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The International Trade Discussion: A Multidisciplinary Approach – Part II

The Editor interviews ***Marian E. Ladner****,* ***Michael A. Levine*** *and* ***Elizabeth Ann Morgan****, Epstein Becker & Green, P.C.*

Part I of this interview appeared in the November issue of The Metropolitan Corporate Counsel *and Part III will appear in January. In Part I, the interviewees began their analysis of the following hypothetical:*

Ultimate Factory (UF) was hired by the Greatest Agency of Global Sourcing (GAGS) the external sourcing agent for Supremo Brands (SB), a small toy and electronic games manufacturer in the United States with global aspirations and an upcoming initial public offering. UF is manufacturing SB's electronic game "Zapped," which features a sophisticated remote control technology, which is a knock-off of a patented system. The game's exterior packaging bears prominent checkmark-like logos that rest on top of the words "Just Win It."

UF's workers work a hundred hours a week, or more in peak season, which lasts nine months each year. UF's workers' hours keep increasing because SB keeps changing its product designs and deadlines. UF has visible cracks in its walls and its foundation. UF's workers are migrants from remote provinces, but they are not paid the current minimum wage, or for the overtime hours they work.

UF also has been using a subcontractor, Uh My (UM), in Mongolia, to fill GAGS' orders on SB's behalf, and it followed all of UF's working practices. UF, however, did not indicate that UM actually made the Zapped units on the shipping documents or bills of lading that accompanies them to SB's consolidation center in Toronto, from which they are shipped to a U.S. distribution center in Vidalia, Georgia. Finally, while many of the Zapped controllers malfunction, the problem is promptly resolved by T. Engineer, who is an Iranian national employed by SB, who can fix anything because of his knowledge of sophisticated remote control systems. Mr. Engineer, however, is exhausted by his frequent trips from China, where he gives production line workers training and instructions on how to build the products, to Toronto and Vidalia.

Marian E. Ladner

Michael A. Levine

Elizabeth Ann Morgan

Editor: Would not the potential IPO of SB open a Pandora's box of disclosure issues?

Morgan: The patent or trademark infringement issues in the hypothetical raise serious disclosure issues for the pending IPO. This is something that is always addressed prior to any public offering or, indeed, any substantial corporate transaction. It is essential to do an IP audit to determine what intellectual property the company owns, whether it is protected, and whether there is any pending or likely infringement action against the company. From the facts set forth in the hypothetical, it appears that the company did not do a good IP review prior to developing these toys: the slogan and trade dress issues, and possibly the patent infringement, would be picked up in a review.

Levine: If this were an acquisition scenario, several other material risks exist for SB's purchaser such as prospective damage to SB's trademarks, goodwill, and reputation, which would be among SB's most important assets. Investors now assess how companies manage their corporate social responsibilities – and the reputational risk that flows from ineffective CSR programs: – these issues also must be factored into the due diligence process. Do SB's design and production processes and suppliers pose risks of negative publicity for SB and its purchaser? From a socially responsible investing perspective, are there environmental, social and governance issues that the company needs to address?

Editor: Safety concerns at the workplace are a critical component.

Levine: Absolutely. In the hypothetical UF has visible cracks in its walls and potential foundation damage. This points to a recent tragedy in Bangladesh, where a facility built in a substandard manner collapsed, causing the deaths of a great number of workers. This resulted in negative media attention and an outcry on the part of NGOs directed against the factory's customers: retailers and brands. Of course, the question must be asked whether it is appropriate to hold a manu-

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facturer's customers responsible for shoddy building construction?

Editor: There is an ongoing debate on this issue. On the one hand, many say that the Western company should not be responsible if it is in compliance with local law. There are, however, international norms that everyone recognizes. How do you draw the line here?

Levine: It is important to note that, retailers and brands typically do not own the factories that produce the products they sell. Typically, a third party does, and has its own employees make the products. That factory also may have been found for the customers by their sourcing agent. Nevertheless – and even though the company may not be legally responsible for certain issues – it is important for it to have a publicly circulated set of expectations for their suppliers. There are international standards for some issues, and the company that ignores them is running grave reputational risks that can have a very negative impact on its share price, or its business prospects. A company's customers and investors may hold it accountable for events for which it is not legally responsible, and the events also may be publicized globally over the Internet, with devastating consequences for its brand, image, reputation, and bottom line.

