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THE NEW FRONT IN U.S. SANCTIONS: UKRAINE AND RUSSIA

By Nick Spiliotes and Aki Bayz

For the past several years, U.S. sanctions have focused on Iran and Syria. However, the recent events in Ukraine have opened a new front in U.S. sanctions enforcement. In March of this year the President issued three Executive Orders in rapid succession, each expanding the scope of potential sanctions targets. These new sanctions, and anticipated additional sanctions, have raised significant compliance concerns for U.S. companies and for non-U.S. companies that seek to comply with U.S. sanctions.

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OFAC Overview

As background, U.S. trade sanctions and economic embargoes are administered by the U.S. Department of the Treasury Office of Foreign Assets Control (OFAC). The OFAC sanctions programs are both country-specific (currently covering Cuba, Iran, Sudan, and Syria) and program-specific (e.g., activities related to terrorism, narcotics trafficking, and proliferation). Under the authority of each sanctions regime, OFAC identifies Specially Designated Nationals and Blocked Persons (SDNs). U.S. persons are prohibited from engaging in, or facilitating, transactions with SDNs.

"U.S. persons" is generally defined to mean any U.S. citizen, permanent resident alien, juridical person organized under the laws of the United States or any jurisdiction within the United States (including foreign branches), and any person in the United States. However, with respect to Cuba and more recently Iran, the sanctions apply to foreign subsidiaries of U.S. companies.

Ukraine Sanctions

On March 6, 2014, President Obama issued Executive Order (EO) 13661 "Blocking Property of Certain Persons Contributing to the Situation in Ukraine." This EO blocks all property and interests in property of persons and entities determined by the Secretary of the Treasury, in consultation with the Secretary of State, to have engaged in or materially assisted in certain conduct with respect to Ukraine, including: undermining the democratic process, threatening the peace or territorial integrity of Ukraine, or misappropriation of Ukrainian state assets.

This was followed by EO 13661, issued March 16, 2014, that blocks all property and interests in property of persons and entities determined by the Secretary of the Treasury, in consultation with the Secretary of State: (i) to be an official of the government of the Russian Federation; (ii) to operate in the arms or related materiel sector in Russia; or (iii) to be owned or controlled by, or to have provided material assistance to, any of the foregoing. To date, 64 persons and entities have been identified as SDNs under these EOs.

EO 13662, issued March 20, 2014, authorizes the Secretary of the Treasury, in consultation with the Secretary of State to identify specific sectors of the Russian economy (specifically noting financial services, energy, metals and mining, engineering, and defense and related materiel) and to impose sanctions on persons and entities that operate in those sectors. This EO is significant, and unique in terms of sanctions enforcement, as it applies to broad economic sectors, and gives the U.S. Government a powerful sanctions tool. To date no sector designations have been made under this EO.

OFAC issued an initial and limited set of Ukraine-Related Sanctions Regulations on May 8, 2014 (URSR). OFAC noted in the official release of the URSR that it will issue a more complete set of regulations in the future, which is expected to include additional interpretive and definitional guidance and statements of licensing policy.

As the situation in Ukraine further develops, it is likely that additional SDNs will be identified, and the scope of the sanctions expanded, either by EO or legislation.

The 50% Rule

It is important to note that the OFAC sanctions apply not only to the specifically identified SDN, but also to any entity 50% or more owned by an SDN (the so-called "50% rule"). As a result, U.S. persons need to be careful in dealing with Russian and Ukrainian persons and entities and undertake appropriate diligence to determine whether they are dealing with an entity subject to sanctions due to SDN ownership, even if the entity itself is not specifically identified as an SDN. OFAC officials have stressed in several public forums that they expect U.S. persons to be "cautious" when dealing with counterparties where the 50% rule may be implicated.

Potential Additional Sanctions

As the situation in Ukraine further develops, it is likely that additional SDNs will be identified, and the scope of the sanctions expanded, either by EO or legislation. For example, on April 30, 2014, legislation was introduced in the U.S. Senate, "The Russian Aggression Prevention Act of 2014," that if enacted in its current form would, among other actions, expand sanctions to cover Russian officials and agents involved in the occupation of Crimea, and seek to impose sanctions tied to the destabilization of eastern Ukraine on four key Russian banks: Sberbank, VTB Bank, Vnesheconombank, Gazprombank, as well as on Gazprom, Novatek, Rosneft, and Rosoboronexport. The legislation also provides for more stringent sanctions in the event Russian armed forces expand further into, or the Russian Government annexes, Ukraine or any other European or Eurasian nation.

