

Our clients now face on a regular basis various legal issues in the international arena, ranging from United States regulation of foreign trade to overseas business arrangements to international disputes. To provide timely information on this broad range of topics of concern to our clients, McKenna Long & Aldridge is initiating the *International Law Report*. We will keep our clients apprised of important developments in areas such as: licensing, protecting, and enforcing intellectual property rights; U.S. export controls, Foreign Corrupt Practices Act, customs and international trade law; international transactional and tax issues; and international dispute resolution.

Our International Practice Group consists of highly qualified and experienced practitioners who address client needs across the full spectrum of challenges that doing business globally presents.

We will be providing this *Report* every other month, and welcome your thoughts and comments.

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## REGULATORY UPDATE

### ▶ New Mandatory Automated Export System (AES) Filing Rules Take Effect October 18, 2003

Manufacturers, wholesalers, distributors, and U.S. order parties are among those who should take note that mandatory Automated Export System (AES) filing for certain articles listed on the Commerce Control List (CCL) or U.S. Munitions List (USML) takes effect on October 18, 2003.

AES is the government's electronic system by which U.S. Principal Parties in Interest (USPPIs) or freight forwarders can file Shipper's Export Declaration (SED) and ocean manifest information with the U.S. Census Bureau. Use of the AES has been voluntary for some time, and many exporters have already begun using this system. On July 17, 2003, however, the Census Bureau amended the Foreign Trade Statistics Regulations (FTSR) to require USPPIs and freight forwarders to file reports in AES in

lieu of filing paper SEDs when exporting CCL- or the USML-listed items that otherwise require filing of an SED. (Note, however, that paper filing requirements still exist with respect to Department of State-licensed shipments). The Census Bureau also eliminated AES Filing Option 3, which allowed both pre- and post-departure filings relating to shipments. See 68 Fed. Reg. 42534 (July 17, 2003).

More recently, on August 21, 2003, the Bureau of Industry and Security harmonized the Export Administration Regulations (EAR) with the FTSR by, among other changes, adding references to the AES where there were existing references to SEDs. The EAR was also amended to require SED or AES filing for exports that require a license under the EAR, not merely exports that are authorized by a license under the EAR. See 68 Fed. Reg. 50470 (August 21, 2003). This new rule went into effect on September 22, 2003.

The Census Bureau claims that participation in AES will benefit participants by facilitating compliance and reducing errors. However, participation in AES requires advance planning, and October 18 is rapidly approaching. Participants in AES must be certified and, where appropriate, registered and trained. There are a number of options for applicants to implement AES filing, and the option chosen affects the steps required for implementation. In general, implementation requires an applicant to submit a Letter of Intent to the Census Bureau and establish that its system can communicate with AES. If an applicant wishes to use AESDirect or AESPLink, the applicant must take a tutorial and pass a certification quiz. More information on this tutorial and certification testing process is available at <http://www.aesdirect.gov>.

**Jason M. Silverman**  
**Washington, DC**

#### ■ Editorial Contact

If you have questions, comments or ideas about articles in the *ILR*, please contact the editor:

**William T. O'Brien**  
202.496.7107

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## INTELLECTUAL PROPERTY UPDATE

### ▶ Important Considerations When Filing Patents Overseas

Here is the scenario: An employee of a small company in the services sector devises a better widget. The company, seeing value in the device, contacts a patent attorney, who advises the company to put a patent application on file for the new widget. The patent attorney works with the employee to develop the necessary paperwork for filing in the United States Patent and Trademark Office ("USPTO"), and the patent application is filed. The patent attorney advises the company that it may take more than a year to hear any opinion from the USPTO on the patentability of the application. So, the company places the application in its files and waits.

Six months later, the patent attorney asks the company if it wants to file its patent application in foreign countries. Does the company really want to file abroad? How much will it cost? And, if this device really is not integral to the company's main business, is it worth filing abroad? Before deciding on how to proceed, and even before filing the initial U.S. application, it is essential to understand the requirements and procedures for filing patents overseas.

## Differences Between U.S. and Foreign Patent Systems

The United States patent system is unique in at least two respects. As an initial matter, the United States is a "first to invent" country, meaning the first person to invent is to be awarded the patent. Second, the United States provides a grace period after the invention has been publicly disclosed. The inventor has a grace period of one year to place the patent application on file with the USPTO.

