

GOING INTERNATIONAL: REWARDS, TRAPS, AND PITFALLS

by Peter Hughes, Esquire



SO YOU HAVE A SUCCESSFUL DOMESTIC CONSULTING BUSINESS, AND NOW YOU ARE CONSIDERING GOING INTERNATIONAL. THIS PAPER WILL CONSIDER THE VARIOUS LEGAL PITFALLS YOU MAY ENCOUNTER, AND THE STEPS TO TAKE TO MINIMIZE THEIR IMPACT ON YOUR NEW BUSINESS PLAN.

The paper will look at the business planning process, how an international expansion may differ from domestic plans, and how to judge success in the international market. We will look at the selection of clients, partners, agents and representatives, and international advisors. We will look at tax and currency management, and at some specific contractual provisions you may encounter internationally. And then we will look at some of the controlling U.S. laws and regulations which will impact on how you operate in the international market. It's a great adventure!

CHOOSE YOUR CLIENT

When deciding to take your consulting firm into the international arena, first think about your business plan for your selected markets. You may have had significant growth success domestically, only to find that the same growth mechanisms do not work as well internationally.

One major consulting firm decided in the 1980's that its next growth area was international. In the 40 years since its founding, the firm had grown successfully in North America (both the U.S. and Canada) by organic growth and strategic acquisitions. From its seminal office in the Northwest, it had grown by the establishment of satellite offices in other cities where it had municipal or county clients. It had then made a leapfrog acquisition across the country, and had turned itself into a strong regional and national player. It now had dozens of offices across the country, each providing similar consulting services to local clients, and was managed through a strong regional structure.

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The firm next established an international division, and expected to succeed by applying the same expansion model internationally. It opened about 20 more international offices, expecting to be able to provide consulting services in its strength areas, and to be able to market on its strong domestic reputation. Most of its new international offices were somewhat successful, and able to develop a certain book of business. However, the firm had not counted on the overhead cost of “projecting American power half way round the world,” and, after eight years of this new business, the firm discovered that none of the new offices or regions had in fact made money when the overhead cost structure was taken into account. Staffing these offices with American expatriates was too expensive a solution for a civil engineering and design practice.

The firm’s domestic business had benefited from many years of steady double-digit growth. However, the firm’s domestic business stuttered in this time frame, and the realization that the international business was in fact a drag on company returns struck home forcefully. The firm realized that using the “shotgun” model for international business had not been a success. With the need to close off excess overhead during a downturn, the firm decided to cut back very substantially on its international business. It closed many of the international offices and cut back severely on the international staff, including retiring the international president whose business model had not been a success. The firm retreated from the international market place for several years while it re-grouped.

Eventually, new international management team was selected. This was now organized on the basis of the firm’s Business Group structure (i.e., its primary P&L managers) rather than on its regional structure. This brought a new profitability discipline to international ventures, and the new team put in place a “rifle-shot” model for the pursuit of international business which applied for the next round of the business cycle. The new team became much more selective on clients and project opportunities, rather than using a “*local office*” model, and the selection was based on the ability of the *project*-based opportunity to carry its own overhead load successfully. This has led to much more significant success.

A more successful model for going after international business has been followed by major EPC firms. Typically, they follow their domestic U.S. clients into international markets, and often have been selected by those domestic clients precisely for their known expertise. Thus, a firm which has a long-standing domestic relationship with a U.S. Government agency (State, Defense, Energy, or USAID, for example), a major international oil or petrochemical company (Chevron, Exxon, or Dow, for example), or with a major property developer, such as a casino company, can find itself selected for its first international projects.

Participating in an international project through that route has substantial advantages. The pre-existing relationship is valuable—each party is a known quantity to the other. The U.S.-based client is used to paying the domestic firm’s customary charges, and is not looking for “local” rates. The standards applicable to the project are well-known to both parties. And that first successful international project is often the springboard to an on-going relationship with

that client in the new region, and can often be the basis for establishing relationships with other clients that country, too.