U.S. companies engaged in activities involving Ukraine and Russia should not only be mindful of the existing sanctions, but prepare appropriately for the potential

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expansion of sanctions. This is particularly relevant for companies operating the sectors identified in EO 13662.

ELECTRONIC INVOICING IN EU PUBLIC CONTRACTS

By Alistair Maughan and Sarah Wells

The public administration sector in the EU is currently undergoing a period of modernization. As discussed in our Winter 2014 edition of the *Global Procurement Quarterly*, the EU has recently overhauled its public procurement regime, including issuing new directives to consolidate and replace the previous regime that had been in force since 2004.

The EU has an ambitious plan to work toward end-to-end e-procurement, in order both to drive out inefficiencies in cross-border public procurement and support the EU's broader digital agenda.

In support of these aims, on April 14, 2014, the EU Council approved a directive intended to implement e-invoicing on all EU public sector contracts.

The Proposed Directive

This e-invoicing directive was first proposed in July 2013 and is part of a package of initiatives relating to e-procurement on which the European Commission has been focusing in recent years, following its Action Plan in 2005. The Single Market Act II highlighted the Commission's intention to require e-invoicing as standard in the EU and this new directive is one step toward this goal.

As it currently stands, e-invoicing works imperfectly because of interoperability issues between the different EU Member States. For example, e-invoicing is mandatory to a certain extent in Denmark, Sweden and Finland – and some other European countries have also taken steps toward it. However, such adoption has often been on the basis of national standards, which can present problems when issuing invoices between EU Member States – a fundamental requirement in a single market economy.

To address these interoperability issues, the European Commission proposes that the European Committee for Standardisation establish a new European e-invoicing standard for the "semantic data model" of the core e-invoice. This is effectively a set of requirements that each e-invoice would have to include so that appropriate verification could take place. This standard will be (a) technologically neutral, (b) compatible with international standards, (c) consistent with data protection legislation, and (d) take into account the special needs of small and medium-sized enterprises as well as local/regional contracting authorities and contracting entities.

Subsequently, contracting authorities will not be able to refuse to accept any e-invoice that meets the harmonized standard.

The e-invoicing standard will need to be implemented within 36 months of the issuance of the directive. Contracting authorities will then have a maximum of 18 months to implement the new standard, although local and regional contracting authorities will have a slight extension of up to 30 months for implementation.

Conclusion

The introduction of e-invoicing will eventually lead to savings across the EU procurement system which will be welcome news for European governments in a time when the economy is facing cut backs, in particular in the public sector. Indeed, the Commission estimates that implementation of e-invoicing in public procurement across the EU could generate savings of up to €2.3 billion a year.

However, there is a long time to wait! The standard will not be fully implemented until the end of 2019. In the interim, Member States must make the necessary preparations to allow for e-invoicing to take place without causing undue stress for businesses, in particular small and middle-sized entities (SMEs), in the process.

GERMAN AND EU RULES ON JOINT BIDS

By Dr. Felix Helmstädter

A German court has confirmed that companies that submit joint or consortium bids on EU public contracts must comply both with the EU's procurement law regime and its antitrust rules. While the court held that a joint bid by two competitors who are both able to perform the contract on a stand-alone basis would violate antitrust law, it is doubtful whether EU antitrust authorities would take an equally strict position.

In competitive tender proceedings under the EU procurement regime, it is common for two or more companies to agree to submit a joint bid or to form a bidding consortium. Indeed, across Europe, governments are actively encouraging increased participation in public contracts by small and middle-sized entities (SMEs), in many cases by using joint bid vehicles. Larger companies also may prefer to set up a bidding consortium when competing for contracts requiring considerable resources within a short period of time, for example with regard to production facilities, financial investments or technical know-how.

