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IMPLICATIONS OF THE FOREIGN CORRUPT PRACTICES ACT FOR INTERNATIONAL FRANCHISING

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Globalization and expansion have become mainstays that various U.S.-based franchises employ in their operations. It is therefore important to be aware of the various risks and potential responsibilities that come with such expansion. Specifically, companies interested in or currently involved in international franchising must be aware of potential liability and responsibility under the Foreign Corrupt Practices Act (FCPA). This article will address the FCPA in the context of international franchising, recent developments in this area, and suggested best practices to employ while operating internationally.

Overview of the FCPA

In 1977, the Securities and Exchange Commission (SEC) conducted a series of investigations based on information that there was widespread corporate corruption after the Watergate scandal. n1 After a number of these investigations showed some form of bribery or questionable payments to foreign officials, Congress passed the FCPA. n2 Generally, the FCPA prohibits payments made with a corrupt intent or inducements to foreign officials for the purpose of obtaining or keeping business. From its inception, the FCPA has been a tool to decrease and ideally eliminate corruption between companies and individuals doing business in or with the United States and foreign officials in matters of trade and commerce. However, in recent years the Department of Justice (DOJ) and the SEC have increasingly used this tool in their proclaimed international fight against corruption, most notably against businesses that have not traditionally been thought of as being at risk for a FCPA violation (e.g., foreign companies with minimal contacts with the United States). In 2009, DOJ offi-

cials stated, "enforcement of the FCPA is second only to fighting terrorism in terms of priority," and the number of cases opened were at least triple the number four years prior. n3

n1 DON ZARIN, DOING BUSINESS UNDER THE FOREIGN CORRUPT PRACTICES ACT § 1-1 (2005).

n2 15 U.S.C. § 78 (1977).

n3 Don Lee, *Avery Dennison Case a Window on the Pitfalls U.S. Firms Face in China*, L.A. TIMES, Jan. 12, 2009, *available at* http://articles.latimes.com/2009/jan/12/world/fg-avery12.

Because the DOJ and SEC are unabashedly using the Act to indict and convict companies and individuals domestically and internationally in various industries, franchisors seeking to move into international markets must be aware of and educate themselves about the FCPA and other antibribery laws.

Primary Provisions Under the FCPA

The DOJ is the chief FCPA enforcement agency, and it coordinates its efforts with the SEC. The Office of General Counsel of the Department of Commerce also answers general questions concerning the FCPA's basic requirements and restrictions from U.S. exporters. Under the FCPA, there are two primary components: the antibribery provisions n4 and the accounting provisions, n5 which include requirements to (1) make and keep books, records, and accounts that accurately and fairly reflect the transactions of a company and (2) devise and maintain sufficient internal accounting controls. The DOJ primarily handles the enforcement of the antibribery provisions, while the SEC primarily handles the accounting and books and records provisions.

n4 15 U.S.C. §§ 78dd-1, -2 (2006).

n5 *Id*. § 78m.

Antibribery Provisions

Under the FCPA, it is unlawful to bribe a foreign official ("any officer or employee of a foreign government or any department, agency, or instrumentality thereof, . . . or any person acting in an official capacity for or on behalf of any such government, department, agency, or instrumentality"

n6) to obtain or retain business. n7 The FCPA potentially applies to any individual, firm, company, officer, director, employee, agent of a company, or stockholder acting on behalf of a firm. n8 Individuals and firms can also be penalized if they order, authorize, influence, induce, or assist someone else to violate the antibribery provisions or if they conspire to violate those provisions. n9 The DOJ has interpreted its jurisdiction over corrupt payments to foreign officials based on whether a violator is an "issuer," a "domestic concern," or a foreign national or business. n10

n6 *Id.* § 78dd-1.

n7 *Id.* §§ 78dd-1, -2.

n8 *Id.*

n9 *Id.*

n10 *Id.; see also id.* § 78dd-3.

Who Falls Under the FCPA

An "issuer" is a corporation that has issued securities or proposes to issue securities registered with the United States or is required to file reports with the SEC. n11 A "domestic concern" is any individual who is a citizen, national, or resident of the United States, or any corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship that has its principal place of business in the United States, or that is organized under the laws of a state of the United States or a territory, possession, or commonwealth of the United States. n12

n11 *Id* §§ 78c, 78dd-1.

n12 *Id.* § 78dd-2.

Issuers and domestic concerns are held liable under the FCPA under principles relating to being in the territory of the United States or having some relation based on U.S. nationality. Issuers and domestic concerns are liable if they take an act in furtherance of a corrupt offer, payment, promise to pay, or authorization of anything of value to a foreign official by using the mail or any means or instrumentalities of interstate commerce. n13 Some examples include telephone calls, facsimile transmissions, wire transfers, and interstate or international travel. n14 It should also be noted that

the FCPA also applies to an act in furtherance of corrupt payments made outside of the United States. Consequently, as the DOJ has stated in demonstrating the FCPA's broad and far-reaching authority, a U.S. company or national may be held liable for corrupt payments authorized by employees or agents who are operating entirely outside of the United States, using money from foreign bank accounts, and without any involvement by persons located in the United States. n15 Such a standard imposes liability even when a foreign entity or person has minimal (and seemingly no) contacts with the United States.

n13 *Id.* §§ 78dd-1, -2.

n14 U.S. DEP'T JUSTICE, A LAY PERSON'S GUIDE TO THE FOREIGN CORRUPT PRACTICES ACT ANTIBRIBERY PROVISIONS, *available at* http://www.justice.gov/criminal/fraud/fcpa/docs/lay-persons-guide.pdf (last visited Jan. 11, 2012) [hereinafter LAY PERSON'S GUIDE TO THE FCPA].