It is also important to look at the credit-worthiness of your client, and its ability to pay. On a motorway project in Turkey, the Turkish Ministry of Transportation committed to projects with a capital cost nearly double their annual budget. Over the five year duration of the project, this meant that the firm had repeated collection and payment problems.

The firm was paid in full for the first year's work—but near the end of the project's fiscal year, when it was nearly time to gear up for the second year's construction season. Towards the end of the second year, we were asked to take a partial delayed payment, beyond the already-late payment cycle we had seen on the project. The third year, the firm was asked to take one-year dollar-denominated notes in payment, and the fourth year, it was asked to take three-year Turkish lira denominated notes! With each passing year, the payment risk increased substantially, and exposure to currency risk similarly increased.

The receivable eventually exceeded \$ 100M, and this and similar receivables for other American companies received attention at the State Department level. An exposure at this level also meant that the firm was vulnerable to an involuntary renegotiation of contract payment terms as it reached the end of the contract period, and it guarded closely against that happening.

CHOOSE YOUR PARTNER

Firms entering new countries generally expect that when they select a partner to work in that country or on a specific project, their interests will coincide. This is not necessarily the case.

The offshore oil and gas platform business was, for many years, difficult to enter into. In the late 1970's, the reason for this finally became apparent when the U.S. Department of Justice sued Brown & Root and J. Ray McDermott for antitrust violations by price-fixing with respect to offshore work in the Gulf of Mexico. In the early 1980's, this meant that new offshore oil provinces were more open, and that other EPC companies could work in them.

The North Sea was the next oil province to open up. The first offshore platforms there were in the shallow southern sector, offshore Holland, in the 1960's. Over time, exploration moved progressively further north, until by the early 1980's, oil companies were looking at deep-water projects off of Scotland and Norway, in the northern sector. One company wanted to work on those projects and particularly on the gravity-based platforms for Statoil in the Norwegian sector of the North Sea.

The company therefore set up an operation in Norway. Statoil made it clear that the firm needed a Norwegian partner, so it established a 50/50 joint venture with a Norwegian petroleum consulting firm, a consortium of several smaller engineering consulting firms. Together, the consortium successfully designed the Gullfaks B platform for Statoil, which was fabricated in Stavanger and launched and placed from there.

Then the firm turned its attention to the next Statoil project, Gullfaks C. At this point, it was discovered that the firm's interests and its partner's interests did not coincide. The company had been predominantly interested in partnering

with the local firm to get access to the Norwegian/Statoil market. They would have preferred to have kept the company out of their local market altogether. They partnered with the firm, not for that first project, but to gain the advantage of learning from the firm and developing an international practice of their own, as encouraged by the Norwegian government, in order to be able to be a net exporter of engineering services from Norway into future oil provinces, such as the South China Sea.

When Statoil was putting the Gullfaks C program together, it was discovered that the firm's partner had gone directly to the client to persuade them that the company was no longer required as part of the design team, and that they could do it all themselves. Statoil, however, was not convinced, and required that the firm continue to have a role on the new project—even if only in a minority 20% position! This mismatch of company goals is frequently the case between ostensible partners.

On the motorway project in Turkey, the firm partnered again with a local firm. The Joint Venture agreement provided that distributions to the local partner would be made offshore, to a bank account in Switzerland. This payment arrangement permitted the local partner, a family-owned firm, to expatriate cash from Turkey in ways which they may not have been able to do directly. As a result, when the JV was short of cash as a result of the slow payments described above, the local partner would demonstrate that they did not have cash in country to satisfy a JV cash call, and the U.S. firm would have to fund the cash call.

CHOOSE YOUR LOCAL REPRESENTATIVE

In many countries, particularly in the Middle East, foreign companies are expected and/or required to have a local sponsor. This is an obvious business relationship for a manufacturing distributorship, for example, but the need is less obvious for professional consulting firms. Nevertheless, it is a frequent requirement.

One company has had success with representatives who were either in the same business as the firm—engineers, constructors—or who were already representatives of major American businesses. These are either professionals or entrepreneurial businessmen (and almost always men, in the relevant countries).

