IFA’s 45th Annual Legal Symposium
The Foreign Corrupt Practices Act: What Every International Franchisor Must Know

Moderator: Eric L. Yaffe  
Gray Plant Mooty  
Washington, DC

Speakers:  
Mary C. Spearing  
Baker Botts L.L.P.  
Washington, DC  
Sarah M. DiLorenzo  
McDonald’s Corporation  
Oak Brook, IL
The Foreign Corrupt Practices Act: What Every International Franchisor Must Know

I. The Foreign Corrupt Practices Act
II. Other Anti-Bribery Laws
III. Enforcement Trends and Resulting Impact on Franchisors
IV. Activities that Increase Risk of Violating FCPA
V. Best Practices for Franchisor FCPA Compliance Programs
TI Corruption Perceptions Index 2011
Transparency International Findings

• Public sector plagued by bribery
• Corruption rampant in 60 countries
• $400 billion lost annually
• Special risk:
  – Developing economies
  – Global companies growing rapidly
I. The Foreign Corrupt Practices Act

US Foreign Corrupt Practices Act

• Passed in 1977
• Goals:
  — Level playing field
  — Reduce corruption
Application of FCPA

Issuers (SEC)

• US or non-US corporations subject to SEC registration and reporting
• Subsidiaries and controlled joint ventures
• Employees, directors, officers and third-party agents

Domestic Concerns (DOJ)
FCPA: Anti-Bribery Provisions

- Prohibits payment of money or anything of value to government official
- To help obtain or retain business
- Acts of third parties can make the company liable if company has actual or constructive knowledge
FCPA: Accounting Provisions

• Enforced by SEC
• Intent not required to prove violation
• Issuers Must:
  – Keep accurate and detailed books, records and accounts.
  – Maintain strong internal accounting controls
• Requirements extend to foreign and domestic subsidiaries.
• Parent company must assure that subsidiaries and affiliates comply
## Penalties and Sanctions

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<tr>
<td></td>
<td>Civil</td>
<td>Criminal</td>
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<tr>
<td><strong>Individual</strong></td>
<td>Up to $10,000 per count</td>
<td>Up to $250,000 per count and/or imprisonment up to 5 years</td>
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<tr>
<td><strong>Business Entities</strong></td>
<td>Up to $10,000 per count</td>
<td>Up to $2,000,000 per count</td>
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Alternative Fine Statute: Twice the gain from the offer.
Recent FCPA Settlement Totals

2011: 15 companies paid $508.6 million
2010: 23 companies paid $1.8 billion
2009: 11 companies paid $644 million
2008: 11 companies paid $890 million

(Siemens paid $800 million in fines and penalties, as well as additional sums paid to settle matters with foreign governments.)
Other Anti-Bribery Laws

UK Bribery Act
- Passed in 2010
- Implemented 2011
- Broader in Scope than FCPA
- Prohibits Government Bribery and Private Bribery
- Prohibits Facilitating Payments
- Requires Effective Procedures to Prevent Bribery
- Strict Liability Offense
- But Adequate Procedures is full Defense for Corporations
Other Anti-Bribery Laws

Canada Corruption of Public Officials Act

• Passed in 1999
• Includes three offenses:
  – Bribing Public Official
  – Laundering Property and Proceeds
  – Possession of Property and Proceeds
• Can only be enforced through criminal prosecution
• Penalties: Unlimited Fine at Judge’s Discretion and up to 5 Years in prison
Global and U.S. Efforts to Prevent Corruption

• Local Country Laws and Reforms
• Global Treaties and Agreements
  – UN Convention Against Corruption (2005)
• Other US Laws and Regulations

• **Bottom Line: Government bribery is illegal everywhere**
Enforcement Trends

• Huge increase in investigations and settlements
• Simultaneous prosecutions in multiple countries
• Higher penalties
• Expanded scope of Bribery Prosecutions
  – FBI Sting Operations
  – Using other laws to crack down on private bribery (Travel Act)
Vast Mexico Bribery Case Hushed Up by Wal-Mart After Top-Level Struggle

Confronted with evidence of widespread corruption in Mexico, top Wal-Mart executives focused more on damage control than on rooting out wrongdoing, an examination by The New York Times found.
Wal-Mart shareholders are understandably upset with the company. The retailer’s shares have taken a pounding after The New York Times reported on a bribery scandal at the company’s Mexican subsidiary that some executives are said to have known about but chose to ignore. In the days after the disclosure, Wal-Mart’s shares lost nearly 8 percent of their value, totaling more than $15 billion.