n15 *Id.*

Before 1998, foreign companies, not including those defined as issuers, and foreign nationals were not subject to jurisdictional liability under the FCPA. Amendments in 1998 expanded the FCPA to include jurisdictional authority over foreign nationals and companies operating or doing business in the United States. n16 A foreign company or person is liable under the FCPA if he or she causes, directly or through agents, any act in furtherance of the corrupt payment to take place in the United States. n17 In this instance, however, the FCPA does not require that such an act use the U.S. mail system or other instrumentalities of interstate commerce. n18 Parent companies in the United States can also be held liable for the acts of their foreign subsidiaries if they authorized, directed, or controlled the activity at issue, as can U.S. citizens or residents (i.e., domestic concerns) who are employed by or acting on behalf of the foreign-incorporated subsidiaries. n19 This demonstrates how the DOJ may find liability under the FCPA if there is a corrupt payment and any nexus to the United States.

n16 *Id.; see also* 15 U.S.C. §§ 78dd-1, -2, -3.

n17 15 U.S.C. §§ 78dd-1, -2, -3.

n18 *Id.*

n19 *Id.*

Corrupt Intent

The person who authorizes or makes the payment must have a "corrupt intent," and the payment must be intended to induce or influence the recipient to misuse his or her official position to direct business inappropriately to the payor or to any other person. n20 Notably, a corrupt act need not succeed to be prosecuted under the FCPA--the offer or promise is enough. n21 However, this provides some relief to corporations from a seemingly stringent application of the FCPA because it is not a strict liability standard. Specifically, the FCPA prohibits any corrupt payment intended to influence an act or decision of a foreign official in his official capacity (or any foreign political party or official or candidate for foreign political office), induce such a foreign official to do or omit to do any act in violation of the lawful duty of such official, secure any improper advantage, or induce such foreign official to use his influence with a foreign government or instrumentality to influence improperly any act or decision. n22

n20 *Id.*

n21 *Id.*

n22 *Id.*

Payment

The FCPA prohibits "an offer, payment, promise to pay, or authorization of the payment of any money, or offer, gift, promise to give, or authorization of the giving of anything of value." n23 As the DOJ has explained, the prohibition extends only to corrupt payments to a foreign official, foreign political party or party official, or any candidate for foreign political office. n24 A "foreign official" is any officer or employee of a foreign government or any department or agency thereof, a public international organization, or any person acting in an official capacity. n25 The DOJ further instructs that if one has particular questions about the definition of a foreign official, it should be presented to the DOJ through the DOJ's FCPA Opinion Procedure, which answers specific questions surrounding the FCPA. n26

n23 *Id*.

n24 *Id.; see also* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

n25 15 U.S.C. §§ 78dd-1, -2, -3.

n26 *See* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

The FCPA applies to payments to any public official regardless of rank or position. n27 The DOJ has explained that what is paramount is the payment's intended purpose rather than the duties of the official. n28 Notably, however, there are exceptions to the antibribery provision for "facilitating payments for routine governmental action." n29

n27 *Id*.

n28 *Id*.

n29 *Id*.

Additionally, payments through intermediaries such as joint venture partners or agents are prohibited. n30 It is unlawful for a person to use an intermediary to make a payment knowing that all or a portion of that payment will go directly or indirectly to a foreign official to influence his or her behavior. n31 According to the DOJ, "knowing" includes conscious disregard and deliberate ignorance. n32

n30 *Id*.

n31 *Id*.

n32 *Id*.

Business Purpose Test

Under the business purpose test, the FCPA prohibits payments for the purposes of securing an "improper advantage" from a foreign official in order to assist such issuer or domestic concern in obtaining or retaining business for or with, or directing business to, any person. n33 The DOJ interprets the "obtaining or retaining business" provision broadly to include more than an award or renewal of a contract. n34 Further, the business to be obtained or retained need not be with a foreign government or governmental instrumentality. n35

n33 *See* 15 U.S.C. §§ 78dd-1, -2, -3.

n34 *See* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

n35 *Id*.

Permissible Payments and Affirmative Defenses

There are explicit exceptions under the FCPA to the prohibition for "facilitating payments" for "routine governmental action." n36 Routine governmental action means an action ordinarily and commonly performed by a foreign official such as obtaining permits, licenses, or other official documents; processing governmental papers, such as visas and work orders; providing police protection, providing mail pickup and delivery, or scheduling inspections associated with contract performance or inspections related to the transit of goods across country; providing phone service, power, and water supply; loading and unloading cargo, or protecting perishable products or commodities from deterioration; or actions of a similar nature. n37 "Routine governmental action" does not include any decision by a foreign official to award new business to or to continue business with a particular party, or any action taken by a foreign official involved in the decision-making process to encourage a decision to award new business to or continue business with a particular party. n38

n36 *See* 15 U.S.C. §§ 78dd-1, -2, -3.

n37 *Id*.

n38 *Id*.

An affirmative defense to the antibribery provisions is that one may assert that the payment was lawful under the written laws of the foreign country or that the money was spent as part of demonstrating a product or performing a contractual obligation. n39 Notably, it is the defendant's burden to prove this affirmative defense.

n39 *Id*.