The firm's first representative in Saudi Arabia was Suleiman Olayan. Mr. Olayan had originally been a truck driver on Bechtel's first project there, the Trans-Arabia Pipeline (the TAP line) for Standard Oil of California and its partners. By the end of the job, Mr. Olayan had four trucks and employed other drivers. The firm went into partnership with him for subsequent projects, and is still in a 50/50 partnership to this day. The relationship has been highly successful for both parties.

When vetting a new local representative, the issue of business integrity is of utmost importance. The U.S. Foreign Corrupt Practices Act¹ forbids bribery of foreign officials by a U.S. company *or its agents*. The retention agreement with a new agent or representative will include necessary FCPA language, and this must be discussed and verified with the agent or representative before he is retained.

For U.S. companies, it is also customary that the compliance mechanism for assuring that these requirements are met will be vested in the General Counsel's office, and not with local or divisional business management.

Penalties for violation of the FCPA are very, very high, and can subject a U.S. company found guilty (or which enters into a settlement agreement) to extended supervision of its international affairs by an external monitor appointed by the U.S. Department of Justice and paid for by the company.

CHOOSE YOUR LOCAL ADVISORS

When entering into a new country, the formation team will probably spend a week visiting potential advisors and selecting them. The formation team will usually consist of the Business Development Manager responsible for developing business in that country, plus a member of the International Business Management team, plus an attorney.

The week will probably begin with a courtesy call on the intended client, followed by advisor visits. The advisors to be selected are the local bank, the accountants, and the legal advisors.

The bank selected will probably be the local branch of the firm's domestic relationship bank—Bank of America, Citibank, HSBC, Standard Chartered, or the like. The local branch will establish accounts for the receipt of client payments, payroll and payments to subcontractors and suppliers, partner distributions, and the like.

Domestically, most clients will use payment and performance bonds (surety instruments) as forms of contractor performance security. Internationally, these are unusual, and the customary instrument is a letter of credit, usually at 10% of the contract amount. These letters of credit are usually issued as "confirmed letters of credit," that is, the client receives an L/C issued by a local bank which is secured in turn by an L/C issued to it by an international bank. This process eliminates the opportunity for the contractor to object to his own bank to a call by the client on the L/C, and confirms the "on-demand" nature of the L/C. These matters will usually be discussed with the local bank during the formation team's visit.

The next step is the accounting firm—again, usually the local affiliate of the firm's domestic accounting firm in the U.S. The accounting firm will provide guidance on the most suitable form of business organization in the new country, whether an incorporated subsidiary, a branch of an existing entity, an LLC, an unincorporated JV, or the like. The choice will probably be determined by the most favorable tax treatment to be obtained.

Many U.S. firms are conservative in their relationship with their domestic taxation authorities, but can be aggressive in their international tax affairs. The accounting firm is the right advisor for tax advice and for currency management advice.

Tax matters to be discussed include corporate income tax and expense management. Also important are payroll tax matters. Some countries tax employees' personal income from day one; others permit an employee to be in country for a certain period of time (30 days, 60 days, 180 days) before taxation begins. It is also possible that the new country may be one in which the use of

“split payrolls” may be beneficial—that is, the employee may be compensated partially in local currency and on the local payroll, and partially offshore in his home country, thus reducing the incidence of payroll taxes. However, this is not legal everywhere, and must be treated with care.

Other countries rely on forms of taxes other than income tax, such as Value-Added Tax (VAT, common in Europe), or Goods & Service Tax (GST, as in Canada). Others charge a flat corporate tax such as a Gross Receipts Tax on first-dollar earned, rather than on net income. In each case, careful tax planning will be done in close consultation with your local accounting firm as tax advisors. In addition, if your firm’s international tax planning involves balancing tax losses in one country (as, for example, from early set-up costs) with taxable income from others, your local tax planning will need to be coordinated with your international tax planning.

Additionally, the accounting firm can provide advice on currency repatriation. Not all local currency is fully convertible to dollars (or other reference currency of the consulting firm), and not all local currency is freely transferable out of country. This can result in marooned currency which can incur substantial currency devaluation risks. The local bank and the local accounting firm can offer useful currency management advice.