While EU public procurement and antitrust laws do not prohibit joint bidding per se, considerable limitations for

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While EU public procurement and antitrust laws do not prohibit joint bidding *per se*, considerable limitations for bidding consortia exist if the parties to the cooperation are actual or potential competitors.

bidding consortia exist if the parties to the cooperation are actual or potential competitors. The permissible scope for bidding cooperation has been emphasized by two recent decisions (an interim order and the related principal proceedings) of the Higher Regional Court of Berlin (*Kammergericht*) which has focused attention on the question of whether, and to what extent, joint bidding remains a practical approach. Due to the close link between public procurement law and EU antitrust law in case of public tenders which have been published in the Official Journal of the EU due to the EU-wide dimension of the contract to be awarded, the decisions seem to be relevant for public tenders not only in Germany, but also in jurisdictions throughout the EU. It is however important to note that the EU antitrust authorities haven't investigated the formation of bidding consortia in recent years and joint bidding still is a common approach in practice.

EU antitrust law sets the limits in substance – procedural aspects governed by public procurement law

Under the EU Directives on public procurement law and the EU Member States' national implementing legislation, "groups of economic operators" (i.e., bidding consortia) are explicitly allowed to submit tenders on public contracts.

However, when implemented at a national level in EU Member States, public procurement law commonly obliges public authorities to exclude bidding consortia that are "anticompetitive" in the meaning of the ban on cartels laid down in Art. 101 of the Treaty of the Functioning of the European Union (TFEU). Hence, as it is the case in Germany, applicable limitations on the scope for joint bids may derive from the harmonized statutory rules and regulations of EU antitrust law rather than from EU or national public procurement law.

German Higher Regional Court put compliance of joint bidding back on the agenda

Since joint bidding is a reasonably common practice and something that many European governments are keen to encourage for policy reasons, the German Higher Regional court of Berlin (*Kammergericht*), raised concerns with its decisions in late 2013 and early 2014, pronouncing in its interim order that the formation of a bidding consortium "principally constitutes an anticompetitive agreement" in the meaning of the German law equivalent of Article 101 TFEU (Sec. 1 of the German Act against Restraints of Competition, GWB).

The generalization in the wording of the court may seem to be surprising. When taking a closer look at the decision, it has to be noted that it is a rather brief interim order and the court's reasoning lacks a detailed assessment. Bringing it into the context of the framework set by EU antitrust law, the decision may be seen as a reminder that joint bidding, as an alternative to a stand-alone bid, is often not an open, binary choice. A joint bid is only an available option when specific criteria are met. However, a general rule saying that the formation of a bidding consortium would violate antitrust law does not exist under EU or German antitrust law.

In the principal proceeding of that case, the Court only addressed the aspect of double participation when submitting bids for different lots. The Court held that in public tenders where the contracting authority has prohibited double participation, a bidding consortium that submits bids for more than one lot has to be excluded from the awarding procedure even if the identity of the partners of the consortium is different with regard to each offer for the different lots (i.e., for lot 1 the consortium consists of companies A and B while for lot 2 the parties to the consortium are A, B and C). Since this consideration was sufficient to exclude the bidding consortium in question and to bring an end to the particular bid protest proceedings, the court did not elaborate on the exact criteria for the formation of a consortium under antitrust law.

Criteria for EU antitrust law assessment

In brief, the following criteria result from the EU Commission's guidelines and case law and are of particular relevance for the assessment of whether cooperation between two or more competitors complies with EU law:

- As a general rule, joint bidding complies with EU antitrust law if both parties to the cooperation agreement are unable to participate in the public tender without teaming up, because they would not be able to perform the contract on a stand-alone basis.
- For this so-called "inability test", objective factors are the easiest way to demonstrate that a stand-alone would be no alternative for either of the parties to the cooperation. Such factors are in particular lack of experience or know-how, production capacities or technical and financial capabilities.