In reaction to the news, the California State Teachers’ Retirement System, known as Calstrs, filed a complaint in Delaware last week accusing directors and officers of breaching their fiduciary duties. It asks for damages and changes to Wal-Mart’s corporate governance.

Unfortunately for shareholders, it is unlikely that the complaint will result in any significant changes at Wal-Mart. It is difficult to survive the motion to dismiss that the defendants can be expected to file, and then proving a violation under Delaware law is nearly impossible if the case moves forward.

The lawsuit that Calstrs filed is known as a shareholder derivative action, which means the company is the plaintiff because it was harmed by the actions. This is a device that gives the owners of a company – the shareholders – a means to police the conduct of corporate directors and management, who would probably be unwilling to sue themselves on behalf of the company.
Recent Cases With Potential to Impact Franchisors

CB Richard Ellis

- Global real estate services firm disclosed possible FCPA violations in China
- Company’s internal Investigation uncovered payments by employees for entertainment and gifts to government officials
- Even "minor" payments or gifts can be basis for violation
- Failure to accurately account for small payments or gifts can be books and records offense
- Company also investigating use of third-party agent involved in 2008 purchase of an investment property in China for a Company-managed fund

Note: DOJ declined to bring action against the company.
Recent Cases With Potential to Impact Franchisors

Morgan Stanley

April 25, 2012: Garth Peterson, former managing director in company’s real estate business in China pleads guilty to violating FCPA by bribing Chinese government official to steer business to Morgan Stanley.

- Conspiracy to evade internal accounting controls
- 250K fine to settle SEC allegations
- Relinquished interest in Shanghai real estate worth $3.4 million
- Permanent bar from securities industry
- To be sentenced July 17, 2012, facing max 5 years in prison and 250K or twice the gain from offense.

Note: DOJ did not bring enforcement action against Morgan Stanley, due to cooperation by company and finding that company had adequate program in place to ensure compliance:
FCPA Risk Factors for Franchisors

- Limited Knowledge of Local Customs and Practices in Non-US Markets
- Master Franchisees who Oversee Entire Countries or Regions
- Partnerships / Joint Ventures
- Dealings with Foreign Vendors and Suppliers
- Need for Direct Interaction with Local Government Officials
- Use of Agents to Assist Entry and Expansion in Local Market
  - Majority of pending FCPA cases before involve agents and distributors
  - Intermediaries can be agents, general contractors, consultants, representatives, distributors or other service providers
Activities of Franchisors That Could Trigger FCPA Risks

- Purchasing Real Estate: Potential Corruption in Valuation Process
- Use of Brokers and Intermediaries in Real Estate Deals
- Use of Agents
  - Ambiguous Roles
  - Lack of Detail in Invoices
- Leasing Property: Terms and Conditions
- Obtaining Licenses and Permits
- Requests for Facilitating Payments
- Customs Issues: Goods Delayed/Held by Officials
FCPA Red Flags

- Lavish Gifts and Hospitality
- Sponsorship of Trips (Airfare, Hotel) for Officials
  - Supplier Facilities
  - Site Visits
- Requests for Charitable Contributions
- Requests to Support Projects
- Grease / Facilitating Payments
Agents: Red Flags

- Payments requested in cash or by check to "bearer"
- Payments through third country or to third party not involved in transaction
- Advance payments or per diems
- Bill not itemized or excessive amounts billed
- Agent rejects anti-corruption clause in contract
- Government official recommends agent
- Family ties or other known connection between agent and government official
Agents: Red Flags

- Excessive or unusual fees or payment arrangements
- Questionable background or reputation
- Current government official or holder of honorary position
- Not licensed to perform work / lack of experience or credentials

*If any of the issues above are found and have not been addressed, stop using Agent*
Hospitality Risks