The final stop will be with local counsel. Both the local bank and the local accounting firm can provide references to local counsel. In addition, many international firms will look at law firm listings to determine which local firms already represent major multi-nationals, such as IBM, GM, or GE, and will select those firms. English language skills as well as an affiliation with a major international law center firm (New York, London) or firm members with international firm experience are good criteria. Again, a sound understanding of US FCPA requirements is also required. It is important to recognize that many countries have now adopted strict anti-money-laundering laws, and that you may be requested to provide unusually detailed information on your company, its history, and its financial affairs to the locally-retained law firm before they can undertake your representation.

The law firm selected will undertake the incorporation and registration and licensing of the international company in the new country, including advice on name selection. In Iraq, for example, a company was hired early on by the Transition Authority for consulting services in the water and wastewater sector; the firm wanted to establish a presence which would carry them forward into the period of reconstruction to follow the war, and therefore wanted to license a permanent establishment in the country. A law firm undertook this registration for us, and met considerable resistance within the local corporate licensing authorities. Eventually, the company was incorporated under an entity name which translates as “The Tents of the Bedouin Consulting and Construction Company.”

The local law firm will also provide independent counsel on tax and currency matters, which is a useful cross-check on the accounting advice received. Local counsel will also provide advice on dealings with regulatory and licensing authorities. Finally, they will be invaluable in understanding local insurance and liability exposure requirements (as discussed further below).

LEGAL CONSIDERATIONS—*FORCE MAJEURE*

One of the most important contractual provisions to be included in an international contract is the clause which excuses failure of performance under certain circumstances, and defines the relief available to the consultant or contractor. This is usually entitled “*force majeure*” or “uncontrollable circumstances.”

In its simplest form, a *force majeure* clause will provide that “neither party shall be liable for a failure to perform its obligations hereunder which is due to causes beyond the reasonable control of such party.” In this form, the clause only operates to excuse a breach or default, but does not provide any additional remedies to the party unable to perform.

In a more extended form, the clause will list a large number of possible causes of non-performance—and then include the catch-all phrase at the end anyway. Such a clause might read:

Neither party shall be liable for any failure to perform its obligations hereunder where such failure is as a result of Acts of God (including fire, flood, earthquake, storm, hurricane or other natural disaster), war, invasion, act of foreign enemies, hostilities (whether war is declared or not), civil war, rebellion, revolution, insurrection, military or usurped power or confiscation, terrorist activities, nationalization, government sanction, blockage, embargo, labor dispute, strike, lockout or interruption or failure of electricity [or telephone service], or other cause beyond the reasonable control of the party affected, and no other party may terminate this Agreement in such circumstances.

In a negotiation with a Japanese company, when a company was attempting to simplify the agreement, the firm commented that this form of the *force majeure* clause was “very French,” with its extended “parade of horrors.” The Japanese negotiator asked what an American company would do with the clause, and the firm pointed out that the simplified form, without the listing of disasters, was legally adequate—both parties agreed on the clause in that form.

In a negotiation with an American hospital company for the operation and maintenance of a hospital facility in Saudi Arabia (building ops, not medical ops), a company noted that the offered *force majeure* clause included the general list, but omitted “war.” The firm was told that this was intentional, that their principals in San Francisco had already agreed to it, and that the company was indeed agreeing to operate the hospital facility for a two year period, even in the event of a regional war. This was confirmed—along with the fact that what was purported to be an 800-bed civilian hospital was in fact a standby military hospital!

One thing to watch with a *force majeure* clause is its placement within the contract. In its original form, such a clause only provides schedule or delay relief. However, most contractors will also want cost relief in the event that they suffer an uncontrolled obstacle to performance, and may also need plant performance relief. This in turn can be a subject of considerable negotiation—as to type of causation, raw costs vs. fully-burdened costs, deadbands, etc.

