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Legal minefields sit on national borders

By Jane Croft

At the same time as international business is becoming more global and interconnected, legal systems remain essentially national.

International companies must navigate judicial systems ranging from the common law varieties typical of English-speaking countries to the Romano-Germanic types used in countries such as Switzerland and Turkey.

For multinationals, the risks of falling foul of local laws can include big fines by regulators and reputational damage, as well as lawsuits that could have been avoided.

To complicate matters, in recent years the complexity of international finance and the law has accelerated, particularly in some areas such as insolvency.

This was illustrated by the collapse of US investment bank Lehman Brothers in 2008 as the financial crisis hit – which split the bank into hundreds of separate entities.

Lawyers say the complex task of unwinding Lehman will lead to years of litigation and numerous court battles in different jurisdictions about who has priority over what assets.

But there are ways that multinationals can prevent – or at least manage – these cross-border legal risks. In extreme cases, they can simply choose not to do business in countries seen as high risk.

They may alternatively opt for joint ventures with a local business partner so they can tap into specialised knowledge to ensure compliance with local laws.

Many US and UK law firms are opening offices in fast-growing markets such as Asia and Latin America to provide their corporate clients with the necessary depth of local knowledge.

Lord Tim Clement-Jones, London office managing partner and international business relations partner at law firm DLA Piper, says many companies use global law firms that have a local presence in key markets.

"The essence is to provide clients headquartered in one country with legal and regulatory advice of a comparable quality in local markets to what they receive from us in their home country, taking into account the local legal regime, the competitive context and enforcement risk," he says.

Companies can deal with risk more easily if they avoid adopting a one-size-fits-all approach. "Where this is not possible or practicable – for example with an online presence across several different jurisdictions – then a highest-common-factor approach may be necessary. But there needs to be a balance between likelihood of enforcement and the costs of compliance," Lord Clement-Jones says.

Companies may use a strategy of evaluating the legal risks and assessing the probability and severity of loss. Some companies also seek to transfer risk to other parties by, for example, limitation of liability clauses in business contracts.

But companies often fail to look carefully enough at whether they have the correct insurance cover.

Nigel Pearson, UK and Ireland underwriting manager at Chubb Insurance, says: "A lot of the clients we insure are multinationals and are looking for simple insurance solutions. However it is not always easy to provide certainty in territories that require policies to be issued by locally admitted insurers.

"We have had claims from companies operating in certain jurisdictions where the authorities have sued them because they have not had the correct licences, for example. It can be surprising how often some of the basic groundwork has not been done.

"It's not unusual to come across companies which have great risk management models on paper and comply with corporate governance codes in principle – but in reality the appropriate behaviour is not necessarily embedded in the day-to-day activities of the businesses."

As business becomes more global, there have moves in more international sectors such as banking to standardise contracts relating to certain types of deals such as over-the- counter derivatives transactions. The International Swaps and Derivatives Association (ISDA) has set up master agreements that spell out each party's obligations, for example.

There has also been an increasing tendency by big companies to opt for business contracts specifying that any legal disputes will be dealt with using international arbitration rather than local courts.

Such arbitration can be helpful, especially if multinationals do not trust the independence or speed of the courts in some countries where they operate.

But risks remain in some areas such as anti-corruption enforcement. Industries such as energy and infrastructure have become favourite targets of US prosecutors, creating a host of legal, commercial and reputational problems for companies.

Lord Clement-Jones says the riskiest areas are "probably extraterritorial application and enforcement of anti-corruption/bribery rules from different jurisdictions which may differ significantly".

Once, payments to government officials in some countries were regarded by many as a cost of doing business

But changes in the legal landscape over the past decade have left companies and executives more vulnerable to sanctions under anti-corruption laws. The late 1990s signing of the anti-bribery convention of the Organisation for Economic Co-operation and Development led to anti-corruption legislation being toughened in many countries.

Companies can now more easily face fines and executives face jail for corrupt activities anywhere in the world.

Last year, for example, defence contractor BAE Systems agreed a $400m fine with US prosecutors to end corruption investigations in the US and UK without admitting bribery.

In 2008 Siemens drew a line under its bribery scandal when it agreed to pay €1bn ($1.5bn) in fines to the US and German authorities.

For companies, one of the biggest threats is exclusion from public works if they are convicted of corruption, under rules set down by the EU, World Bank and others.

The UK's new bribery act – which comes into force in July – finally brings UK rules on corrupt payments into line with other OECD countries.

The UK government had to publish guidance to help companies interpret the act, as some companies were concerned that areas such as corporate hospitality could be outlawed under the new act.

But many investors still remain unhappy that it will be left up to the UK courts to decide whether a company operating overseas with a London listing will be covered by the act and can be prosecuted.

Initiatives to stamp out graft in Asian countries are also under way. They include 28 Asia-Pacific governments signing up to a regional anti-corruption programme overseen by the OECD and the Asian Development Bank.

But Trace, the US non-profit association that tracks cross-border corruption, lists 10 Asian countries including China among the world's top 34 nations for bribery.

Compliance lawyers say that the Department of Justice and the Securities and Exchange Commission in the US have become increasingly aggressive at enforcing the Foreign Corrupt Practices Act, with the number of investigations up from *five* in 2004 to *56* in 2010.

Recently French telecoms group Alcatel-Lucent agreed to pay $137m to US authorities to resolve allegations that illegal payments were made to government officials in Malaysia, Thailand and elsewhere.

But, while companies operating across borders do face increased complexity in the regulations governing their behaviour, they also can reduce their legal risks.

"There are one or two things companies can do to address issues," says Mr Pearson of Chubb.

"They include looking at whether their insurers have the ability to issue local policies in certain territories, whether they have a global network of offices to administer their insurance and, from a risk perspective, whether or not their risk management register encompasses all the areas that need to be looked at.

"The companies should also assess whether they have a reasonable strategy to address such risks, be it insurance or some other form of risk mitigation."