

message from partner in charge

Our new *Canadian Update* newsletter focuses on U.S. legal developments of interest to Canadians:

- Ms. Luxton and Mr. Walsh report that proposed U.S. climate change legislation could dramatically impact the way Canadian companies do business in the United States and requires focus on cross-border climate change assessments.
- Mr. Paw notes increased DOJ and SEC enforcement, in the United States and abroad, under the U.S. FCPA, adding that companies raising capital or issuing credit cross-border need Canadian/U.S. FCPA compliance programs.
- Mr. Rosener highlights points from our “Distressed M&A Outlook” survey, including increased opportunities expected in the second half of 2009.
- We also note that the FTC delayed enforcement of the Red Flag Rules until November 1, 2009, with companies issuing credit (including trade credit) to certain U.S. companies or consumers required to have effective identity theft policies to avoid risk of litigation and U.S. government penalties.

Also, Pepper’s new interactive Canadian Webinar Series will further educate clients and friends about U.S. issues of concerns to Canadians.

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U.S. Climate Change Legislation Moves Front and Center

With strong backing from the Obama administration and congressional leadership, U.S. climate change legislation took a big leap toward passage in recent developments. On June 26, the House of Representatives voted to adopt H.R. 2454, the American Clean Energy and Security Act of 2009. The bill now goes to the Senate, where the President and united Senate leadership have vowed to amass the daunting 60 votes needed to enact this legislation before the end of the year.

The United States and Canada are under pressure to at least announce new climate change policies prior to or at the December 7-18, 2009 climate change treaty meeting in Copenhagen. Both countries have failed to meet their goals set by the Kyoto Protocol of a 7 percent and 6 percent reduction between 1990 and 2012, respectively. In fact, U.S. emissions increased 17 percent between 1990 and 2007 and Canada’s by 26.6 percent (compared to 17.4 percent and 21.3 percent reductions in the United Kingdom and Germany during the same period), and both countries have been sharply criticized by international environmental groups.

The U.S. climate change bill remains controversial and many additional concessions to economic reality will be necessary to win passage. But the legislation’s striking success thus far has made it clear that companies in the United States and Canada must take very seriously the chances of dramatic changes in virtually every aspect of the way they do business in the United States. The bill (a) uses a partially free and partially auctioned cap-and-trade system to reduce industrial emissions of carbon dioxide; (b) establishes more stringent energy efficiency requirements for products, industrial processes, and buildings; and (c) sets renewable energy standards for states, to encourage increased use of non-fossil fuels to generate electricity.

The cap-and-trade system will be complex and costly. Although this cap-and-trade scheme allows any level of emissions as long as the company holds greenhouse gas (GHG) emission allowances or offsets that cover the amount of actual emissions, the cost of purchasing such allowances and offsets can be substantial, particularly if a company is not in

the industrial sectors that qualify for a rebate of the cost of such emissions. Effects will spread beyond the sphere of environmental law, affecting activities involving energy, tax, securities, corporate merger and acquisition strategy, international trade, construction, real estate, intellectual property, and product marketing. For example, the U.S. Securities and Exchange Commission is looking into increased disclosure requirements regarding climate-change risks, and increases in natural disasters (allegedly due to climate change) are forcing insurance companies to change their financial models, from a focus on historic trends to anticipation of changing trends.

Increasingly, companies on both sides of the border are becoming alert to the need to undertake targeted climate change assessments. In fact, given the tendency of Canadian laws to mirror U.S. laws to ease cross-border commerce, Canadian companies should be watching and, if appropriate, seeking to inform the U.S. Congress of potential negative cross-border economic effects. One provision in the existing bill allows the President to ban the import of goods from countries that do not have a climate-change regulatory scheme comparable to the U.S. system unless they hold international reserve GHG emission allowances to offset the carbon emitted during the manufacture of the goods. While this provision is directed at developing

nations, if Canada does not adopt a system similar to the U.S. climate change program, its goods could be subject to this “tariff.” In anticipation of more emphasis on GHG emission reductions, the Canadian Voluntary Carbon Standard Association has amended its rules to allow projects in Canada to qualify for its greenhouse gas emissions offsets, a move that should be scrutinized with the U.S. climate bill and potential future Canadian climate-change legislation in mind. Savvy businesses may find opportunities in this coming wave of change, but in any event cannot afford to ignore it, even in the near-term planning horizon.