- Meals, lodging, entertainment and travel provided to government officials may trigger FCPA liability
- Affirmative Defense: “Reasonable and bona fide” expenses directly related to:
  - Promoting/demonstrating products or services, or
  - Fulfilling a contract with a government agency
How to Address FCPA Risks: Effective Compliance Programs

Required by US Federal Sentencing Guidelines

Up to 95% reduced fines if Companies demonstrate seven key criteria:

1. Standards capable of *reducing risk* of criminal activity
2. *Oversight* by high-level personnel
3. *Due care* in delegating discretionary authority
4. Effective *communication* to all levels of employees
5. Systems for *monitoring, auditing, and reporting* suspected wrongdoing *without fear of reprisal*
6. Consistent *enforcement* including disciplinary measures
7. Procedures in place to *prevent repeat problems*
Whistleblower Reporting / No Retaliation

“Whistleblowers”

• Employee who reports accounting fraud or internal controls violations
• Protected under US Sarbanes-Oxley Act

The Company must not take any action against an employee who reports an issue in good faith
Best Practices in FCPA Compliance Programs

Enterprise-Wide Risk Assessment
- Identifies Significant Legal, Financial, Reputational Risks
- Ranks Severity and Likelihood and Impact
- Ensures Procedures in Place/Adopted to Protect Against Risk
- Each Country/Market Must Address all Potential Risk Areas
- Targeted FCPA Risk Assessment
  - Employee Survey
  - Third Party Survey
  - Gap Analysis
Best Practices in FCPA Compliance Programs

- **McDonald’s Standards of Business Conduct**
- McDonald’s Global Anti-Corruption Policy
  - Compliance Officer coordinates with Local Markets
  - Mandatory Training
  - Materials Translated into Local Language
  - Hard copies of policy for all employees at manager level and above
McDonald’s Global Anti-Corruption Policy

• Communication of Standards to Developmental Licensees
  – Policy Development Manual
    ✓ Shares Best Practices
    ✓ Covers Elements of Compliance Program

• Franchise Agreements
  – Require Compliance With All Laws
  – Contain OFAC Provision
  – Contain FCPA /Anti-Bribery Provision

“Building local businesses, one opportunity at a time.”

IFA’s 45th Annual
LEGAL SYMPOSIUM
McDonald’s Global Anti-Corruption Policy

- Applies to Directors, officers and employees including JVs and controlled subsidiaries
- **Prohibits:**
  - Facilitating payments
  - Giving or receiving kickbacks (“commercial bribery”)
  - Improper offers or payments to government officials
  - Any of the above using third party to make offer or payment
McDonald’s Global Anti-Corruption Policy

International Gifts and Hospitality Guidelines

• Gifts or Hospitality to Government Official Require the Following:
  – Prior approval from Designated Officer and Global Compliance
  – Accurate Description in Books and Records
    • Name and Position of Official
    • Name and Position of McDonald’s Employee Involved
    • Description of Gift / Hospitality
    • Precise Value of Gift / Hospitality
McDonald’s Global Anti-Corruption Policy

Due Diligence

• Required for:
  ✓ Developmental Licensee Candidates
  ✓ Conventional Franchisee Candidates
  ✓ All Agents

• Tiered based on Risk (Location, Type of Agent, Scope of Project or Service)
• Coordinated by Global Compliance
• Dynamic and Evolving Process
McDonald’s Global Anti-Corruption Policy

Due Diligence: Elements of Review

- Government sanctioned screening
- Reputation and experience / credentials
- Media Search
- Business verification and references
- Certification of financial stability
- Anti-Corruption certification
McDonald’s Global Anti-Corruption Policy

Procedures for Engaging Agents for Services Outside US

- Agents defined as all third parties representing McDonald’s before government officials, such as:
  - Lobbyists
  - Architects
  - Permit expeditors
  - Real estate brokers
  - Tax consultants
  - Attorneys
McDonald’s Global Anti-Corruption Policy

Procedures for Engaging Agents for Services Outside US

- Payments to Agents Segregated and Tracked
- Compliance Controls:
  - Agent must itemize invoices
  - Agent must sign contract with anti-corruption clause
- No Success Fees
- No Lump Sum Arrangements