license, while the preparation of construction documents and the performance of CA-phase services may not.

The benefit of reduced licensing costs may, however, be outweighed by other considerations. For example, providing conceptual design services from a U.S. office for a project in Brazil may carry a prohibitive tax burden, as Brazilian companies are required to withhold an excessive percentage of any payments to foreign entities for professional services. On the other hand, as the World Bank recently reported that it takes an average of 120 days to establish a business in Brazil, >>

\*Requirements vary greatly between countries and provinces. Be sure to consider regulatory issues specific to the project location.

bearing the tax burden may be the only available short-term option.

Zetlin & De Chiara recently advised a client on meeting the business registration and licensure requirements for a project located in Hong Kong. Our client first established a wholly-owned subsidiary, based in Hong Kong, which enabled the client to set up an office in Hong Kong, staff the office with personnel transferred from its U.S. offices, and provide services in association with a local architect of record. Once the requisite local experience is obtained, a representative of the firm will be able to apply for a Hong Kong architect license, at which point the firm's Hong Kong subsidiary will be permitted to serve as architect of record on projects in the city.

In contrast to Hong Kong, Abu Dhabi requires the firm, not the individual, to be licensed though the firm must show that it employs individuals with the requisite professional design experience to support the license.\*

In any event, it is important that a design firm obtain an early picture of the licensing scheme and requirements of the foreign jurisdiction before undertaking an assignment. There may be alternative means to proceed. Or the hurdles may simply be too high, which is better to know before committing valuable resources to the endeavor.

## IMMIGRATION AND EMPLOYMENT

Another important consideration is whether you will be able to staff the new foreign office with personnel from your U.S. offices and how soon you can begin. Doing so is considered by many to be one of the best ways to control and maintain the design integrity and quality of your firm's services.

Stringent immigration laws regulating foreign workers are not the sole province of the United States. It is important to determine the specific requirements of the jurisdiction in question as early as possible, in order to plan and act accordingly. Some jurisdictions, such as Hong Kong, require a valid commercial real estate lease and a valid employment agreement to obtain a work visa. Concerned about the impact on its local workforce, Hong Kong also requires an employer to explain why the particular employment position cannot be filled by a



local employee. However, a brief business plan that projects future hiring from the local workforce and explains the need to transfer current employees familiar with the firm may suffice.

Similarly, Brazil will not issue temporary visas to a professional unless that professional possesses special knowledge not available in Brazil. However, a permanent visa may be available as an alternative if the employee will be in a senior managerial position.

Countries may also require local health insurance coverage for work visa holders and may not allow employees to re-enter the country if such insurance is not current, as is the case in Abu Dhabi.

In addition to maintaining locally-required insurance, an employer may be required to provide other employee benefits and holidays, etc. Hong Kong, for example, requires employers to pay into the mandatory provident fund – a formal benefits system that provides retirement benefits to employees. Brazilian law also confers similar, broad rights and benefits on employees, including, for example, payment into a severance indemnity fund and a profit-sharing fund. Brazil also requires the payment of an extra month's salary, known as 13th salary.

National and local payroll tax withholding requirements must be ascertained as well. All of these represent not just hurdles to be overcome, but costs to be balanced when considering a move into a foreign jurisdiction.

## BANKING AND TAXES

Another significant concern is how to collect payment for services rendered. Domestically, your fees and payment schedule are always considered up front when approaching new projects, but currency and tax issues are rarely discussed. Doing business abroad adds layers of complexity to these facets of your business. It is imperative to obtain guidance from a qualified tax and accounting expert, knowledgeable not just in United States and international tax law, but also with specific knowledge of the tax laws of the jurisdiction in which the project is located.

Contract payment terms may help resolve some of these concerns. For example, you might address the currency issue by requiring payment in the United States and in U.S. dollars, assuming that your client is able to do so. This option becomes more complicated when hiring local subconsultants who want to be paid in the local currency. A provision requiring that your payment will be net of taxes and that all domestic or non-U.S. taxes are your client's responsibility may also help. This may not, however, absolve your firm of the requirement to file local income, VAT, or other tax returns. >>

\*Abu Dhabi's requirement that a firm have ten years of continuous, relevant experience as a single legal entity presents a major barrier to foreign firms seeking to license a branch office to provide architectural or engineering services in Abu Dhabi. Dubai has a fifteen-year requirement.