More information about this issue is provided by our recent Client Alert, available at http://www.pepperlaw.com/publications_update.aspx?ArticleKey=1549.

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Guilty Verdict Highlights Importance of Due Diligence in International Transactions

The U.S. Justice Department has rapidly expanded its enforcement of the Foreign Corrupt Practice Act (FCPA), which prohibits payments to foreign government officials to obtain or retain business and entries in corporate books to conceal such payments. Investigations have hit a broad range of companies and industries, resulting in record-setting judgments.

This enforcement trend has a significant impact on Canadian companies, whether they have operations in the United States, raise capital in U.S. markets, or simply have financial transactions that pass through U.S. banks. Understanding how liability arises, and what safeguards need to be in place, is critical to all Canadian companies conducting international business.

This area also is important as Canadian authorities begin to expand their own focus under the Canadian Corruption of Foreign Public Officials Act (CFPOA). While this law has not yet been widely used, the Canadian government introduced

legislation in May 2009 to expand CFPOA jurisdiction, and the Royal Canadian Mounted Police (RCMP) have added staff to investigate international bribery and assist foreign investigators.

Mr. Paw's article discusses a recent FCPA trial in the U.S., and some of the implications from that verdict on compliance with U.S. law. Canadian companies need to consider this carefully as the liability net is cast more broadly in this enforcement area.

Handbag Maker Convicted for ‘Burying Head in the Sand’

An important trial under the Foreign Corrupt Practices Act ended with a guilty verdict in a Manhattan federal courtroom last week, providing a powerful reminder of

the importance of conducting thorough reviews of foreign business partners and investments.

Background: The ‘Pirate of Prague’ and Suitcases Stuffed with Cash

A federal jury convicted Frederic Bourke, founder of handbag maker Dooney & Bourke, of conspiring to bribe government leaders in Azerbaijan in a 1998 oil deal, in violation of the FCPA. Bourke invested – and lost – \$8 million with a Czech expatriate, Viktor Kozeny, in a bid to buy SOCAR, the state oil company. Dubbed the “Pirate of Prague” by *Fortune* magazine, Kozney remains a fugitive, avoiding extradition while claiming the FCPA does not apply to him.

Prosecutors charged that Bourke made his investment, knowing that Kozeny gave Azeri public officials millions in cash and a secret two-thirds interest in the deal. Bourke’s defense was that he invested only after his lawyers deemed the deal legal. He later even traveled to alert Azeri officials of the scheme. But prosecutors rebutted this defense with evidence of Bourke’s knowledge, including his own recorded rhetorical question: “Do you think business is done at arm’s length in this part of the world?” Jurors also heard riveting testimony involving suitcases stuffed with cash and secretive walks in a park to discuss the deal.

Prosecutors argued that Bourke consciously avoided learning about the bribes by not asking questions about the deal terms, and “sticking his head in the sand” to avoid learning if his partner paid bribes to government officials. The court’s instructions on willful blindness permitted conviction if jurors found Bourke knew or took steps to avoid learning of payments to Azeri officials. Jurors had to determine if Bourke “deliberately closed his eyes” to what otherwise would have been obvious to him.

The Verdict: ‘It’s His Job to Know’

In finding Bourke guilty, jurors emphasized the importance of the court’s “head in the sand” instructions. The foreperson summarized the rationale of his verdict, stating “[i]t was Kozeny, it was Azerbaijan, it was a foreign country. We thought he knew and definitely could have known. He’s an investor. It’s his job to know.” Another juror, recalling a timeline used by prosecutors during closing argument, said there were too many “red flags” for Bourke not to have known. Another emphasized that Bourke had put himself in a “bad situation.” A unanimous guilty verdict on the conspiracy to violate the FCPA resulted.

Reminder: U.S. Identity Theft Regulation – Do You Have Your Policies in Place Under the Red Flag Rules?

