

## **Franchising and the FCPA**

The Foreign Corrupt Practices Act (FCPA) applies to all US companies and individuals which conduct business overseas. FPCA practitioners recognize there are two components: (1) the anti-bribery component, handled by the Department of Justice (DOJ) and (2) the books and records components, handled by the Securities and Exchange Commission (SEC). None of this is new information and indeed, has been present in the FCPA since it was enacted in 1977. This breadth and scope of the FCPA make it mandatory that any business or person which conducts business overseas does so in compliance with the FCPA. One of the lessons learned from 2010 is that a business not traditionally thought of as high risk for FCPA compliance can still run afoul of the FCPA. In October, CB Richard Ellis, a global real estate firm, disclosed possible FCPA violations in China. As reported by the FCPA Blog, the Company reported in a SEC filing that its employees made payments for entertainment and gifts to Chinese government officials, which were discovered during an internal investigation. This blog will look at the franchising industry and explore its possible FCPA exposure.

The franchising model has been in vogue for many years. It has been a successful model in the US and now many corporations are looking at overseas expansion opportunities. Franchise law has become well developed across the US, with many states developing laws to protect the rights and obligations of both parties in a franchise agreement. According to an International Franchise Association survey nearly 1,600 franchise systems in 2008, "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."

There are no reported FCPA enforcement actions regarding franchisors. However, the factors in a franchise relationship would appear to lead to clear FCPA responsibility of the franchisor for its overseas franchisee's actions. Additionally, court interpretation of the FCPA has held that it is applicable where conduct, violative of the Act, is used to "to obtain or retain business or secure an improper business advantage" which can cover almost any kind of advantage, including indirect monetary advantage even as nebulous as reputational advantage. As almost everyone knows, the FCPA prohibits payments to foreign officials to obtain or retain business or secure an improper business advantage. Nevertheless many US companies view franchisors as different from other types of more direct sales representatives, such as company sales representatives, agents, resellers or even joint venture partners, for the purposes of FCPA liability. However, the DOJ takes the position that a US company's FCPA responsibilities extend to the conduct of a wide range of third parties, including the aforementioned company sales representatives, agents, resellers, joint venture partners and distributors. It does not take too great a leap of imagination to see that a franchise relationship could be contained within this interpretation. It does not take too many legal steps to see that a franchisee's actions can impute FCPA liability to a US franchisor.

There are other factors, unique to the franchise relationship, which would point towards FCPA liability of the US franchisor. A US franchisor's intent and the degree of control it

exercises over its overseas franchisees' operations are factors the DOJ/SEC might consider in determining whether to pursue an FCPA case against a franchisor for bribes made by one of its foreign franchisees. It is always in the financial interest of a US franchisor for its franchisees to be successful businesses. Additionally, most US franchisors require its overseas franchisee's to use the same company name for branding.

How would all of this play out for a franchisor? As a franchisor moves into foreign markets there could well be the temptation 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. Even if it is not the US franchisor's own employees which engage in the FCPA violations, the US franchisor will still face the risk of an enforcement action if the franchisee's employees engage in such conduct.

Most franchisors have thorough financial vetting requirements before allowing any person or business to become a franchisee. However, how many of these same business perform FCPA compliance due diligence on their prospective overseas franchises? How many US franchisors have FCPA compliance training programs? How many evaluate, on an ongoing basis, the FCPA compliance and program of their overseas franchisees? How many US franchisors have a compliance hotline or other reporting mechanism for any compliance violations made against their franchisees?

If you are a US franchisor, looking to expand overseas, one of the first things you should do is to perform a FCPA risk assessment and then use that risk assessment to implement a full FCPA compliance program within your company going forward. If you are a US franchisor which has international franchises but which has not previously reviewed your FCPA requirements, you should do so as soon as possible. If not, your FCPA exposure may be unlimited....

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