Banking provides its own challenges. Opening a local bank account may or may not be a regional requirement, but it might serve to alleviate some payroll issues. While it may be sensible to patronize an international bank with branch offices in the United States, keep in mind that you may need to travel to the foreign jurisdiction to open the account, and that you may not be able to (or it may not be prudent to) freely transfer funds between the foreign and domestic accounts. Transfers are heavily regulated, not just for tax purposes, but to prevent money laundering and terrorist financing, and also may vitiate any shareholder limited liability protections that your corporate structure might provide.

Again, all of these issues and possible solutions should be discussed with a qualified tax and accounting advisor.

## INSURANCE AND DECENNIAL LIABILITY

Before commencing services on a project abroad, you should also confirm with your insurance consultant that your firm has adequate coverage in place. Your domestic professional liability policy, for example, may include some form of “international” coverage, but it may not be as extensive as you think. It is important to make sure that your policies will not only reimburse you for claims, expenses, settlements, and judgments resulting from claims on projects in other countries, but that the insurance carrier will actually defend you against claims in that country as well. Otherwise, you will have to pay the fees and seek reimbursement later. In many jurisdictions, this can be a very expensive proposition.

It is also very important to confirm that your policy is effective for the specific country in question, as coverage may be excluded for certain countries and territories.

If you are relying on your domestic professional liability policy for international coverage, you should have the same contract risk management and insurability concerns that you do for domestic projects. The policy exclusions will apply internationally, just as they do domestically. For example, you will not have coverage for strict liability, warranties, high standards of care, and time of the essence provisions.

Another important insurance/liability issue to consider is decennial liability. Decennial liability is a form of strict liability not covered by industry standard professional



liability policies. Under typical decennial liability schemes, the design professional and contractor are both strictly and separately liable to the owner for any defect that threatens the structural stability or safety of the building during the first ten years after the completion of the project – thus the name “decennial” liability. In the event of a defect, the parties must compensate the owner regardless of fault. Negligence need not be shown. The United Arab Emirates, for example, has adopted a decennial liability scheme, which applies to projects in Abu Dhabi, as well as the other members of the U.A.E. It is important that you speak with an attorney to determine the scope of any decennial liability scheme in the jurisdiction you are considering working in, as well as with your insurance expert to determine whether insurance policies are available to cover those risks.

## LOCAL CUSTOMS

One final point of note is that it is not enough to determine what the laws are in a jurisdiction. Familiarizing yourself with industry customs particular to that region can be just as important. Industry norms might dictate that an architect or engineer take on project responsibilities not normally within their scope in the United States. For example, in Qatar, the lead design professional is expected to take on certain document management responsibilities - not just maintaining their own project records, but maintaining all records for the entire project. It is, therefore, important to

understand local customs and make sure you have a concise, written scope of basic services, additional services, and exclusions, as always.

Local custom may also require the design professional to post a performance bond covering its services. While such bonds are typically not available for design professionals, a client may, instead, ask for a bank guarantee or letter of credit as collateral for the proper completion of your services, payable to the client should your client have to hire another professional to complete your services. Banks will typically require 100% or more of the guaranteed amount to remain on account while the guarantee is outstanding.

As you can see, there are numerous issues to be considered when looking to expand your design practice into the international market. It is, therefore, essential that you seek qualified legal, insurance, and tax guidance relevant to the jurisdiction in which you would like to do business and that you obtain such guidance as early in your planning process as possible. This will not just help you to limit your legal and financial exposure, but will also allow you to consider the costs of compliance as you formulate your international business plan. ■

# CONSTRUCTION AND CORRUPTION: THE FOREIGN CORRUPT PRACTICES ACT



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The thought of corrupt foreign business practices conjures up images of greedy bureaucrats and dishonest businessmen drinking expensive scotch in crystal glasses while plotting the demise of a local village for personal gain, or luring tribal chieftains into permitting the exploitation of local treasures with the promise of a diamond-clad gold watch. These examples are obvious, but most real-life instances of corruption are not as easy to spot.