A particular New York law firm is notorious for its drafting of an “Uncontrollable Circumstances” clause which is loaded with “Inclusions” and “Exclusions,” and in which both inclusions and exclusions can have “excepted”

provisions. This clause, which appears in the “Definitions” section of the contract, produces the most protracted elements of the negotiation. Subsurface conditions, economic conditions such as non-historic spikes in commodity prices, weather conditions, non-specification influent conditions, timing of licensing by regulatory agencies, and several others have produced both protracted negotiations and extended disputes.

LEGAL CONSIDERATIONS—DECENNIAL LIABILITY

Decennial liability is a form of liability exposure of great concern to design professionals operating in Civil Law countries. It originates in the French Napoleonic Code, and provides that, in the event of the collapse or threatened collapse of a building, the designer and builder of the building are both considered to be liable unless they can demonstrate that the collapse or threatened collapse was not their fault.

“The contractors’ and architects’ decennial liability existed in the original text of the French Civil Code (1804), in articles 1792 and 2270. The spirit of the law was to protect non-professionals against defects which they could not detect at the time of acceptance of a building.”

This principle has been adopted in many other countries where their legal code is Civil Code-based, “including jurisdictions in the Middle East such as the United Arab Emirates, Saudi Arabia, Kuwait, Iraq, Egypt, Jordan, and Qatar. The specific wording of the applicable codes varies, but all of these countries mandate strict liability for building defects.”

One company first met decennial liability issues on an off-shore oil platform project in Egypt. The concept created major concerns, since the firm’s normal contractual warranty was for one year following substantial completion of the project (i.e., available for use for the purpose intended), with no extended warranty provisions. No liability insurance was available at that time to cover the exposure.

The normal building problem in Egypt is that an owner will ask an architect for the design of an apartment building of eight stories. Then the owner and the contractor will agree that two additional floors could be included, giving 25% more rentable space, so the contractor will build an apartment building of ten stories on an eight story foundation. Then the building superintendent moves in, and builds his mother-in-law a two-floor adobe apartment on the roof, such that the building now has the weight of twelve stories on an eight-story foundation. Every two weeks or so in the early 1980’s, an apartment building in Cairo would collapse under these circumstances, killing tenants, and the owner, designer, and contractor would be immediately arrested.

The firm eventually concluded that it was designing engineered industrial facilities which it would then build to its own specifications, and that their engineered buildings just did not collapse as cheap commercial buildings might. The decennial liability law is a marginally-effective *in terrorem* substitute for sound building codes and an effective and non-corruptible building inspection system. Under the circumstances, the firm therefore concluded in its risk analysis that it could go forward with the offshore platform project notwithstanding the unusual (for the firm) decennial liability exposure.

However, this conclusion may not be satisfactory for design consultants who are going into decennial liability countries, and who will not control the construction of buildings to their design. The decennial liability exposure cannot be modified by contract, and decennial claims are available to subsequent purchasers or occupiers of buildings which collapse or which are threatened with collapse. The prudent design professional will therefore have an extended discussion of decennial liability issues with his or her professional liability insurance carrier before venturing into such jurisdictions.

LEGAL CONSIDERATIONS—BOYCOTT REQUESTS AND FCPA

There are a number of international boycotts still being practiced, of which the most notorious is the Arab boycott of Israel, promulgated by the Central Boycott Office of the Arab League, headquartered in Damascus. Language which imposes the boycott on tenderers or contractors will frequently be encountered in invitations to bid, requests for proposals, or contract forms from Arab League countries.

It is not legal for U.S. companies or their foreign affiliates to agree to engage in the boycott. The U.S. antiboycott laws are contained in the Export Administration Act, 1977 amendments, and the Ribicoff Amendment to the 1976 Tax Reform Act. They are administered by the U.S. Department of Commerce through the Export Administration Regulations (15 CFR Chapter 7).

These regulations create two obligations for U.S. companies and their foreign affiliates: first, to report boycott requests, and second, not to agree to engage in the boycott. Reports of the receipt of boycott requests are required on a quarterly basis.