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Q+A CORNER with Melissa Milstead, Associate General Counsel of McKinsey & Company

1. **What litigation, legislation or regulation are you keeping a close eye on, and why?**
McKinsey's public sector practice helps federal, regional and local governments improve efficiencies and effectiveness across a broad swath of subjects and so, for me, knowledge of the industry as a whole is important. I try to remain current on public sector legal news broadly, even when not directly related to the services industry, because of how our government clients may be affected. Lately, I have focused on anti-corruption laws, Federal and state developments in healthcare, export control reform, and emerging trends with Public Private Partnerships. The US Foreign Corrupt Practice Act and global anti-corruption laws have been of particular interest with the release of the FCPA guidance last year, emerging international laws and increased enforcement of existing anti-corruption laws. Additionally, I have been closely watching the Federal developments following the implementation of ACA as well as how the States are responding.

2. **What project(s) are currently taking up most of your time?**
As I mentioned, I have been focusing on staying abreast of anti-corruption trends and help guide our uniquely-structured firm on how to comply with far-reaching anti-corruption laws (including FCPA). Another focus area for me are the Federal and state freedom of information laws. Although Federal FOIA is pretty well established, public records access laws vary greatly from state to state. Additionally, even where the related regulations appear clear or even akin to Federal FOIA, state case law often has drastically different interpretations than similar Federal FOIA provisions. This is important to understand as part of the risk analysis for each geographical area/ engagement we consider.

3. **What accomplishment(s) as an attorney at McKinsey are you most proud of?**
Our legal structure is unique in that our great team of attorneys balance the full cross-section of legal matters. This is also true in the public sector where, although public sector expertise is necessary, it is also necessary for me to act as a generalist. Because my responsibilities include the full scope of legal issues that affect a global firm doing public sector work, my days are a fast-moving combination of a wide variety of projects and tasks that are intellectually challenging and of high importance to my colleagues and our Firm. It's a great feeling when I am able to keep all these balls in the air and successfully find ways to "get to yes" for our ever-growing practice. By acting as an effective problem-solver, I can contribute to helping our practice to grow and consider additional areas of expertise and service.

4. **What challenges and opportunities do you see for McKinsey in the next 10 years?**
McKinsey is uniquely equipped to understand and assist the public and private sectors in approaching questions effectively and competently. We have an opportunity to bring to bear our unparalleled experience and expertise to help governments serve the public in the most effective ways possible. Broad public service also brings with it challenges – protecting proprietary and confidential approaches while meeting disclosure obligations, ensuring local and international legal compliance globally, and keeping ahead of changing laws and trends are just a few. I look forward to continuing to help McKinsey find ways to address these opportunity and challenges as we serve the public sector in Washington and throughout the United States.

- Market shares and market structure are as well relevant for the assessment of potential anticompetitive effects. In particular, there exist so-called safe-harbors under the EU Commission's horizontal guidelines, pointing out, for example, in case of joint market shares of less than 20%, a production cooperation agreement would not be considered to have anticompetitive effects.
- In specific market surroundings, especially in case of certain so-called bidding markets which are characterized by a strong dependence of all market players from public authorities (i.e, in the field of subsidized regional passenger transport), even higher market shares do not necessarily imply a violation of Art. 101 TFEU. In those markets, the market shares of each company may change rapidly when the term of a service contract ends, a fact which has to be taken into consideration as well.
- In case a joint bid or teaming arrangement would nevertheless fall within the scope of Art. 101 TFEU, it could still be justified if the following conditions are met: the cooperation (1) leads to efficiency gains which will be (2) passed on to, and for the benefit of, consumers while (3) the restrictive effects on competition are indispensable to achieve these efficiencies, and (4) there is no general elimination of competition on the market concerned by the cooperation.
- Accordingly, economic efficiencies may justify the formation of a bidding consortium. However, it has to be noted that it's often not enough just to argue that the only advantage for the parties was to save costs and therefore to be able to submit an offer at a lower price. Rather, the economic efficiencies have to be of certain significance and must be passed on to the customers.

Examples of cooperation agreements cleared by the EU Commission

The EU Commission has previously cleared a number of high profile joint bids under EU antitrust rules, particularly with regard to large construction projects (*e.g*. the Eurotunnel project), and early telecommunications infrastructure or other projects requiring substantive investments or specific technological know-how (*e.g*., launch of satellites or insurance of unusual risks).