## WOULD YOU CONSIDER THE VIGNETTES BELOW TO ILLUSTRATE CORPORATE CORRUPTION?

### SCENARIO 1

An engineering firm wins an infrastructure project, and the government official in charge of the project asks the firm to hire a specific local subconsultant. While the firm does not see a clear benefit from the potential arrangement, it understands that its cooperation is important to the relationship, and agrees to comply with the request. Unbeknownst to the firm, the subconsultant is controlled by individuals close to the government official, to whom the subconsultant kicks back a portion of its fees.

### SCENARIO 2

A design firm is approached by a local sales consultant, claiming to have invaluable connections with individuals in the health ministry that is now searching for a firm to design a new health care facility. The consultant offers to help the design firm win the design contract in exchange for a commission. The firm agrees, wins the contract, and happily pays the commission. Unbeknownst to the firm, the consultant is an associate of the deputy health minister in charge of hospital construction, with whom he shared the commission.

### SCENARIO 3

A global engineering firm is collaborating with a small local firm on the design of a new bridge. Local law requires the global firm's engineers to have a local permit, the published fee for which is 300 rubles (about \$15) and which is granted only upon the investigation and review of the engineer's background. The process usually takes weeks. The local joint venture partner advises it can assist and procures the required permit in just two days. The partner then sends along an invoice for 3000 rubles, calling it a "permit fee". The engineering firm pays the fee (about \$150) without noticing or investigating the reason for the 1,000% premium over the published fee. Of course, the difference was paid to the permit official to "expedite" the application for the permit.

## THE UNITED STATES FEDERAL GOVERNMENT DOES.

It is no secret that corruption is an integral part of the business culture in many countries throughout the world. That is particularly true in the construction sector, and especially applicable to fast-growing economies such as those in the BRIC countries. But because firms operating abroad remain subject to U.S. anti-corruption laws, the pervasive nature of corruption in those countries does not give such firms a free pass – to the contrary, it imposes additional compliance burdens.

U.S. anti-corruption laws are among the world's toughest and can present unanticipated traps for firms doing business globally. The most important of these U.S. anti-corruption laws is the Foreign Corrupt Practices Act ("FCPA"), which not only prohibits corrupt transactions by companies and their employees, but also imposes

affirmative obligations on companies to impose effective internal controls over their practices.

The FCPA regulates two broad areas. First, anti-bribery provisions prohibit corrupt transactions with foreign officials in order to obtain or retain business. These provisions apply to every individual or company, regardless of size or (with very narrow exceptions) the nature of their connection to the United States, such that even foreign firms operating in the U.S. are subject to these provisions in their foreign operations.<sup>1</sup> These provisions are quite broad, and cover even those transactions where the corrupt nature of the payment is not expressly disclosed to the paying firm and the payment itself is funneled through an undisclosed intermediary. Second, accounting provisions require companies to keep accurate books and

records and to maintain internal controls over their transactions. These accounting provisions do not require proof of the firm's knowledge, and although they apply only to "issuers" of securities, they cover many of the larger privately-held firms.

Violations of the FCPA have cost violators billions of dollars. Corporate penalties can include fines, debarment from doing business with U.S. and foreign governments, and disgorgement of profits. Prison time for executives, managers, and employees, as well as forfeiture of their assets, is rapidly becoming *de rigueur*, as prosecutors are increasingly seeking to make penalties personal. Firms also face additional costs of hundreds of millions of dollars for legal fees and for remediation efforts, including expensive and intrusive government-supervised monitoring programs. In addition to an American >>

assessment, all of these costs may also be assessed in other countries where the firm does business and where anti-corruption enforcement is taken seriously.<sup>2</sup> Few, if any, of these costs are insurable, and many can pose an existential threat to a business.

Enforcement is on the rise, both in the United States and abroad, and the recently-appointed head of the Criminal Division of the U.S. Department of Justice announced a new focus on FCPA enforcement as a priority for the Obama administration. Moreover, the recently enacted Dodd-Frank Financial Reform Act of 2010 created financial bounties for private whistleblowers who report corporate FCPA violations to the government.

While the FCPA is complex and may be viewed to cause more sleepless nights than the travel schedules associated with the related foreign projects, FCPA enforcement authorities provide guidance on creating a compliance program to reduce the risk of violations. Drafting and implementing a compliance program is a crucial part of doing business abroad.