The U.S. government and U.S. companies, through a series of actions and consent decrees, have agreed upon forms of language which may appear in contracts between boycotting countries and U.S. companies, and upon forms of language which are forbidden. The nuances of these distinctions are not immediately clear, and a U.S. consultant who meets such language should consult with experienced counsel as to what forms of language may be acceptable, and which are not. The more sophisticated agencies in boycotting countries are familiar with these forms of language, and will usually craft their contracts in ways which pass muster (usually, through the use of passive language). However, less sophisticated and unacceptable language is still seen from time to time and must be both reported and modified for acceptability.

The Export Administration Regulations also govern general U.S. exports. Most exports take place under a general license for which no special action is required. However, strategic materials and information are controlled and special licenses may be required for them.

Finally, as noted above, U.S. companies and their foreign affiliates are governed by the U.S. Foreign Corrupt Practices Act. Any U.S. company operating internationally will need to be acutely aware of the requirements and limitation of the FCPA for its foreign operations.

CONCLUSION

In taking your consulting firm into an international practice, you will need to begin with a sound business plan and an understanding of the ways in which international practice may differ economically and legally from your domestic practice. Recognize that startup costs will be surprisingly high, and that the period before which returns are realized can be quite long. Monitor the progress of your international operations, and be prepared to modify them to fit your business plan goals if necessary.

Select your clients with care. Recognize that your goals and your partners' goals may not coincide, and may even be antithetical. Be very careful with your local agents and representatives, and your local business development personnel, to make sure that your own high ethical standards continue to be observed in your international practice. Select high quality local advisors—bank, accountants, and law firm—and follow their advice carefully. Put strong corporate checks and balances in place. Manage your international liabilities with care, and use your Professional Liability insurance advisors to place appropriate coverage for your new international operations.

And finally, be aware of the U.S. government interests which apply to your international operations—export control, antiboycott, FCPA, money laundering, and income taxation. Bon voyage!

ENDNOTES

1 FCPA: 15 U.S.C. Ch. 2B, sec. 77dd- 1 contains the following prohibition:
§ 78dd-1 [Section 30A of the Securities & Exchange Act of 1934].

Prohibited foreign trade practices by issuers

(a) Prohibition

It shall be unlawful for any issuer ..., or for any officer, director, employee, or agent of such issuer or any stockholder thereof acting on behalf of such issuer, ... corruptly in furtherance of an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value to--

(1) any foreign official for purposes of--

(A) (i) influencing any act or decision of such foreign official in his official capacity, (ii) inducing such foreign official to do or omit to do any act in violation of the lawful duty of such official, or (iii) securing any improper advantage; or

(B) inducing such foreign official to use his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality,

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person;

(2) any foreign political party or official thereof or any candidate for foreign political office for purposes of--

(A) (i) influencing any act or decision of such party, official, or candidate in its or his official capacity, (ii) inducing such party, official, or candidate to do or omit to do an act in violation of the lawful duty of such party, official, or candidate, or (iii) securing any improper advantage; or

(B) inducing such party, official, or candidate to use its or his influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality.

in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person; or

(3) any person, while knowing that all or a portion of such money or thing of value will be offered, given, or promised, directly or indirectly, to any foreign official, to any foreign political party or official thereof, or to any candidate for foreign political office, for purposes of--

(A) (i) influencing any act or decision of such foreign official, political party, party official, or candidate in his or its official capacity, (ii) inducing such foreign official, political party, party official, or candidate to do or omit to do any act in violation of the lawful duty of such foreign official, political party, party official, or candidate, or (iii) securing any improper advantage; or

(B) inducing such foreign official, political party, party official, or candidate to use his or its influence with a foreign government or instrumentality thereof to affect or influence any act or decision of such government or instrumentality, in order to assist such issuer in obtaining or retaining business for or with, or directing business to, any person.

³Laure Leservoisier, Avocat au Barreau de Paris, “French Decennial Liability of Contractors,” at isites.harvard.edu/fs/docs/icb.topic30438.files/Old_Content_Spring2005/class_6/reading_6-4.pdf.
⁴Colleen Palmer, “Beazley Insight - Decennial Liability: A Potential Time Bomb for U.S. Design Professionals?” at www.beazley.com/A&E.