Governmental Actions and Private Causes of Action

Violators of the FCPA are subject to possible criminal or civil penalties or other governmental action. The following criminal penalties may be imposed: corporations and other business entities are

subject to a fine of up to $ 2,000,000; officers, directors, stockholders, employees, and agents are subject to a fine of up to $ 100,000 and imprisonment for up to five years. n40 Additionally, under the Alternative Fines Act, the fines can be much higher--up to twice the benefit that the defendant sought to obtain by making the corrupt payment. n41 Further, the DOJ has said that fines imposed on individuals may not be paid by their employer or principal. n42 The individual must pay.

n40 *Id*.

n41 18 U.S.C. § 3571(d).

n42 *See* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

The attorney general or SEC may bring a civil action and impose a fine of up to $ 10,000 against any issuer or firm as well as any officer, director, employee, or agent of a firm, or stockholder acting on behalf of the firm, who violates the antibribery provisions. n43 Additionally, in an SEC enforcement action, the court may impose an additional fine not to exceed the greater of (1) the gross amount of the pecuniary gain to the defendant as a result of the violation or (2) a specified dollar limitation. n44 The specified dollar amounts are based on the egregiousness of the violation, ranging from $ 5,000 to $ 100,000 for a natural person and $ 50,000 to $ 500,000 for any other person. n45

n43 *See* 15 U.S.C. §§ 78dd-1, -2, -3.

n44 *See* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

n45 *Id*.

Further, under the guidelines issued by the Office of Management and Budget, a person or firm that violates the FCPA may be barred from doing business with the federal government. n46 Additionally, the DOJ has noted that a person or firm found guilty of violating the FCPA may be ruled ineligible to receive export licenses; the SEC may suspend or bar persons from the securities business or impose civil penalties on persons in the securities business for violations of the FCPA; the Commodity Futures Trading Commission and the Overseas Private Investment Corporation also have possible suspension or debarment from agency programs for violation of the FCPA; and a payment unlawfully made to a foreign government official cannot be deducted under the tax laws as a business expense. n47

n46 2 C.F.R. pts. 180, 901.

n47 *See* LAY PERSON'S GUIDE TO THE FCPA, *supra* note 14.

Additionally, a competitor who alleges that bribery led to the defendant winning a foreign contract may bring a private cause of action for treble damages under the Racketeer Influenced and Corrupt Organizations Act (RICO) or for other causes of action under other federal or state laws. n48

n48 *Id*.

Books, Records, and Internal Controls

Under the FCPA, only an issuer is required to maintain books, records, and internal accounting controls. n49 Specifically, the accounting provisions require corporations covered by the provisions to (1) make and keep books and records that accurately and fairly reflect the transactions of the corporation and (2) devise and maintain an adequate system of internal accounting controls. n50 These provisions broadly cover various types of business transactions and accounting controls. n51 Courts have held that the books and records provisions "[give] the SEC authority over the entire financial management and reporting requirements of publicly held United States corporations." n52 Therefore, the government can bring an action under the accounting or books and records provisions without ever having to bring a bribery action.

n49 15 U.S.C. § 78m(b).

n50 *Id*.

n51 *Id*.

n52 SEC v. World-Wide Coin Invs., Ltd., 567 F. Supp. 724, 746 (N.D. Ga. 1983).

In addition to issuers being liable, the SEC will also hold officers, directors, or other persons personally liable for causing a misstatement in the company's books or records. Under various case law, such persons can be found indirectly liable for causing the corporation's violations, knowingly implementing fraudulent procedures, or controlling the corporation in a way that violates the FCPA. n53

n53 *See* SEC v. Solucorp Indus. Ltd., 274 F. Supp. 2d 379 (S.D.N.Y. 2003); *In re* Gore, Exchange Act Release No. 38,343, 63 SEC Docket 2435, 1997 WL 94186, at *11 (Feb. 27, 1997).

If an issuer holds 50 percent or less of stock or voting power of a foreign or domestic firm, then such issuer must make a "good faith" effort to ensure that the foreign subsidiary or domestic firm (likely a joint venture) maintains adequate internal accounting controls in line with the statute. n54 If an issuer controls more than 50 percent of the stock or voting power, then the issuer is held to a higher standard; it must ensure that the foreign or domestic firm adheres to the accounting provisions. n55

n54 15 U.S.C. § 78m(b)(6).

n55 *Id*.

Recent Trends

Due to the expansive and frequent use of the FCPA by the DOJ and SEC, there have been various recent developments that provide further guidance on the application of the FCPA. Notably, lobbying efforts by corporations have increased. Specifically, the U.S. Chamber of Commerce wants Congress to enact more pro-business amendments such as (1) adding an affirmative defense for companies with compliance programs; (2) adding an element of willfulness for corporate criminal liability; (3) clearly defining a "foreign official"; (4) limiting a domestic company's liability for acts of its foreign subsidiaries; and (5) limiting a company's successor liability for prior acts of an acquired company. n56 It was recently announced that more guidance on the FCPA will be released in 2012. n57 Lisa A. Rickard, the president of the U.S. Chamber's Institute for Legal Reform, said, "[the] announcement is a welcome acknowledgement of what we in the business community have long said--DOJ's current FCPA enforcement practices need clarification and modernization." n58 Additionally, the SEC has adopted whistleblower provisions under Dodd-Frank to give financial incentives to those who provide information that leads to a successful SEC enforcement action and makes a whistleblower eligible to receive 10 percent to 30 percent of amounts recovered. n59

n56 Joe Palazzolo, *US Chamber of Commerce Presses for Changes to FCPA*, WALL ST. J. BLOGS: CORRUPTION CURRENTS (Oct. 27, 2010, 10:45 AM), http://blogs.wsj.com/corruption-currents/2010/10/27/uschamber-of-commerce-presses-for-changes-to-fcpa/.

n57 Samuel Rubenfeld, *U.S. Chamber Cheers Upcoming DOJ Guidance on FCPA*, WALL ST. J. BLOGS: CORRUPTION CURRENTS (Nov. 9, 2011, 2:56 PM), http://blogs.wsj.com/corruption-currents/2011/11/09/u-schamber-cheers-upcoming-doj-guidance-on-fcpa/.

n58 *Id*.

n59 Press Release, SEC, SEC Adopts Rules to Establish Whistleblower Program (May 25, 2011), *available at* http://sec.gov/news/press/2011/2011-116.htm.