### **A robust FCPA compliance program benefits a firm in three ways:**

- 1** It significantly reduces the risk that a violation will occur in the first place.
- 2** If a violation does occur, it enables the company to detect the violation, mitigate its impact, and determine whether to self-report the violation to the authorities and potentially receive favorable treatment.<sup>3</sup>



- 3** If a violation does occur and comes to the attention of enforcement authorities, the lack of a compliance program – or a compliance program that exists on paper but is otherwise ineffective – is a significant factor in determining the penalty. A compliance plan alone can be the difference between being assessed a manageable fine or being hit with devastating penalties and prison time for the company's executives.<sup>4</sup>

A compliance program must be specifically tailored to the firm and designed to address the risks faced by the firm in the geographic markets in which it operates.<sup>5</sup> The program must also be “reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct.”<sup>6</sup>

### **A compliance program should incorporate the following points:**

#### **LEADERSHIP**

When a prosecutor determines whether to charge a firm for the criminal conduct of an employee, the key inquiry is whether the misconduct is the act of a single rogue employee, or is the product of an inadequate corporate culture created (or tolerated) by the management.<sup>7</sup> For that reason, it is critical that the firm develops a strong ethics and compliance message, and that the firm's message is continuously reinforced by leadership.<sup>8</sup>

#### **INTERNAL CONTROLS**

The purpose of internal controls is to provide a set of checks and balances through which inappropriate transactions may be detected and prevented before the firm becomes committed to them. From the point of view of FCPA compliance, internal controls help ensure that: (a) the firm captures and documents complete and accurate information about its transactions, (b) compliance-sensitive transactions are subjected to heightened review by appropriate management, and (c) each employee or manager participating in the review and approval of the transaction exercises his or her independent judgment

based on complete and well-documented information.

#### **THIRD PARTY MANAGEMENT**

Third parties – such as sales representatives, agents, expeditors, and the like – are well-known conduits for corrupt payments. At a minimum, firms operating abroad are expected to undertake two sets of inquiries when dealing with any third party. The first is an inquiry into whether the transaction with the third party is needed in the first place, or whether the transaction can be handled by the firm directly. Secondly, if the third party is needed, the firm should conduct thorough due diligence both on the third party itself and on the proposed transaction with a particular emphasis on identifying any warning signs (commonly known as “red flags”) that might signal that the transaction is suspect.

#### **PRE-ACQUISITION /PRE-JOINT VENTURE DUE DILIGENCE**

Even the best-run firms can stumble into a minefield of compliance risks when acquiring other companies or entering into joint ventures with them. The mere presence of corruption concerns need not necessarily scuttle the deal. A significant deal in the mid-2000s involved Nokia's acquisition of a division of Siemens – which was then in the middle of the biggest anti-corruption prosecution in history – to create the successful (and compliant) Nokia Siemens Networks. But great care must be taken to determine the existence and extent of FCPA risk in the transaction – and the necessity for subsequent remediation measures – in order to avoid incurring successor liability.

#### **HUMAN RESOURCES**

A firm can act only through its employees. For that reason, the employees' understanding and respect for the firm's compliance procedures is the difference between a compliance program that uselessly exists only on paper, and one that has been internalized and followed. Training must emphasize the importance >>

<sup>1</sup> See 15 U.S.C. § 78dd-1 (applicable to “issuers”), 78dd-2 (applicable to “domestic concerns”, meaning any company that “has its principal place of business in the United States, or which is organized under the laws of a state [or territory]” or any individual person who is a citizen, national, or resident of the United States”), and 78dd-3 (applicable to “any person” who is neither an “issuer” nor a “domestic concern.”).

<sup>2</sup> For instance, European Union enforcement authorities, after years of criticism for their inaction on foreign corruption, have been assuming an increasingly assertive posture in the past year. The United Kingdom has also recently passed its Bribery Act of 2010, a British counterpart to the FCPA, and its Serious Fraud Office (“SFO”) has stepped up enforcement.

<sup>3</sup> United States Sentencing Guidelines (2007) (“USSG”), § 8C2.5(g) provides for a reduction of up to 5 points in the company's “culpability score,” which is used in sentencing decisions, for companies that discover and self-report the violation. Notably, under the proposed revisions of the Sentencing Guidelines that are expected to go into effect later this year, a compliance program that enables the firm to detect and self-report a violation can reduce the firm's liability even if senior executives were involved in the offense.