On November 1, 2009, the U.S. Federal Trade Commission will begin enforcing identity theft “Red Flag Rules.” Under the Red Flag Rules, many financial institutions and “creditors” operating from within the United States (including any operating U.S. subsidiaries of Canadian companies, public and private) are required to have a written identity theft program in place. The applicable definition of “creditor” is broad and includes businesses or organizations that regularly defer payment for goods or services or provide goods or services and bill customers later. “Creditors” operating in the United States who have “covered accounts” - (1) an account primarily for personal, family, or household purposes, that involves or is designed to permit multiple payments or transactions, or (2) “any other account” for which there is a “reasonably foreseeable risk to customers or the safety and soundness of the financial institution or creditor from identity theft” (a loosely defined, expansive concept) — should take note and, if not already completed, put simple compliance policies in place to deal with regulatory and litigation risks. For further information, please contact Susan Krembs at 1.212.808.2743 or Matthew Silver at 1.215.981.4117.

The Lesson: Due Diligence Is More Important than Ever

The Justice Department made clear in aggressively prosecuting Bourke that companies engaged in international business cannot turn a blind eye to “red flags” of improper payments. Claims that business is “always done this way” in other parts of the world, or that a business partner made the payments on his own, simply will not serve as defenses under the Foreign Corrupt Practices Act.

Vigilance about how a company’s international business is conducted, and due diligence on international business partners such as sales agents, consultants and distributors is essential. Requiring business partners to understand and

abide by the FCPA and the company's compliance and ethics culture is a similarly crucial step.

Business executives often regard performing due diligence on business partners as daunting tasks. But the risks are too great to ignore. Companies must make realistic assessments of the risk in doing international business. FCPA audits must be appropriate for the type of risk posed by the transaction, accounting for risks of the particular industry, the prior history of the organizations, the geographic region involved and the nature of the proposed business partner, including its ties to foreign governments and whether it has been subject to prior regulatory or media scrutiny. As these risks or the importance of the business partnership grow, the level of rigor required in the review must expand. For key international business partnerships or acquisitions, nothing can replace the value of an in-country review, including personal interviews of key players, reviews of critical documents and systems, and sampling of various accounting issues, all conducted by experienced U.S. legal

and investigative staffs trained on FCPA and other compliance issues and working with local experts.

The Bourke trial and recent statements by federal regulators are reminders of the important role that FCPA compliance plays in helping companies meet their obligations, even in difficult economic times. Indeed, the Justice Department official in charge of FCPA prosecutions said recently that while it is "very tempting for companies to divert resources which are scarce away from compliance" these companies "need to be especially vigilant in this economic climate to not cut back. Our law enforcement efforts are not going to be scaled back, and so it would be, I think, a grave mistake for a company to take that path."

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Market Conditions to Produce Significant Distressed M&A Opportunities in Second Half of 2009

The current economic downturn will offer greater discounts on distressed assets than previous downturns have offered, drawing both financial and strategic buyers to the market in the coming months, according to 92 percent of respondents to a new **Distressed M&A Outlook** survey conducted by mergermarket, Carl Marks Advisory Group LLP and Pepper Hamilton LLP.

In the second quarter of 2009, Carl Marks Advisory Group LLP and Pepper Hamilton LLP commissioned mergermarket to survey 75 investment bankers, private equity practitioners, hedge fund investors and lawyers regarding their outlook for distressed M&A activity in the upcoming year. Respondents provided invaluable insight into current market conditions, as well as a forecast for the year ahead.

"With a variety of factors contributing to an increased volume of distressed opportunities, both buyers and sellers are expected to eagerly pursue deals, as each side stands to gain unique benefits," said Jim Rosener, managing partner of the New York office and head of the International Practice Group at Pepper Hamilton LLP.

Aside from attractive discounts, debt-related issues will likely be the most prominent drivers of distressed M&A activity in the upcoming year, according to respondents. An increase in covenant defaults is identified as a major catalyst to distressed deal flow, as is companies' inability to meet debt obligations or refinance upcoming maturities.

Distressed investors are likely to find the greatest opportunity in the following two sectors:

- Real Estate, where 63 percent of respondents expect to see the highest volume of distressed deals in the year ahead.
- Financial Services, which 38 percent of respondents believe will experience the highest volume of distressed M&A this year.

Sixty-three percent of respondents expect most distressed deals to be handled outside of court; however, Chapter 11 reorganizations may be an exception as these are expected to be extremely common over the next 12 months.