However, recent case law is rare since it is left to the companies themselves to determine compliance with EU antitrust law, meaning there is no longer any formal procedure in place to receive prior clearance from the authorities. To give some guidance, the EU Commission has issued amended guidelines on horizontal agreements in 2011, providing a differentiated framework for cooperation for example in the fields of joint production and joint marketing. In light of this framework set by the EU, including the obligation of Member States not to enforce stricter rules in the field of application of Art. 101 TFEU, it seems to be doubtful whether the recent decisions by German courts are in line with the EU Commission's more economic and differentiated approach.

Sanction risks

Under public procurement law, a joint bid submitted by a consortium which is found to be anticompetitive generally has to be excluded from the competitive tender procedure by the contracting authority. Also, in theory, the parties to the cooperation agreement could risk being fined by the national or EU antitrust authority for violation of antitrust law. They may also face damage claims from the contracting authority and/or competitors. While exclusion from tender proceedings in such cases has been enforced by national courts recently, antitrust authorities' practice seems to be less invasive.

In practice, check first

In a planned joint bid situation, the safest approach in practice is to check at an early stage for compliance with the relevant antitrust and public procurement law provisions when seeking to cooperate with actual or potential competitors. As a general rule, the litmus test remains whether the participating companies have, from an objective point of view, the capacities, know-how and other required resources to participate in a specific tender procedure on a stand-alone basis. If this is not the case, joint bidding will be easier to justify. Otherwise, a joint bid still may be justified under specific conditions which should be analyzed carefully from both an antitrust law and a public procurement law perspective.

READ MY LIPS: "MANDATORY" MEANS … MANDATORY

By Alistair Maughan and Sarah Wells

Does anyone know the Estonian word for mandatory? Whatever it may be, the European Court of Justice (ECJ) recently ruled in an Estonian case that where a contract requirement is specified to be "mandatory", it means just that – and an authority cannot simply decide to overlook it in evaluating bids on a public contract.

At first glance, this "word means what it says" conclusion may not appear surprising. But, in previous cases, EU courts have not always been so unforgiving. In previous editions of our European Procurement and Government Contracts Digest, we have reported cases where EU courts have allowed authorities to be flexible and exercise discretion to ask for more details from a bidder to clarify

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a mistake or bid uncertainty – as long as that discretion is exercised openly, transparently and even-handedly.

But in a December 2013 case before the EU, *Nordecon AS v Rahandusministeerium (C-561/12)* ("*Nordecon*") based on a preliminary ruling from Estonia, the ECJ rejected any discretion on the part of an authority to overlook non-compliance and negotiate on a tender that did not comply with the mandatory requirements of the technical specifications relating to the contract.

Nordecon: Issues and Decision

Under EU public procurement rules, certain procedures must be followed when awarding a contract, of which one is the negotiated procedure. In *Nordecon*, the Estonian Highways Office (EHO) launched a negotiated procedure in relation to the building of a road. The contract notice for this tender included a mandatory specification that the central reservation of the road was to be 13.5m wide from the 26.6km mark to the 32km mark and 6m wide from the 32km mark to the 40km mark.

Four tenders were submitted, but one of these tenders proposed a central reservation of 6m wide along the entire length of the road. The EHO then invited the remaining tenderers to alter their offers to be for a 6m central reservation along the entire length and ultimately accepted a joint tender of the Lemminkainen consortium that offered the lowest price. Nordecon complained, and various court decisions then took place around the issue of whether the negotiations conducted by the EHO were permitted to concern the mandatory requirements in the contract notice (such as the width of the central reservation of the road).

Under Article 30 of Directive 2004/18/EC (which was superseded by Directive 2014/24/EU as of April 17, 2014), the negotiated procedure provisions provided that "*contracting authorities shall negotiate with tenderers the tenders submitted by them in order to adapt them to the requirements which they have set in the contract notice, the specifications and additional documents, if any…*". Under Article 2 of Directive 2004/18/EC, contracting authorities were obliged to "*treat economic operators equally and non-discriminatorily*" as well as to act in a "*transparent*" way.

In reaching its decision, the ECJ focused in particular on the obligation of transparency (no doubt in line with the general EU principles of proportionality, equality and legal certainty) in stating that, in order to meet such obligation, contracting authorities were to ensure compliance with the mandatory requirements of the contract. Furthermore, the ECJ highlighted that if the mandatory requirements were able to be negotiated, then the fixing of mandatory requirements would have no useful effect, and equal treatment of bidders based on such conditions would not then occur.