<sup>4</sup> *Id.*, § 8B2.1(a) states that a compliance program “shall be reasonably designed, implemented, and enforced so that the program is generally effective in preventing and detecting criminal conduct. The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.”

<sup>5</sup> U.S. Attorneys' Manual (“USAM”) § 9-28.800(B).

<sup>6</sup> USSG, § 8B2.1(a).

<sup>7</sup> *Id.*

<sup>8</sup> USSG, § 8B2.1(a)(2).

of compliance, and articulate clearly and starkly the consequences of noncompliance both to the firm and to the employees personally.

### INTERNAL RESOURCES

The firm should implement written policies governing business processes that carry elevated risk of exposure to FCPA liability.<sup>9</sup> These include direct interaction with government officials; retention of third parties; cash funds; travel and entertainment; gifts; charitable donations; standards for reviewing third-party invoices and employee expense reports; and pre-employment and pre-promotion investigation of employees.

### AUDIT

The greatest discrepancy between a traditional audit and the FCPA lies in the notion of materiality. Because traditional audits are typically conducted with a specific

materiality threshold (usually set at the level of tens or hundreds of thousands of dollars), they may ignore transactions below a certain amount. However, most transactions that can land a firm in FCPA trouble will fall well below that threshold. The FCPA, on the other hand, does not have a materiality threshold, and even a de minimis corrupt payment can carry a risk of criminal liability.

### REASSESSMENT OF THE COMPLIANCE PROGRAM

As with any other part of its business strategy, the firm must periodically reevaluate its compliance program to ensure that it maintains maximum effectiveness to counter the risks that the firm faces.<sup>10</sup> The firm must also undertake such a review if the compliance program fails to detect or prevent a violation.<sup>11</sup> Particularly when the firm implements a compliance program for the first time, it is unlikely to achieve its

maximum potential.

While these points are not the only ones that should be included in a compliance program, they certainly provide a solid foundation for developing a comprehensive program that is appropriately tailored to insure compliance. In light of the Department of Justice's new focus on enforcement, firms with existing business abroad should reassess their compliance programs to assure their continued adequacy. For those firms that are new to the international arena, formulating and implementing a compliance program is not an option, it is a necessity. Unfortunately, failing to develop and implement a satisfactory compliance program could be catastrophic. ■

<sup>9</sup> Id., § 8B2.1(b)(1) ("the organization shall establish standards and procedures to prevent and detect criminal conduct.");  
<sup>10</sup> USSG §§ 8B2.1(b)(5)(B), 8B2.1(c).  
<sup>11</sup> USSG § 8B2.1(b)(7).

## CHINA: THE NEW FRONTIER IN URBAN DEVELOPMENT



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Foreign executives visiting China's huge coastal cities are sometimes surprised to learn that China is still a predominantly rural country. According to China's National Bureau of Statistics, China had 622 million urban residents at the end of 2009 – a population well over twice the size of the entire U.S. but still just 47% of China's total.

China's urbanization rate is still below the global average and much lower than what executives are accustomed to seeing in U.S. and European markets. China's current plans to achieve a 67% rate by 2030 – shifting 280 million people to cities within two decades – is set to become a signature event in shaping the global economy this decade.<sup>1</sup>

Because of its rapidly accelerating rate of urbanization, China presents great opportunity for both design professionals

and developers. This article outlines a methodology to predict where China's near-term need for construction/ infrastructure services will be.

Chinese economic development for the past three decades has been closely tied to rural-urban migration. From just 18% in 1978, China's urbanization rate has increased .9% on average each year. Natural population growth has been essentially flat since the 1970s, so almost all of this increase has come from