Since the FCPA began to be widely used by the SEC and DOJ, prosecutions and enforcement actions have increased exponentially. Despite the initial intent of the application of the Act being narrow, the SEC and DOJ have aggressively used the FCPA to apply broadly to various industries. In fact, merely looking at the increased number of enforcement actions by the DOJ and SEC demonstrates their commitment to enforcing this antibribery law. In 2004, there were only two FCPA-related actions by the DOJ and three actions by the SEC. In 2009 alone, there were approximately twenty-five actions by the DOJ and approximately fifteen actions by the SEC. In 2010, there were approximately fifty FCPA-related actions by the DOJ and approximately twenty-five by the SEC. And to date in 2011, there have been approximately ten FCPA actions by both the DOJ and SEC. Not only are companies at risk, but individuals in these companies are also highly susceptible to FCPA liability. As Cheryl J. Scarboro, former chief of the SEC's FCPA Unit, has said, the DOJ and SEC "will continue to focus on industry-wide sweeps, and no industry is immune from investigation." n60 For this reason, it is important to look at the trends the DOJ and SEC have employed in enforcing some FCPA actions.

n60 Press Release, SEC, SEC Charges Seven Oil Services and Freight Forwarding Companies for Widespread Bribery of Customs Officials (Nov. 4, 2010), *available at* http://www.sec.gov/news/press/2010/2010-214.htm.

Lindsey Manufacturing Company

The first FCPA conviction of a corporation after a trial occurred in May 2011. Lindsey Manufacturing n61 was convicted of violating the FCPA by paying sales representative Grupo Internacional de Asesores S.A. (Grupo) a commission payment to pay bribes to Mexican officials, so that Lindsey Manufacturing could obtain utility contracts. n62 Lindsey Manufacturing; its president, Keith Lindsey; and its chief financial officer, Steve Lee, were convicted of conspiracy to violate the FCPA and five other substantive violations of the FCPA. The DOJ touted this as a victory. Specifically, Assistant Attorney General Lanny Breuer said:

> Today's guilty verdicts are an important milestone in our Foreign Corrupt Practices Act enforcement efforts. . . . As this prosecution shows, we are fiercely committed to bringing to justice all the players in these bribery schemes--the executives who conceive of the criminal plans, the people they use to pay the bribes, and the companies that knowingly allow these schemes to flourish. Bribery has real consequences. n63

n61 Greenberg Traurig LLP represented Lindsey Manufacturing and Dr. Keith Lindsey in this suit.

n62 Press Release, Dep't of Justice, U.S. Attorney's Office Cent. Dist. of Cal., Southern California Company, Two Executives and Intermediary Convicted in Scheme to Bribe Officials at State-Owned Electrical Utility in Mexico (May 10, 2011), *available at* http://www.justice.gov/usao/cac/Pressroom/pr2011/071.html.

n63 *Id*.

After the convictions, the defendants filed a "Motion to Dismiss the Indictment with Prejudice Due to Repeated and Intentional Government Misconduct," arguing that the government presented the grand jury with "knowingly false and misleading representations on critical matters" and purposefully omitted "disclosure of material facts" during testimony of FBI Special Agent Susan Guernsey. n64 In December 2011, the court blasted the federal prosecutors' handling of the FCPA case against Lindsey Manufacturing and its executives by vacating the defendants' convictions and tossing the case for multiple acts of brazen prosecutorial misconduct. The result in this case demon-

strates that contesting prosecutorial misconduct may provide some relief to corporations that feel improperly investigated or tried.

n64 Defendant's Motion to Dismiss the Indictment with Prejudice Due to Repeated and Intentional Government Misconduct, United States v. Aguilar, No. CR10-01031-AHM (C.D. Cal. May 9, 2011).

It is not likely that the Lindsey Manufacturing case will be the last time that the prosecution is accused of prosecutorial misconduct; and it is clear that judges are not fond of such behavior. Before the decision came down, Judge Matz stated in the Lindsey case that the allegation of prosecutorial misconduct must be addressed to determine whether the defendants' due process rights had been violated. He further stated that at best there was an "extraordinarily sloppy investigation and prosecution of this case." He also said, "There are a lot of troubling things that have gone on here. . . . I don't know if there was a stench that developed in this case, but there was a bad odor at times." n65 This result may signal to corporations and corporate individuals accused of FCPA violations that going to trial may be worth it.

n65 Supplemental Brief in Support of Motion to Dismiss the Indictment with Prejudice Due to Repeated and Intentional Government Misconduct at 2, 8-9, United States v. Aguilar, No. CR10-01031-AHM (C.D. Cal. July 25, 2011).

