

The Foreign Corrupt Practices Act: Implications on Systems, Franchisees

The prospect of a government investigation into FCPA violations is frightening, and frankly, that is just what the government intends.

BY ERIC L. YAFFE AND ASHLEY M. EWALD



With the economic crisis in full swing, most businesses are trying to cut costs and follow the old adage, “a penny saved is a penny earned.” Now is not the time to scrimp on compliance costs, especially in the Foreign Corrupt Practices Act arena, where cutting back on compliance efforts now could cost companies millions of dollars later. A recent *Los Angeles Times* article quoted U. S. Justice Department officials as saying that “enforcement of the FCPA is second only to fighting terrorism in terms of priority” and reported that “there are currently at least 91 cases open, triple the number from four years ago.”

As the FCPA has special provisions for U.S. businesses and citizens doing business internationally, it merits close scrutiny by systems that are currently operating in or expanding into foreign markets. According to an International Franchise Association survey sent to nearly 1,600 franchise systems last spring and discussed in the December issue of this magazine, “nearly two-thirds (61 percent) of respondents currently franchise or operate in non-U.S. markets and three-fourths (74 percent) plan to begin international expansion efforts or accelerate their current ventures immediately.” For these companies, the FCPA should be at the forefront of their compliance efforts.

The FCPA and Its Penalties

What do franchisors and franchisees need to know to stay within the bounds of the FCPA as they expand into foreign markets? First, it is important to understand what the act requires. The FCPA has three basic components: an anti-bribery provision, which prohibits companies, their employees, and their agents from bribing foreign government officials; an accounting provision, which mandates that companies devise and follow a system of internal accounting controls; and a record-keeping provision, which requires companies to keep accurate books and records. The accounting and record-keeping provisions only apply to companies that are publicly traded in the United States. The anti-bribery provision, however, applies to both publicly-traded companies and private companies with their principal places of business in the United States, as well as to U.S. citizens, nationals, and residents.

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The anti-bribery provision merits special note for franchisors and franchisees, because as they seek to expand into certain new markets abroad, the temptation will be high to “grease the skids” and make

payments or offer gifts to government officials or their family members to get the permits or permissions necessary to open and operate. In many countries, bribery is a common way of getting business done, and there can be tremendous pressure from local agents or franchisee candidates to follow regional customs and use bribes to become or remain competitive. However, even if a U.S. franchisor's own employees aren't doing the bribing, if their agents are, they could still face the risk of an enforcement action. Whether a U.S. franchisor could be liable for FCPA violations committed by its foreign franchisees is a more difficult question, however, and one that has not been litigated. The franchisor's intent and the degree of control it exercises over its foreign franchisees' operations are factors the government might consider in determining whether to pursue an FCPA case against a franchisor for bribes made by one of its foreign franchisees.

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It is important to note that some payments to foreign officials are allowed under the FCPA. So-called "facilitating payments" made to foreign officials to induce them to perform the types of routine tasks that they should perform anyway—generally ones in which they do not exercise much discretion—are not considered violations of the FCPA, nor are payments which are expressly permitted under local laws. Reasonable or bona fide business expenditures to foreign officials directly related to product promotion or demonstration, such as paying foreign officials' travel expenses to visit the United States to see a product demonstration, are also considered acceptable. When in doubt about whether a payment would be permitted under the FCPA, franchisors and franchisees should consult with an attorney well-versed in the law.

The stakes could not be higher for

corporations and their executives if an enforcement action is brought, as both civil and criminal penalties are contemplated for violations, including astronomical fines and even the possibility of prison sentences. Two recent cases underscore the point. In December 2008, Siemens AG pleaded guilty to violating the FCPA and was required to pay a criminal fine of \$450 million in its Department of Justice settlement and \$350 million in disgorgement of profits under its civil fine agreement with the Securities and Exchange Commission. On the heels of this highest-ever FCPA fine came the news in February that Kellogg Brown & Root LLC, a former Halliburton subsidiary, had pleaded guilty to FCPA violations and agreed to pay a \$402 million criminal fine and another \$177 million in disgorgement of profits as a civil fine. The former CEO of KBR already pleaded guilty in September and has a sentencing date set for May.

While it may be tempting to look at these high-profile cases and assume that the government only prosecutes big corporations when huge fines are at stake, it would be unwise to dismiss the FCPA as something that concerns only large companies or large bribes. Previous guidance memos issued by the government have indicated that "materiality" or the dollar amounts involved are not as important as the facts and circumstances surrounding a violation. Thus even small missteps can become prosecutable offenses depending upon the circumstances.

Best Practices for FCPA Compliance Programs

Franchisors and franchisees can take several proactive, preventative measures to limit their FCPA risks and increase their compliance with the law. It is critical that companies enact compliance programs

aimed at setting the corporate tone to focus on the importance of compliance, educating their employees about the FCPA and how to spot and avoid potential pitfalls, and deterring illegal behavior.