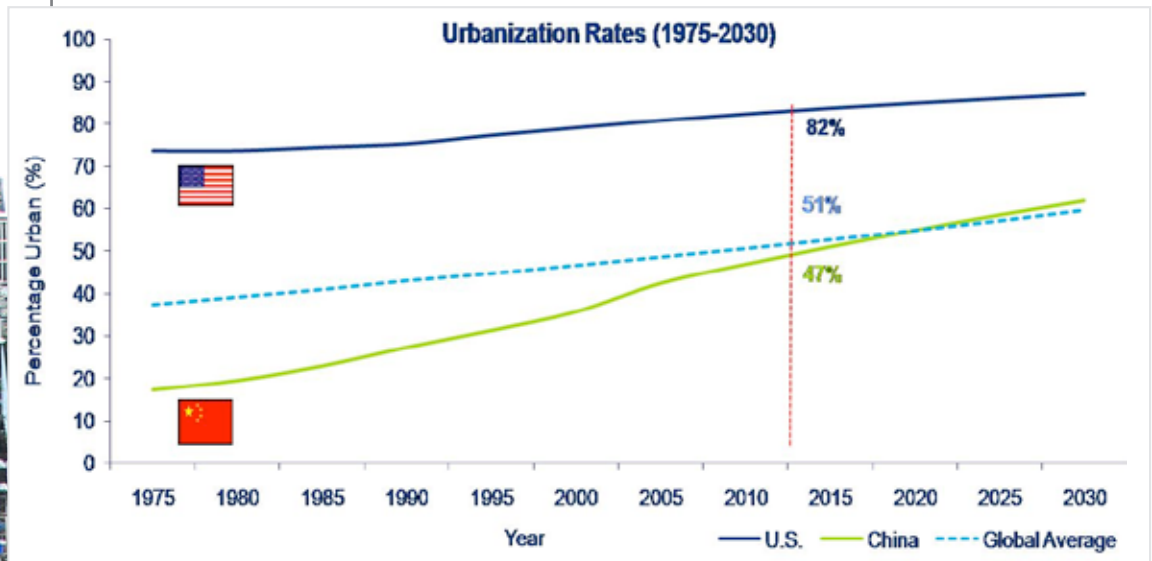
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*Because of its rapidly accelerating rate of urbanization, China presents great opportunity for both design professionals and developers.*

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the flow of millions of rural workers to Chinese cities each year. On paper, China's 50 year-old system of urban-rural

<sup>1</sup> Chinese Academy of Social Sciences, Blue Book on Micro Economy, April 2010.



household registration was meant to strictly control this movement.<sup>2</sup> In reality, migrant workers have come to represent nearly 30% of China’s urban population today, even though lack of permanent urban status denies them many of the rights and privileges of city life (e.g. property ownership, access to services).

In recent months, China has begun signaling that it is preparing to wind down the household registration system, removing the primary barrier to much faster rural-urban migration.

For example, in his remarks before the National People’s Congress (NPC) in March, Premier Wen Jiabao pledged to begin phasing out restrictions on permanent residency in smaller cities by year’s end. What has already been the most remarkable urbanization experiment the world has ever seen – the only comparable event is the leap in U.S. urbanization rates from 20% to 40% during the second half of the 19th century – now seems poised to move into hyper-drive.

U.S. businesses have already been deeply affected by the urbanization of China’s workforce - first in terms of low-cost production and more recently, in terms of top-line revenue growth - but what are the implications of acceleration?

Tens of millions of new permanent residents are likely to generate tremendous demand for housing and modern infrastructure of every kind – transport, power, water and sewer systems, etc. Higher disposable incomes associated with urbanization will also be

critical to finally unleashing latent consumer demand. China’s Academy of Sciences recently estimated that for every 1% increase in urbanization, China can expect a 1.6% increase in the contribution made by domestic demand to China’s GDP. So as urbanization helps rebalance the Chinese economy, U.S. investors will likely discover vast new reservoirs of potential customers for their goods and services, from basic consumer items to advanced healthcare services and financial products.

On a very practical level, U.S. investors face the challenge of choosing where to focus their future investments in this expanding urban landscape. From just 198 cities in 1978, the number of Chinese cities - defined as population centers with at least 100,000 inhabitants not engaged in agriculture - has risen to 655 and is expected to climb to over 1,000 as urbanization accelerates.

Of these 655, China’s National Development and Reform Commission estimates that over 120 have populations exceeding 1 million, with a similar number claiming 500,000 to 1 million inhabitants. Given this complexity, which of China’s urban centers are potentially best poised for short-term takeoff?