In contrast, in most every other country around the world, the first person to *file* the patent application (not necessarily the true first inventor) will receive the patent, and no grace period exists after public disclosure. So, while in the U.S. it is to the inventor's benefit to get that patent application on file early, it is crucial for the purposes of foreign filing to get the application on file as soon as possible.

## **The Patent Treaties**

Under an intellectual property mutual benefit treaty, known as the Paris Convention, as long as certain criteria are met, an inventor who has filed a patent application in the United States will have the benefit of that U.S. filing date as the date of filing in other countries. Thus, an early filing date in the U.S. will help the inventor to be first to file in, for example, Japan.

In most other countries around the world, if the inventor, or anyone else for that matter, discloses the invention to the public or uses it publicly before a patent application is filed, then the invention is deemed to be dedicated to the public, and the inventor cannot get a patent. Early U.S. filing helps here, too. So long as a U.S. application meets local law requirements and is filed before public disclosure, the inventor can still apply for a patent in Paris Convention countries.

The key under the Paris Convention is that the application must be filed directly in each country chosen for patent protection within one year of the U.S. patent application's filing date and in whatever form is required by the foreign patent office. The foreign patent office may require translations, fees, signatures, and so forth. It may also be necessary to have an attorney or agent in the foreign country make the filing. All of these factors contribute to cost.

Direct entry into foreign patent offices under the Paris Convention can be costly and may not be within the company's budget or business plan. A treaty that is ancillary to the Paris Convention, known as the Patent Cooperation Treaty ("PCT"), can help the company delay making excessive monetary commitments to the foreign patent process and allow the company time to make strategic foreign filing decisions.

Under the PCT, the company can file an international patent application as a placeholder for the eventual national filings that the Paris Convention requires within one year of the U.S. patent application filing. The international application is good for over 100 countries and can be filed in English with the USPTO and should list all of the countries in which the company may eventually want patent protection, even if such decision is not certain. Countries can be deleted from the list, but not easily added later. Like Paris Convention filings, the PCT international application must be filed within one year of the U.S. filing date, but can be handled solely by the U.S. patent attorney. A few countries, like Taiwan, did not sign the PCT, so they must be entered under the Paris Convention within the one-year period provided.

Eventually, the company will have to decide where to file foreign applications. In accordance with changes to the PCT in 2002, most countries now require the application to be filed according to their laws within 30 months (2 1/2 years) from

the U.S. filing date. A handful of countries that have not yet approved the treaty changes still require the filing to be made within 20 months of the U.S. filing date. However, filing in those handful of countries can be delayed by filing a Demand for International Preliminary Examination, which delays the filing until 30 months from the U.S. filing date. It is worth noting that the 20-month rule was the standard course in all countries until the treaty changes in 2002. Prior to the treaty changes, the 20-month rule made the filing of the Demand for International Preliminary Examination a matter of course for most companies proceeding under the PCT so that they could delay the ultimate filing in each country until the 30-month date. The Demand must be filed within 19 months of the U.S. filing date.

Software products that can help calculate the cost of filing are available, but \$5000 per country per filing is a conservative average to get the application on file. Some countries also require annual payments to keep the application pending. Attorney fees in both the U.S. and each foreign country will add to the expense. The U.S. patent attorney can help estimate the total cost.

The eventual filing in each country can be costly, just like under the Paris Convention -- especially in countries where translation can cost about 45 cents a word, such as Japan. However, the PCT route can help a company pare down in which countries it wants to target its product, and therefore its patent protection. As the company may find out, over time, foreign filing can be costly. If the product is a big seller, however, the investment in foreign patent protection may be essential.