Seemingly, even extensive CSR programs may not always protect the company. Wal-Mart is being sued, in Federal Court in California, in substance, for allegedly failing to adequately respond to reportedly substandard conditions detected during supplier code of conduct audits. The suit is based on novel theories, including, that: 1) these failures amounted to Wal-Mart's breach of implied contracts (to enforce its Code) with its third party suppliers' employees; 2) that it negligently implemented its supplier monitoring program, and 3) that it made false statements about its CSR efforts.

In addition, it is essential for companies to understand that under the Alien Tort Claims Act they may be sued in U.S. courts for conduct that occurs wholly outside of the U.S. Archer Daniels, Nestlé, Firestone, and other major corporations have cases pending against them under this statute.

Editor: How would Epstein Becker put together a team to deal with a problem along the lines outlined above in your hypothetical?

Ladner: From the trade side and assuming SB was a client, we would ask them to show us their documentation for similar shipments. We start with the paperwork, and we follow that up with discussion with relevant process owners to determine operational roles.

Next, we need to understand the product and how it gets to market. Most companies have a clear understanding of their landed cost, but very often they do not understand how their goods really get to market. This entails developing an understanding of the product – including the underlying technology – and the role that a variety of players have in getting it to its final destination. We often talk to the engineers as well as the marketing executives to analyze the issues associated with the company's compliance and governmental reporting.

Morgan: From the IP perspective, were the client to come to us before shipping the product to the U.S. – the predevelopment phase – we would advise a change in the packaging and slogan, and a design around for the patent issues. If the product were developed and had shipped, we would make the client aware of the risks, of likely claims and of possible defenses. There may be sufficient value in the lifecycle of the product here to permit going forward despite the risk. For example, in patent infringement cases, since United States Supreme Court decision in *eBay Inc. v. MercExchange,* it is no longer certain an injunction will issue based on a finding of patent infringement. From a trademark perspective, there is also potential injunctive relief. Additionally the client should be advised about exposure to potential treble damages and personal liability for the corporate managers.

Levine: Our analysis of this hypothetical from our different perspectives indicates that our firm views global business issues through an interdisciplinary lens, and that it has real bench strength – expertise to address the array of legal areas that are likely to matter – *before* a crisis erupts. No doubt, there is some initial expense when different people look at critical customs issues, IP issues, the corporate social responsibility aspects of business operations. The benefit, however, is clear: this results in a cohesive, coordinated, and, above all, proactive identification of risks, and a planned approach to potential problems before they emerge. Risk identification better enables clients to cost-effectively manage risk, as opposed to potentially cost-prohibitive, and reactive, damage control. A modest upfront investment can avoid the interruption of business operations and major costs, such as lost top management time and communications expenses required to address a true crisis situation.

Another service that we provide concerns the development and enhancement of cohesive global compliance programs. If, for example, there is no formal CSR program in place, or if what is in place no longer adequately addresses current risks, we counsel clients about building the capacity to comply, and thereafter, implementing systems that serve to sustain compliance.

Permit me to add that, while there are non-lawyer service providers for areas raised by the hypothetical, certain legal privileges may not apply to related communications. Accordingly, companies have to assess whether apparent cost savings may actually turn out to present substantial litigation and liability risks and result in greater costs over time.

Ladner: Our hypothetical highlights the absence of adequate internal controls over this transaction on the part of the company. The many different issues that impact the import and export process are not contained within robust internal controls, policies or procedures. This is precisely the kind of thing that Sarbanes-Oxley was enacted to address, and its focus on internal controls and on documenting the processes is going to underpin the way we do business in the future.

A critical focus of our international trade group – working as an integrated team – is revising or enhancing internal controls, the reporting procedures and the various policies for documenting company operations and the processes underlying those operations. Where we find gaps, we work with the company to fill them. Where we find a void, we bring a variety of resources to bear, both from within the company, from within the firm and from areas of expertise outside both, to achieve compliance with a minimum of cost to the company. We also are always mindful of opportunities for cost savings and for streamlining the supply chain.