As a rough illustration of how a U.S. investor might consider tackling the problem, consider the three-step approach below. By avoiding reliance on historical data, we’ve tried to peer around the corner by tracking where investments are currently being made – sort of a “follow the money” approach. >>

<sup>2</sup> Established in 1958 to control internal migration and rationalize the distribution of scarce resources, the hukou system strictly classifies China’s population according to non-agricultural and agricultural status, roughly corresponding to urban and rural residency. Status is determined at birth, with few avenues for change. In the latest example of growing pressure to end the system, thirteen state-owned newspapers ran front-page editorials on March 1 calling for its abolishment.



- 1 The map above depicts the 26 cities that China’s Ministry of Transportation reports will either break ground or add track to urban mass transit systems during 2010. In December, China’s State Council approved US\$130 billion funding for these projects, an effort critical to enabling growth in China’s most promising urban centers. To qualify, Chinese planners set three criteria – population in excess of three million, GDP of more than RMB 100 billion (~US\$15 billion) and fiscal revenue of more than RMB 10 billion (~US\$1.5 billion). All are potentially suggestive of favorable markets for goods and services, so it seemed like a good place to start.
- 2 We next compared these 26 cities against the Ministry of Railway’s grand plan to build a high-speed rail network across China. China plans to invest approximately US\$300 billion over the next five years to connect 70% of Chinese cities with populations exceeding half a million. Again, we were only interested in rail lines under construction during 2010 – the 20 to make that cut are circled in green. So if urban transit gives us a pretty good indication of where markets may be set to take off, cities

slated to become major high-speed rail hubs may signal that Beijing is targeting a location for deeper integration into the national, as well as global, economy.

- 3 Finally, of the 20 cities with subway systems under construction in 2010 and soon to be located on high-speed rail routes, we looked at estimates by State Grid, the largest electric power transmission and distribution company in China, of where it expects demand for power will grow fastest between 2010 and 2020. Of the 20 cities, seven emerged as locations where demand is anticipated to grow more than 6% annually. China is weighing plans to invest nearly US\$600 billion to meet rising urban power demand through 2020. Whether the electricity is ultimately used to power homes or industrial plants, these projections can possibly serve as a barometer of the future vitality of an urban economy.

So from a dizzying universe of 655 cities, in this hypothetical example, we have managed to quickly winnow it down to just seven – Changsha, Chengdu, Chongqing, Fuzhou, Nanchang, Xi’an and Wuhan. All are provincial capitals, all but one are located in China’s interior, and all have populations that would easily place them among the top five largest cities in the U.S. And when we compared several recent indicators, such as growth in urban disposable income, against national rates and those of the four Tier I cities familiar to most U.S. investors – Beijing, Guangzhou, Shanghai and Shenzhen – we found strong validation for these selections.

This is obviously a simple example, and every business will have its own criteria separate and apart from the above for developing a short-list of potential locations for its next investment. It may be, for example, that the trends highlighted in the above data could be of more interest to companies in the Architectural, Engineering and Construction industries than those in other industries seeking growth opportunities in China. Yet for many U.S. executives, such exercises will become increasingly commonplace as companies try to get out in front on one of the most critical business opportunities of the 21<sup>st</sup> Century. ■

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The CSG also co-ordinates with Deloitte China and subsidiaries of Deloitte U.S. Chinese companies seeking access to U.S. markets. Bilingual professionals from the appropriate subsidiary of Deloitte LLP U.S. provide service to globalizing Chinese companies.

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## CHINA: NEW REGULATIONS ESTABLISHING FOREIGN INVESTED PARTNERSHIPS



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As is well known, the Chinese economy has grown at an astounding rate – recently surpassing Japan. At the same time, traditional restrictions upon access by foreigners to China’s markets have been relaxed. Reflecting this trend of openness and transparency, new regulations took effect on March 1, 2010, allowing two or more foreign individuals or enterprises to form partnerships and operate within China with the aim of boosting “the development of the modern service industry.” While some time will likely pass before the full impact of these regulations is known, their arrival on the international scene is noteworthy.

Although previous regulations permitted partnerships *to operate* in China, those rules restricted the ability of foreign individuals and enterprises *to form* partnerships. The new regulations introduce the concept of the Foreign Invested Partnership (“FIP”), a vehicle enabling foreign individuals or enterprises to form partnerships in China and operate in the country without prior approval of the Chinese government. As the image demonstrates, these FIPs have been created under the auspices of and are governed by rules promulgated by China’s State Council and China’s State Administration of Industry and Commerce.