**Rebecca Goldman Rudich**  
**Washington, DC**

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## **EXPORT UPDATE**

### **▶ Corporate Successors-in-Interest Considering Acquisitions Should Prepare for Greater Scrutiny of Export Activities**

In March 2003, a major aerospace company agreed to pay a multimillion dollar fine in settlement of U.S. State Department charges concerning export-control violations allegedly committed by one of its units. Importantly, though, the charges related to events which occurred while the unit was owned by another company which had specifically retained responsibility for resolving such allegations as a condition of the unit's sale to the aerospace firm. Similarly, a high-tech research company paid a \$1.76 million penalty in November 2002 to settle U.S. Commerce Department charges alleging that a company it acquired in 1997 had, prior to the acquisition, made unauthorized exports of biological toxins. These and other recent enforcement actions demonstrate the U.S. government's increasing willingness to hold corporate successors-in-interest liable for pre-acquisition export-control violations committed by the firms they acquire.

Both the Commerce Department and the State Department have taken this position even where the parties have structured the acquisition as an asset sale and explicitly agreed that the seller will retain sole responsibility for potential violations which may have occurred at the business units while they were under the seller's ownership. Because of the increased risks posed by this enforcement posture, it is important that corporations considering acquisitions prepare for the greater scrutiny which such transactions may invite from government regulators.

## **Successor Liability: Traditional Theories and Exemptions**

Under traditional theories of successor liability, a purchaser of corporate assets is not responsible for the seller's liabilities. Although courts have recognized some standard exceptions to this rule, in the absence of fraud or agreement by the successor to assume the liabilities of the predecessor, these exceptions do not permit liability to be extended to the successor corporation unless there has been a continuity of ownership between the two corporations (usually in the form of a stock transfer). In their recent activities, however, both the State Department and the Commerce Department have applied a broad "substantial continuity" exception to the general rule, which permits the imposition of liability upon a successor corporation where the successor:

1. retains the same employees, supervisory personnel and the same production facilities in the same location;
2. continues production of the same products;
3. retains the same business name;
4. maintains the same assets and general business operations; and
5. holds itself out to the public as a continuation of the previous corporation.

The expansion of successor liability to corporations which "substantially continue" the acquired business is troublesome for several reasons. First, the departure from traditional rules limiting successor liability creates uncertainty by making it more difficult for corporations to place the risk of an enforcement action where they intend it to lie. As noted earlier, the State Department has held a corporate successor liable for pre-acquisition export control violations in the face of an express agreement by the seller to retain responsibility for such actions. Second, as shown by the list above, the broadened theory imposes liability for many of the same reasons which likely motivated the sale in the first place. Finally, the expansion of successor liability is unjustified where the seller of the assets in question remains a viable corporate entity answerable for any violations which may have occurred during its period of ownership.

## **Review the Target Company's Export Activities**

As noted by the Commerce Department in its press release announcing the Sigma-Aldrich decision, "[t]hese cases set the important precedent that when acquiring another firm, a company should scrutinize the export control practices of the acquired company in order to avoid the risk of incurring substantial liability along with the assets of the company." In light of the government's recent success in proceedings against successors-in-interest, corporations should insist upon a comprehensive review of the target company's export activities as part of the due-diligence which they undertake prior to completion of the acquisition. This review should identify the internal policies and procedures (written or otherwise) which govern the conduct of export transactions at the target company, and test the operation of these controls through a review of export documentation (selected at random) from the company's export files.

A potential acquisition is also a good opportunity for the acquiring corporation to ensure that its own house is in order, as notice of the acquisition may serve as the impetus for the government to begin a discretionary review of export control procedures at the acquiring company; indeed, approval of license applications may be suspended until corporate compliance is brought to a satisfactory level. We suggest that a corporation approach this review with the goal of centralizing export



effective representation as they expand and conduct business in new markets.

### Using Formal Affiliations with Foreign Local Counsel

As an alternative, some companies have begun to rely upon U.S. law firms that have invested significant time in establishing and maintaining formal affiliations with well-established local counsel in emerging markets, thereby providing clients with easier access to the expertise they need as well as access in a greater number of markets. These affiliations are made with well-known local lawyers with varying expertise, including relevant experience advising on local law issues, conducting due diligence reviews, helping to identify new business opportunities, acting as an intermediary to key local governmental representatives, or providing specialized litigation advice in local courts as well as in international courts or arbitration. By maintaining such affiliations, firms have the flexibility to offer greater expertise without the client having to bear the cost of “learning curve” expenses or the significant overhead that can be associated with branch offices of U.S. firms. For instance, companies using firms that have formal affiliations in broad emerging markets can more easily perform “quick look”

assessments of a greater number of foreign markets to determine the relative attractiveness of a given country, based on the current regulatory and political environment. Having formal affiliations with a spectrum of established foreign practitioners allows the U.S. firm to provide its client with the most relevant and most current expertise in numerous emerging markets.