JGC Corporation

In April 2011, JGC Corporation, a Japan-based engineering and construction company headquartered in Japan, agreed to pay $ 218.8 million in criminal penalties for FCPA violations from a joint venture bribery scheme involving four partners. n66 Further, the DOJ and SEC recovered approximately $ 1.5 billion in civil and criminal penalties from all four partners. JGC's settlement has been touted as one of the largest FCPA settlements ever. n67 Allegedly over nearly a decade, from 1995 to 2004, TSKJ--the joint venture--won contracts to build facilities in Nigeria that were worth more than $ 6 billion. n68 TSKJ hired Jeffrey Tesler and a Japanese trading company to pay bribes to the Nigerian government officials for the contracts. In addition to the financial penalties levied on JGC, it entered into a deferred prosecution agreement with the DOJ for two years in which JGC retained an independent compliance consultant that would help JGC with a compliance program and other

agreed-to measures. n69 If JGC abides by the agreement, the DOJ will dismiss the criminal information against the company.

n66 Press Release, U.S. Dep't of Justice, JGC Corporation Resolves Foreign Corrupt Practices Act Investigation and Agrees to Pay a $ 218.8 Million Criminal Penalty (Apr. 6, 2011), *available at* http://www.justice.gov/opa/pr/2011/April/11-crm-431.html.

n67 *Id*.

n68 *Id*.

n69 *Id*.

[*144] Notably, the JGC settlement signals the broadened jurisdictional scope of the FCPA. JGC is not a domestic concern or issuer and has not been accused of being an agent of a domestic concern or issuer. The nexus of contacts with the United States is that JGC conspired to execute a bribery scheme with partners of TSKJ who were domestic concerns or issuers, and aided and abetted the domestic concerns or issuers. Additionally, the DOJ seemingly used JGC's use of bank accounts with U.S. currency to create the basis of a nexus with American soil. Companies should be aware that only minimal contact with the United States is necessary for an enforcement action. Moreover, there is increasing international cooperation for enforcement of the FCPA and other antibribery laws. For example, in the JGC-TSKJ action, France, Switzerland, Italy, and the United Kingdom all played a role. Therefore, it has been increasingly important that companies in the United States or doing business with the United States be particularly mindful of the FCPA.

Tenaris S.A.

In May 2011, Tenaris S.A. agreed to pay $ 8.9 million to the DOJ and SEC for FCPA violations. n70 Notably, Tenaris was the first deferred prosecution agreement with the SEC. It also entered into a two-year nonprosecution agreement with the DOJ.

n70 Samuel Rubenfeld, *Tenaris SA Pays $ 8.9 Million to Settle FCPA Probe*, WALL ST. J. BLOGS: CORRUPTION CURRENTS (May 17, 2011, 11:59 PM), http://blogs.wsj.com/corruption-currents/2011/05/17/tenaris-sa-pays-8-9-million-to-settle-fcpa-probe/.

Tenaris is a manufacturer and supplier of steel pipe products to the oil and gas industry that is based in Luxembourg. Tenaris admitted that its employees and agents offered and made improper payments to officials of an Uzbekistan state-controlled oil and gas production company and that it did not accurately reflect the payments in its books. Tenaris used a sales agent to get information about competitors' bids and would then outbid the competitors based on this information. n71 The sales agent was then paid a commission on all the contracts that Tenaris won, and Tenaris was aware that a portion of the commission would go to pay an official of the state-controlled company. Because Tenaris voluntarily disclosed its misconduct, U.S. officials were willing to work with the company. Robert Khuzami, the director of the SEC's Enforcement Division, stated, "The Tenaris foreign bribery scheme was unacceptable and unlawful, but the company's response demonstrated high levels of corporate accountability and cooperation." n72

n71 *Id.*

n72 *Id.; see also* Press Release, SEC, Tenaris to Pay $ 5.4 Million in SEC's First-Ever Deferred Prosecution Agreement (May 17, 2011), *available at* http://sec.gov/news/press/2011/2011-112.htm.

Tenaris was one of the first companies to take advantage of the SEC's program, started in January 2010, that encouraged companies to self-report their misconduct. If companies participate in this program and meet criteria of voluntarily coming forward, they may take advantage of such options as cooperation agreements, nonprosecution agreements, and deferred prosecution agreements. Although some companies may be hesitant to come forward and voluntarily self-report, the Tenaris example demonstrates how U.S. regulators actually prefer such behavior rather than having to find violations through their own investigatory process.

SHOT Show Trials

In what is known as the SHOT Show Trials, FBI agents arrested twenty-two defendants on January 18, 2010, in a multiyear sting operation. n73 The DOJ alleged that the defendants participated in a scheme to bribe the defense minister of Gabon. The group agreed to pay $ 1.5 million to the minister in exchange for a $ 15 million contract for the Gabonese presidential guard. n74 This was the first FBI sting operation in an FCPA probe. The defendants were allegedly told that if they inflated

their prices on their invoices it would essentially mask the payments to the Gabon minister. However, the government was actually using an informant, Richard Bistrong, to orchestrate this fictitious agreement. Bistrong and undercover FBI agents met with each defendant. The defense counsel argued that Bistrong never said that the payments were a kickback or bribe, but in fact stated that the agreement was legal. Further, it was argued that Bistrong was a known name in the defense industry, and, therefore, the defendants argued that Bistrong's representations were credible. Previously, Bistrong had been the target of the DOJ's investigation of corrupt sales to the United Nations before serving as an informant and had pled guilty to conspiracy charges. n75

n73 Joe Palazzolo, *Judge Declares Mistrial in FCPA Sting Case*, WALL ST. J. BLOGS: CORRUPTION CURRENTS (July 7, 2011, 4:38 PM), http://blogs.wsj.com/corruption-currents/2011/07/07/judge-declares-mistrial-in-fcpa-sting-case/.

n74 *Id*.

n75 *Id*.