As a result, the ECJ held that negotiations were not permitted involving the mandatory requirements of the technical specifications relating to the contract.

Conclusion

It is interesting to note that under the new Directive 2014/24/EU, the situations in which the negotiated procedure can be used have been expanded. The previous "*negotiated procedure with prior publication of a contract notice*" under Article 30 of Directive 2004/18/EC has been replaced with "*competitive procedure with negotiation*" under Article 29 of Directive 2014/24/EU. Article 29 specifically states the information provided must be "sufficiently precise" and also prohibits the technical specifications defining the minimum requirements and award criteria from being subject to negotiation.

Ultimately, bidders must therefore ensure that they comply with the mandatory requirements set out in a contract notice. Contracting authorities should also carefully consider what requirements are made mandatory to ensure that if, for example, bidders do suggest improvements upon their original ideas, such improvements can be taken on board.

SUSPENSION AND DEBARMENT ON THE RISE

By Alyse Latour and Catherine Chapple

At a time when the U.S. government has been aggressively pursuing suspension and debarment of federal contractors at record levels at the urging of Congress, it is perhaps to be expected that the number of suspensions and debarments have increased in recent years. In May of 2014, the Government Accountability Office (GAO) released a report studying the sharp rise of enforcement actions at certain U.S. governmental agencies in which it found that the number of suspension and debarment actions more than doubled at civilian agencies in the last five years.

Brief History

In 2011, GAO examined ten agencies and found that certain agencies with billions of dollars in contracting activity had not pursued a single procurement-related suspension and debarment action in the preceding two years. After examining the most-active and least-active agencies, GAO determined that certain characteristics were common among those agencies issuing the most procurement-related suspension and debarment. As

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a result, GAO recommended that six agencies adopt those characteristics, which included the installation of a staff dedicated to suspension and debarment, the implementation of detailed enforcement policies and procedures, and the provision of an active referral process.

Since 2011, government-wide suspension and debarment actions have risen from 1,836 in fiscal year 2009 to 4,812 in fiscal year 2013.

GAO Findings

Since that time, government-wide suspension and debarment actions have risen from 1,836 in fiscal year 2009 to 4,812 in fiscal year 2013. Notably, at the six agencies that were the focus of GAO's 2011 report – the Departments of Commerce, Health and Human Services, Justice, State, Treasury, and the Federal Emergency Management Agency – suspension and debarment actions increased from 19 to 271 during the same time period. According to the report, these agencies fully implemented GAO's recommendations. Changes implemented by these agencies included adding personnel, issuing new operating procedures and guidance, and tracking and referring suspension and debarment cases.

GAO also found that the actions of the Office of Management and Budget (OMB) and the Interagency Suspension and Debarment Committee (ISDC) significantly contributed to the elevated numbers. The ISDC has assisted agencies in pursuing suspension and debarment of contractors by coordinating lead agency responsibility and providing mentoring and training to agency officials.

What Does This Mean?

Given the increased frequency with which the government is pursuing suspension and debarment actions, it is imperative that contractors are aware of the risk and make every effort to avoid mistakes that could land them in the sights of the suspension and debarment authorities. An effective compliance program is key in assisting contractors in identifying and preventing potential violations. By taking proactive steps, federal contractors can help mitigate the risk of becoming one of the increasing numbers of contractors embroiled in procurement-related suspension and debarment proceedings.

Government Contracts & Public Procurement

Morrison & Foerster's Government Contracts and Public Procurement practice handles litigation, compliance, and counseling matters for clients throughout the United States, Europe, Latin America and Asia. Our attorneys represent prime contractors and subcontractors, manufacturers and service providers, as well as companies that work with government agencies through grants, cooperative agreements, and other vehicles. Companies seeking to provide products to, or to perform work on behalf of, government entities face a multitude of complex regulations and bureaucratic policies, which often vary widely from one jurisdiction to the next. Our attorneys can help navigate this maze. With 17 offices in seven countries, our global team of attorneys is familiar with and prepared to advise our clients concerning the unique legal and business challenges of public procurement work in almost any country.