A wide variety of issues should be considered when examining foreign markets, and it is valuable to be aware of these in turning to foreign local counsel for assistance. For example, it is key to examine local human resources issues, such as what the requirements are for the hiring and retention of foreign nationals, as well as other relevant labor laws. The restrictions on foreign investment are also essential to the decision on where to invest, as is the impact of the tax laws. In order to ensure that these considerations are addressed, it is important to find local counsel that has knowledge of all of these areas of law.

Likewise, in situations where dispute resolution is required, having formal affiliations with influential foreign litigators is an invaluable tool when evaluating the relative chances of success in foreign tribunals as well as managing the intricacies of foreign national court trial and appellate procedures. It is important to find experienced counsel with the capacity to handle the broad array of litigation situations that might arise.

### Managing Foreign Local Counsel Effectively

Crucial to the success of formal affiliations is that the U.S. firm actively manage, nurture and supervise the local counsel so as to create a seamless web between the two firms. The U.S. firm must bring to bear its extensive knowledge of the U.S. company's operations and business objectives, so that it can effectively guide the local firm as to precisely which objectives the client needs to achieve in the foreign market. In other words, the U.S. firm must not make the mistake of expecting the

agreements, billing arrangements, malpractice insurance and the pace of work. Be aware of the differences from the outset.

- Establish clear goals and objectives that consider the reality of the legal, political and business environment abroad.
- Develop a consistent, reliable means of communication and foster regular and close communication.
- Form an understanding of the foreign environment in which you will be seeking foreign local counsel.

foreign local counsel to provide global solutions to the client's needs. Rather, the local counsel should only be expected to provide the expertise sought for in the foreign matter.

As part of creating a seamless web, U.S. firms must consider both the practical considerations of working with foreign firms, such as time differences, differing work days, different legal systems, compatibility of technical systems, and the cultural differences between the U.S. approach and that taken in the jurisdiction abroad. Work often moves at a different pace abroad and the significance of certain cultural mores may be central to developing the essential relationship of mutual trust.

In order to enhance the communications process, it is best to arrange from the outset a reliable means of communication with local counsel. This will require a realistic assessment of capabilities and logistics. It is necessary to consider the most accessible times and means of communication, and arrange for alternatives in case an unexpected event occurs. The most successful approach will likely be to arrange for a means of consistent and regular contact, such as designating a weekly check-in or overview meeting, via fax, email or a regular conference call, to keep abreast of developments and stay focused on mutual goals and objectives. This also allows for those working with foreign local counsel to reevaluate and position themselves to stay on top of developments as they occur, and not after it is too late to affect the outcome.

Also important to accomplish early on in the collaborative process is developing a clear understanding of the role the local counsel will be playing and the legal system in which they will be operating. U.S. firms should strive to form an understanding of the legal climate in which the local counsel is operating in order to be able to communicate effectively and develop realistic goals. This will often require that U.S. attorneys make extra individual efforts to learn about the local foreign jurisdiction, and that U.S. firms prod local counsel to be forthcoming with the expertise and insight they bring to the table. Developing goals and clear objectives for the local counsel, particularly goals that comport with the reality of the political, cultural, business and legal system abroad, will also be essential for a successful partnership. This will also include covering all the practical arrangements of budgets, billing arrangements and the like.

## Conclusion

Globalization increasingly requires the ability to operate adeptly in the world-wide marketplace. The utilization of law firms with a network of foreign affiliations offers a cost-effective way to leanly maximize the overseas reach and capability of the legal team. With careful management and oversight, these collaborations can successfully address the overseas needs of firms working in the global marketplace.

**William T. O'Brien**  
**Washington, DC**

## ■ Contact Us

If you would like more information about MLA's [International Law Practice](#), please contact any of the McKenna Long & Aldridge attorneys with whom you regularly work. You may also contact:

**Allen B. Green**  
202.496.7523

**Gordon D. Giffin**  
404.527.4020

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