At the end of the trial of the first group of four defendants in July 2011, the jury was deadlocked, and thus a mistrial was declared. Some argue that because of the use of the sting operation, the use of Bistrong as an informant with his numerous credibility issues, and the fact that some of the defendants were inexperienced in the industry it was difficult to find the defendants guilty. n76 The DOJ pledged to retry the defendants, and the matter is now scheduled for a retrial in February 2012. The second group of SHOT Show defendants were in trial in October 2011, and the outcome in this trial will surely signal to the DOJ and the business community how the public feels about sting operations in this context.

n76 *Id*.

n77 Press Release, U.S. Dep't of Justice, Former Controller of a Miami-Dade County Telecommunications Company Sentenced to 24 Months in Prison for His Role in Foreign Bribery Scheme (Jan. 21, 2011), *available at* http://www.justice.gov/opa/pr/2011/January/11-crm-091.html.

Individual Liability Under the FCPA

Not only have corporations been affected by the FCPA, but increasingly numerous individuals have also been held liable for their actions. In the Haiti Teleco case that involved bribes to former government officials in Haiti, Antonio Perez, the controller of telecommunications in Miami-Dade County, pled guilty and was sentenced to two years in prison and two years of supervised release, and was required to pay $ 36,375. In the TSKJ case previously discussed, Jeffrey Tesler, who served as an intermediary in the joint venture bribery scheme, pled guilty to violations of the FCPA. Tesler faced a maximum of ten years in prison and agreed to forfeit nearly $ 149 million. n78

n78 Samuel Rubenfeld, *Jeffrey Tesler Pleads Guilty to Two FCPA Counts*, WALL ST. J. BLOGS: CORRUPTION CURRENTS (Mar. 11, 2011, 2:16 PM), http://blogs.wsj.com/corruption-currents/2011/03/11/jeffrey-tesler-pleads-guilty-to-two-fcpa-counts/.

China-Affiliated Companies

Due to the way that many Chinese companies do business, Chinese companies have been a focus of FCPA investigations because the giving of gifts plays a large role in business development practices there. In fact, the DOJ currently has nearly thirty investigations involving companies with affiliations to China. In March 2011, IBM reached a settlement with the SEC for violating the FCPA's books and records and internal control provisions by providing improper cash payments, gifts, and travel and entertainment to government officials in South Korea and China. n79 Because of expectations of gift giving, American companies must be careful when dealing with entities in China and exercise best practices based on U.S. law.

n79 Press Release, SEC, IBM to Pay $ 10 Million in Settled FCPA Enforcement Action (Mar. 18, 2011), *available at* http://www.sec.gov/litigation/litreleases/2011/lr21889.htm.

INTERNATIONAL FRANCHISING MODELS

To date, there has been no publicly announced enforcement action by the SEC or DOJ involving a U.S. franchisor. Nevertheless, it is important to consider the possible effect of the FCPA on franchises and particularly international franchising, n80 specifically because the SEC and DOJ are increasingly demonstrating their broad jurisdictional application of FCPA enforcement across various industries due, in part, to cooperation of foreign governments and other governmental entities. This is particularly important as more countries are implementing their own antibribery laws. For example, the United Kingdom Bribery Act of 2010 creates criminal liability for active or passive bribery of foreign public officials or for failure to prevent bribery and carries a penalty of imprisonment for up to ten years with an unlimited financial fine. n81

n80 *See* Robert Smith et al., Address at the International Franchise Association Legal Symposium: What Is a Franchise? What Are the Various Types of Franchise Relationships? (May 16-18, 2010); Tao Xu et al., Address at the International Franchise Association Legal Symposium: Planning for International Expansion--Things to Consider Before Expanding (May 16-18, 2010).

n81 Bribery Act 2010, c. 23 (U.K.), *available at* http://www. legislation.gov.uk/ukpga/2010/23/contents; *see also* MINISTRY OF JUSTICE, THE BRIBERY ACT 2010 GUIDANCE, *available at* http://www.justice.gov.uk/downloads/guidance/making-reviewing-law/briberyact-2010-guidance.pdf.

In order to understand the effect on franchises, one must first have a clear understanding of what a franchise is. Although franchising laws vary from state to state, one can gain a general understanding of what a franchise is by looking to the Federal Trade Commission (FTC) rule for guidance. The fundamental elements of the FTC rule that demonstrate a franchise relationship are (1) a promise to provide a trademark or other commercial symbol, (2) a promise to exercise significant control or provide significant assistance in the operation of business, and (3) a required minimum payment of $ 500 during the first six months of operation. n82 For purposes of this article, the element of control is the one that will be the most pertinent. Therefore, this section will examine the various models of franchises, focusing on models used in the international context, and the implications of the models in light of the FCPA.

n82 16 C.F.R. §§ 436.1 *et seq*.