As a part of such compliance programs, an executive-level officer with a good understanding of the FCPA and the corporation's responsibilities under it should be placed in charge of corporate compliance. Doing so sends an important signal to both employees and the government that the company takes its compliance responsibilities seriously.

Companies should also develop written codes of conduct for their employees and agents that include strong language prohibiting bribery and specifically mentioning a zero-tolerance policy for violations of the FCPA. In addition to having their own employees sign certifications that they have received information about the FCPA and understand its provisions, franchisors and franchisees may also wish to have their agents receive informa-

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tion about the FCPA and have them sign certifications as well.

It would also be prudent for companies that have sufficient resources to implement and publicize an FCPA whistleblower hotline that is confidential and accessible online or over the phone in all languages spoken by their employees. The purpose of the hotline should be two-fold: a safe way for employees to ask questions and seek guidance so that they do not engage in behavior that could run afoul of the FCPA; and a means for whistleblowers to leave messages reporting problematic conduct that has already occurred. Messages to the hotline reporting violations should be taken seriously and fully investigated.

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FCPA training should also be conducted frequently, including with agents. The training should identify known “red flags,” especially those specific to a company’s industry. It is important to keep written records documenting all efforts to train employees, as in the event that a company is investigated for violating the FCPA, being able to show that it has taken steps to minimize the risks of a violation could go a long way toward limiting its liability.

Risk-based Compliance Efforts

Companies can also engage in risk-based compliance, meaning they can dedicate a higher level of attention, compliance resources, and oversight to business dealings occurring in countries where bribery is more common, particularly in Asia, the Middle East, and Latin America. One useful source for determining which countries are perceived as most corrupt is Transparency International. A map designating countries where corruption is considered most common is available at its Web site, transparency.org. In addition,

particular types of business dealings are more at risk for bribery than others, and oversight and accounting regulations should increase with these transactions. For example, regular analysis can be conducted of commissions paid to international agents, discounts given to agents or distributors, and travel and other expenses submitted by them.

Franchisors, master franchisees, and franchisees should pay particular attention to their vendor relationships abroad. Background checks of new and existing business partners can be helpful in determining whether the company should work with a particular vendor. New and renewal contracts with vendors should explicitly state the vendors’ obligation to comply with the FCPA and not to engage in any bribes. Contractual clauses can also be included that give the franchisor, master franchisee, or franchisee the right to audit the vendor.

Special training should be given to international sales teams and those who have financial incentives to get deals done abroad, as these individuals are more at risk to engage in behavior that violates the FCPA. Close scrutiny should be paid to those charged with obtaining government licenses and approvals to operate in foreign countries. Moreover, it is important to be aware of highly-competitive markets where the incentive to bribe is high.

Increased due diligence should occur when considering a merger with or acquisition of a company abroad. As with training efforts, due diligence work should be well-documented. In addition, any contracts signed in such situations should include representations and warranties that no FCPA violations have occurred. Indemnification clauses should also be included in the event that such violations are discovered later.

Consistent Compliance Is Crucial

The key to any compliance program is consistency. Indeed, the 2007 U.S. Federal Sentencing Guidelines call for analysis of a company’s compliance program and its consistent enforcement in determining the fine the company might face for an FCPA violation. If the company has a compliance and ethics program that is “promoted and enforced consistently throughout the

organization through (A) appropriate incentives to perform in accordance with the compliance and ethics program; and (B) appropriate disciplinary measures for engaging in criminal conduct and for failing to take reasonable steps to prevent or detect criminal conduct,” the fine may be reduced.

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Companies should periodically evaluate the effectiveness of their compliance programs and should take steps to improve them whenever possible. Some may want to consider hiring outside counsel or auditors to review their compliance programs every few years to determine whether their programs are being fully promoted and followed and to get advice on how to enhance compliance efforts.

In the unfortunate event that a violation is discovered, a company should immediately hire independent outside counsel to investigate. The employee(s) or agent(s) involved should be disciplined, demoted, or fired, and steps should be taken to prevent the violation from occurring again. Outside counsel can help determine whether self-reporting the incident to the government is necessary.

The prospect of a government investigation into FCPA violations is frightening, and frankly, that is just what the government intends. Its harsh penalties are aimed at provoking companies to be proactive about their compliance, especially when operating on foreign soil. By following the steps outlined here, companies can minimize their risk of violating the law and ultimately, the risk to their shareholders and their brands. ■

Eric L. Yaffe is a principal and Ashley M. Ewald is an associate of Gray Plant Mooty. Both are members of the firm’s Franchise & Distribution and White Collar Crime practice groups. They can be reached at 202-295-2200.