The predominance of out-of-court deals is likely related to time constraints, as many respondents cite time as a major drawback to handling deals in court. Fifty-nine percent of respondents say the distressed M&A process can exceed four months when handled in court. Meanwhile, on cases handled outside of court, only 25 percent of respondents say the process can take this long. “If implementable, out-of-court solutions are generally less expensive and disruptive. However, it is not clear whether companies with complex capital structures will ultimately be able to obtain all of the consents necessary to use these solutions,” explains Duff Meyercord, partner at Carl Marks.

Time constraints also are expected to put pressure on management teams within distressed companies, which in turn may influence the dynamics of distressed transactions going forward. According to Jim Rosener, “Not only is the market characterized by people having to do something and forced to do it on a tight timetable, but there also is an increased opportunity as management loses focus and interest over these orphaned businesses.”

Additional findings:

Exit outlook: 65 percent of respondents plan to delay their exits from distressed investments in the upcoming year.

Valuations: 54 percent of respondents say asset-based valuations tend to be the primary determinant of price.

Alternative strategies: 79 percent of respondents expect debt buy-backs to increase in the year ahead.

On August 11, 2009, from 12:00 – 1:00 P.M. (Eastern), join us for a complimentary online seminar, that will discuss the report findings and implications for the combination of eager sellers and opportunistic buyers who will undoubtedly provide fuel for distressed activities in the second half of 2009.

Register online at https://www.regonline.com/Distressed_MA_Opportunities.

If you would like a copy of this report, please contact Brian Dolan at 1.215.981.4568 or dolanb@pepperlaw.com.

Canadian Webinar Series

Foreign Corrupt Practice Act Effect on Canadian Companies

September 30, 2009 | 12:00 – 1:00 P.M. EASTERN

Mr. Paw will discuss major enforcement efforts under the U.S. Foreign Corrupt Practice Act, with a particular focus on how these efforts affect Canadian companies given the broad jurisdictional view taken by U.S. authorities. He will look at some enforcement trends of particular note to Canadian companies looking to invest or raise capital in the United States. He also will provide guidance on avoiding avoid liability and best preparing for smooth international transactions and operations.

Moderator

Susan J. Krembs, Partner, Pepper Hamilton LLP

Speaker

Gregory A. Paw, Partner, Pepper Hamilton LLP

Register for this complimentary online webinar at <https://www.regonline.com/FCPA>.

U.S. Climate Change Legislation

October 15, 2009 | 12:00 – 1:00 P.M. EASTERN

The clock is ticking, and the Obama administration and Democratic congressional leadership are committed to enacting U.S. climate change legislation in time for the December 7-18 climate change treaty negotiations in Copenhagen. Ms. Luxton and Mr. Walsh are following developments closely as Senate leaders work to get the 60 votes needed for passage, then work out differences with the House bill adopted June 26. Join us for an update and analysis of the prospects for climate change legislation this year and potential impacts for Canadian and cross-border businesses.

Moderator

Susan J. Krembs, Partner, Pepper Hamilton LLP

Speakers

Jane C. Luxton, Partner, Pepper Hamilton LLP

William J. Walsh, Of Counsel, Pepper Hamilton LLP

Register for this complimentary online webinar at https://www.regonline.com/US_Climate_Change.

M&A Strategy in 2010: Finding Opportunity in a Changing Environment

Acquiring companies when they're weak can offer many benefits. However, acquiring a distressed company also presents many unique challenges. The experts will address the essentials for acquiring companies in distress, including:

- the prevalence of “stalking horse” bids
- buying within the Companies’ Creditors Arrangements Act (CCAA) and Bankruptcy and Insolvency Act processes
- managing cross-border distressed acquisitions
- avoiding the insolvency process through reorganization, restructuring, and “pre-packs”
- negotiating with court appointed monitors.

James D. Rosener will be speaking on the “Acquiring Companies in Distress” panel on November 30 at 11:00 A.M. in Toronto, Ontario. The conference is being presented by The Conference Board of Canada.

For more information, please visit

<http://www.conferenceboard.ca/conf/09-0192/default.aspx>.

Pepper Hamilton LLP Attorneys at Law

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