Direct-Unit or Single-Unit Franchising

The direct-unit or single-unit franchising model is the oldest and arguably most commonly used model in the United States in which a franchisor sells one of its units at a time and has direct involvement with the franchisee. There is no third party involved in the operations between the franchisor and franchisee. Therefore, it is the franchisor's responsibility to handle training, marketing, supplies, and other support to the franchisee rather than outsourcing this task. Many like this model because it gives the franchisor complete control of expansion, the franchisor can keep 100 percent of the fees that the franchisees pay, and arguably it will create more uniform products and services across markets. In terms of control, this model may be appealing; however, this may not be an ideal model when considering expanding into an international market. Because expansion only occurs one unit at a time, growth in international markets is slow, and it may take some time to see the benefits of such expansion. The franchise is also likely unfamiliar in the foreign market, and it may be more beneficial to expand at once with more than one franchise rather than unit by unit. This approach might heighten the franchise's visibility sooner in the foreign area. Additionally, because the franchisor would be directly involved in the relationship with the international franchisee, it is more likely that the franchisor should be present in the new market, again requiring more involvement with the operations of the new franchisee. Notably, the franchisor in this model tends to have more control over the operations of its franchise and a greater return on the franchisee profits.

Although the direct-unit or single-unit franchising model may seem to be appealing in terms of control and profit return, a franchisor in the United States must be careful in light of FCPA implications due to the level of control it has over the foreign franchisee. In the direct-unit or single-unit franchising model, a franchisor would have little ability to deny its involvement and consequently to absolve itself from liability if a foreign franchisee violated the FCPA by bribing a foreign official or improperly keeping the books and records. Due to the level of control the domestic franchisor has in the model, it would be easy for the DOJ and SEC to find a nexus between the two and impute the corrupt intent of the foreign franchisee to the American franchisor. Moreover, the government would argue that it was in furtherance of the domestic business that the foreign franchisee took the actions. Although the exposure to FCPA liability in this type of model is great, it also gives the do-

mestic franchisor considerable ability to put the right controls in place through direct training in compliance methods and by making sure there is a universal message of complying with the provisions of the FCPA. In other franchising models, there is a risk that the message will get lost, which is less likely in the direct-unit or single-unit franchising model. Although franchisors in this model likely could not free themselves from legal responsibility, domestic franchisors have more of a chance to define the message and directly encourage and influence compliance in their ranks.

Area Development or Multiunit Franchising

In the area development or multiunit franchising model, a U.S.-based franchisor employs an area developer who operates or controls multiple local franchises in a specified area. If a franchisor uses this method, then there will likely be faster growth than is seen in a direct- or single-unit scheme. Typically, area developers are sophisticated businesspersons and have knowledge about the particular territory in which the franchisor is interested or have a better ability to find out about the territory. Oftentimes, the area developer has one agreement with the franchisor and a separate agreement with the area franchises. Different from the direct- or single-unit model, utilizing an area development approach can be financially beneficial to a domestic franchisor because the area developer bears some of the financial burden by paying some of the expenditures or expenses for the local franchisee's needs.

Although a domestic franchisor has less control in the area development or multiunit franchising model than it would in the direct-unit design, the domestic franchisor still has some and arguably significant control and oversight of its international franchises, which still make it susceptible to FCPA exposure. Indeed, it is important to carefully choose an area developer who understands the vision of the franchisor and is aware of, trained in, and supports complying with the FCPA and other antibribery and anticorruption laws. The importance of this selection is heightened by the fact that the area developer--who presumably is present in the foreign area market (or has oversight of a local agent acting for the area developer)--is involved with more of the hands-on training and support. There must be a clear message to the area developer that bribery and improperly maintaining its books and records is not how the franchisor does business. Moreover, in light of the SEC and DOJ's expansive jurisdictional reading of the FCPA, it is critical that the area developer is aware that he or she is personally susceptible to criminal and civil penalties for violating the FCPA--even though the area developer is outside the continental territory of the United States. Not only should

the franchisor send the message to the area developer, but the area developer must also ensure that the message trickles down to the various area franchises under his or her control.

Master Franchising

Master franchising is the most common expansion method used in international franchising. This method usually involves a contract between a domestic franchisor and a master franchisee in a particular area that then contracts with third-party subfranchisees within a specified territory. Frequently the domestic franchisor will have no contractual relationship with the subfranchisees. The master franchisee effectively acts as the franchisor in the local market and will recruit, research, train, and provide other support in the local area on behalf of the domestic franchisor. This can benefit the domestic franchisor because it can rely on the master franchisee's awareness of the area, real estate, language, culture, customs, etc., which creates a more specialized approach to doing business.

In the master franchising model, domestic franchisors have two potential entities that could make it susceptible to FCPA liability--the master franchisee and the subfranchisee. Due to the direct relationship and control between the franchisor and master franchisee, it is not difficult to find a nexus of involvement with the United States. However, because there is no direct contractual relationship between the domestic franchisor and subfranchisees, this area of FCPA exposure is less clear. Arguably, the subfranchisee is controlled by the master franchisee, not the domestic franchisor, because the subfranchisee only receives instructions from the master franchisee and may never interact with the franchisor. However, despite a lack of contractual relationship between the franchisor and subfranchisee, it is still conceivable that the SEC and DOJ could find legal responsibility involving the domestic franchisor and/or the subfranchisee if the subfranchisee were to violate the FCPA.

Factors Considered by the DOJ and SEC

The DOJ and SEC may consider the precise role of the franchisor, the involvement between the franchisor and master franchisee, the discretion of the master franchisee to make decisions, the interaction between the franchisor and subfranchisee, and the methods of payment between the franchisor and subfranchisee (i.e., if royalty payments are sent directly to the franchisor from the subfranchisee), among other factors. If the ultimate (and substantial) responsibility, authority, and con-

trol of the franchise remain with the domestic franchisor, then this is an easier question. Further, if it appears the franchisor effectively authorized or assisted the party to violate the FCPA by authorizing its behavior in the local market, the franchisor may have some exposure. However, one redeeming element for a domestic franchisor that truly has no involvement in the prohibited behavior is the element of corrupt intent. Because an FCPA violation is not a strict liability offense, domestic franchisors should be quick to argue that they did not have the requisite corrupt intent due to lack of knowledge. Accordingly, they cannot be held liable, and any intent attributed to the master franchisee or subfranchisee should not be imputed to them.