These new regulations supplement China’s existing Partnership Enterprise Law and the Administrative Measures on Registration of Partnership Enterprises, which pertain to both domestic and foreign partnerships.

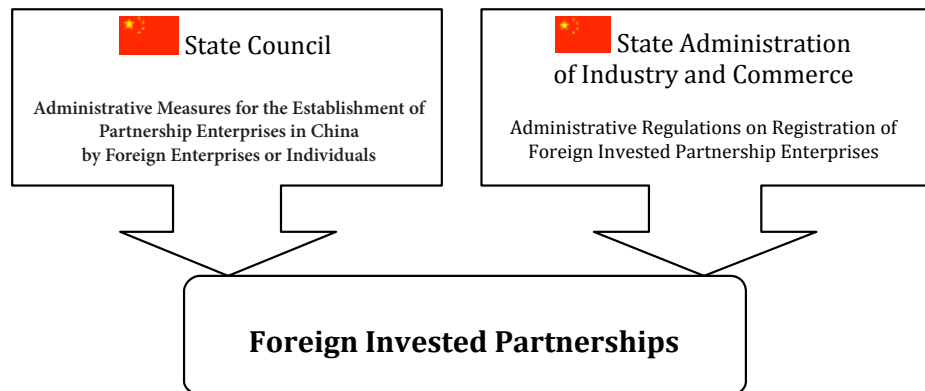
Foreign individuals or enterprises may form either a General FIP or a Limited FIP. In a General FIP, each partner is jointly and severally liable for the partnership’s debt, and each may sign contracts and conduct business on behalf of the partnership; alternatively, the partners may unanimously appoint one or more “executive” partner(s) with exclusive power to sign contracts and conduct business on the partnership’s behalf.

A Limited FIP is comprised of limited partners joined by at least one general

partner. As with a General FIP, the general partners in a Limited FIP may sign contracts and conduct business on behalf of the Limited FIP, and they will be held jointly and severally liable for the debts of the partnership. In contrast, limited partners may not sign contracts or incur obligations on behalf of a Limited FIP, and their liability is limited to the extent of their capital contribution to the partnership.

from the Ministry of Commerce and other relevant agencies prior to registration. Additionally, the Chinese government restricts access to certain industries altogether (although this prohibition generally does not affect the architectural and engineering professions).

The newly implemented regulations reflect a clear policy determined to promote



In addition to liberalizing the restrictions upon the formation and operation of partnerships in China, the new policies also attempt to simplify the regulatory scheme governing FIPs. Specifically, in contrast to other entities, FIPs are not required to obtain approval from the Ministry of Commerce before registering with the local State Administration of Commerce. It should be noted, however, that if a FIP is proposed for certain industries (including transportation, finance, telecommunications and advertising), approval must be obtained

the formation and operation of foreign partnerships within China without onerous registration requirements. A Foreign Invested Partnership may therefore be an attractive vehicle for companies considering entering the Chinese market. However, given that the regulations have been in effect for only a few months, prudence dictates that a watchful eye be kept on how they are put into practice. As always, experience will remain the best teacher. ■



## FIRM NEWS

- Founding Partner **Michael S. Zetlin** was named the 2011 New York Construction Lawyer of the Year by *Best Lawyers in America*. The publication names a single Lawyer of the Year in each specialty in each region.
- Founding Partners **Michael K. De Chiara** and **Michael S. Zetlin** were named *Best Lawyers in America*. The publication compiles its lists by conducting exhaustive peer-review surveys in which thousands of leading lawyers confidentially evaluate their professional peers.
- *Super Lawyers Magazine* named partners **Carol J. Patterson**, **Raymond T. Mellon**, **Michael K. De Chiara**, and **Michael S. Zetlin**, as four of the top construction litigation attorneys in New York, and **James J. Terry** as a leading attorney in construction/surety law. Only five percent of all lawyers in New York are recognized by *Super Lawyers Magazine*.
- Partner **Lina G. Telese** was named Honorary Member of the New York Chapter of American Institute of Architects. The award is bestowed by the AIA in recognition of the significant contributions of a person outside the profession of architecture. Only two such awards were given in 2010.

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## ZETLIN & DE CHIARA LLP

2010 Volume 16 No. 3

Review Publication from  
Zetlin & De Chiara LLP  
Counselors at Law

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