Area Representative Franchising

An area representative essentially acts like an independent contractor for the domestic franchisor. The area representative markets, supervises, and carries out other roles in the local market on behalf of the franchisor. Although the franchisor still has control, the goal of this arrangement is to shift the risks and burdens of international franchising to the area representative. Because of this, this model has the least FCPA exposure. However, many entities do not want to assume the responsibility of the area representative model (assuming the risks) because they would rather have the authority and financial compensation of a master franchisee.

In terms of FCPA potential liability, the concerns are [*147] similar to those in a master franchising model; however, a domestic franchisor could attempt to distance itself from the independent contractor and require its area representative expressly to assume legal responsibility for its actions. It is unlikely, however, that FCPA legal responsibility can be contracted away particularly because the DOJ unabashedly extends FCPA duties and liability to third parties. Therefore, it is still important for a franchisor that uses an area representative to be vigilant in its selection of an area representative and in its subsequent training.

Joint Venture Franchising

Finally, the last model that should be considered in the context of international franchising is joint venture franchising. Essentially, the franchisor forms a separate entity in a local community to develop its franchisees there, and the franchisor is a shareholder of the franchise. If a franchisor is the sole or majority shareholder, then the legal exposure involving the FCPA is greater. This is particularly relevant if the franchisor is intimately involved in the operations and management of the com-

pany. Although a separate entity is formed, it does not require a huge leap to assume that the government could hold the domestic franchisor liable for the actions of this separate entity that has clear ties to the domestic franchisor.

Best Practices for International Franchisors

It is also important for international franchisors to know that the prohibitions of the FCPA supersede any culturally acceptable business practices in a foreign country that conflict with this law. Accordingly, such franchisors must be attentive to and intentional about saturating their domestic and international operations with values and practices that do not violate the Act.

Because all of the franchise models discussed involve some level of FCPA exposure, it is important to consider the best practices that international franchisors can employ to minimize their liability under the FCPA and other antibribery laws. This is particularly critical because agents of franchisors or franchisees can create FCPA liability for a franchisor under traditional agency principles even if they do not have actual authority to bind the franchisor.

Presumably, a franchisor has already conducted market research before deciding to enter a foreign market. But a franchisor must also engage in a vetting process and do its own due diligence in researching the background of potential local franchisees, master franchisees, and other area representatives by using resources available in the United States (e.g., Chamber of Commerce, DOJ, SEC, etc.). This will aid its ability to forecast potential FCPA or other legal liability based on the agents it intends to use. Further, the franchisor should document the results of the due diligence performed on the franchisee. If the franchisor learns of red flags, it must analyze those red flags and determine if there is a legitimate business purpose. If appropriate, a franchisor may consider seeking the advice of local legal counsel.

After the franchisor agrees to enter into an agreement with a franchisee, the franchisor must make sure that the contractual language that is used is as specific as possible and is clearly defined to outline the actual duties of the franchisee and its employees. Further, there should be strong FCPA language and warranties against violating the FCPA and other antibribery laws. Franchisors should also include contractual language that allows for audits and termination rights of master franchisees, area representatives, and area developers if red flags or violations are identified. Franchisors may also consider having board or management review of potential FCPA liability decisions.

Franchisors should also have in place some type of compliance program and written manual available in hard copy and electronically, tailored to fit the company's business, that educates franchisees, employees, agents, and anyone affiliated with the franchise about the FCPA and other anti-bribery and relevant laws. For example, franchisors should train franchisees to ensure that franchisee employees and their agents are accurately invoicing sales and payments with no hidden fees. Employees and other franchise affiliates should be routinely trained, and the franchisees and franchisors should keep a record of those employees and affiliates who have gone through the mandatory compliance training programs. These compliance programs must be translated into the languages spoken where the franchise is located. After completing the required training in the company's compliance measures, all employees and subagents of the franchisees should be certified, and the franchisor should keep records of these routine certifications.

Moreover, there must be some type of reporting and monitoring system. Within each local franchise unit, franchisors should have a point of contact for questions about possible violations, a hotline for anonymous calls, and a local monitor of behavior and accounting. Internal and self-reporting should be encouraged, and employees and affiliates must be assured that there will be no retaliation made against them. The company should then have a process in which the local franchisee reports the information back to the domestic franchisor. Depending on the franchise model used, there may be some interim steps utilized (i.e., approaching the area representative, master franchisee, or other local contact before contacting the domestic franchisor). Additionally, it would be prudent to pay particular attention and monitor those countries in areas where bribery or gifts are encouraged in business relations. In sum, franchisors must be diligent when entering a foreign market and make sure to use best practices routinely and consistently.

Conclusion

Because the DOJ and SEC continue to enforce the FCPA against domestic companies and even companies that have minimal ties to the United States, it is not difficult to imagine that domestic franchisors could soon face FCPA enforcement actions. Therefore, franchisors and their legal counsel must be educated in the FCPA and other anti bribery laws to ensure protection against such exposure. Franchisors and foreign franchisees must use best practices when doing business in foreign markets. As recent developments have shown, this area is continuing to develop and the scope

of FCPA enforcement is ever changing, and thus, practitioners and franchisors (who are part of an easy-target industry) must pay attention.