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MANAGING ACQUISITIONS COMPLIANCE IN INTERNATIONAL FRANCHISE EXPANSION

This article examines the major concerns when evaluating how to ensure compliance with the Foreign Corrupt Practices Act (FCPA) for a franchise looking to expand internationally, and from this examination, to craft the best approach to ensuring compliance with the FCPA. Couple franchising’s exponential growth and reliance on third parties for expansion of the franchise system with the recent crack down on FCPA compliance by the Securities and Exchange Commission (SEC) and the Department of Justice (DOJ), and there is the perfect storm regarding risk to the franchisor of inadvertently creating liability under the FCPA. By adopting a commitment to non-tolerance of bribery or otherwise corrupt practices, as well as adopting a system-wide, robust, and comprehensive anti-corruption compliance program, franchises expanding internationally can mitigate their unique risks regarding the commission or imputation of potential FCPA violation within the franchise system.

I. INTRODUCTION

Recall the blazing headlines from earlier this spring exclaiming that twenty FIFA officials (and counting) were being indicted on various corruption related offenses resulting from the government uncovering a massive twenty-four year scheme resulting in FIFA officials and their subsidiaries received over $150 million in bribes from sports marketing companies in order to secure marketing at the World Cup and other FIFA events. In addition, there were allegations of senior officials receiving over $10 million in exchange for securing their votes as to where certain future world cups would be held. The FIFA prosecution and investigation is ongoing and has brought into question the legitimacy of hosting rights awarded to Russia and Qatar in 2018 and 2022, respectively. While this case certainly highlights the prevalence of corruption (and current focus on halting) within the way business is secured throughout the world, the FIFA case has not resulted in any charges specifically of FCPA violations because, since FIFA is not a “public international organization,” its officials are not “foreign officials” for FCPA purposes. However, the broad jurisdiction of the FCPA not reaching this case is more the exception than the norm. Instead, the norm is that the FCPA typically will apply—evidenced by the growing number of individuals and companies, like Goodyear Tire and Rubber Company (2015), BNY
Mellon (2015), Ralph Lauren Corporation (2013), and Garth Peterson of Morgan Stanley (2014), appearing in the headlines in recent years due to FCPA violations (just to name a few). The increase over the past decade of FCPA enforcement actions undertaken by the DOJ and the SEC against companies as well as individuals make clear that ensuring FCPA compliance is one of the agencies’ top priorities, and as such, should be a major strategic concern for businesses operating abroad. In fact, the DOJ recently stated that FCPA enforcement is number two of the agency’s priorities around the world, second only to anti-terrorism.

On the other hand, franchising has become a major economic force, and according to statistics reported by the International Franchise Association, currently, there are “over 750,000 franchised business establishments employing more than eight million people and generating approximately $800 billion (annually).” Franchising, is a business system based on expansion through the establishment of licensing relationships. Franchising provides an attractive model for international expansion for a number of reasons. First, franchising offers a somewhat simple avenue for growing an already known brand and proven system. Second, the potential foreign franchisees provide knowledge and expertise of the local foreign market. Third, franchising, compared to other methods of expansion, is relatively speedy and has limited associated expenses for the franchisor. From data reported through a survey of 1,600 American franchises conducted by the International Franchise Association, “nearly two-thirds of respondents currently franchise or operate in non-U.S. markets and three-fourths planned to begin international expansion efforts immediately.” With franchising’s explosive growth, it is not hard to fathom that franchising’s international expansion would alert the radar of the agencies enforcing the FCPA. Couple the crackdown regarding FCPA enforcement with the exponential growth and expansion seen of late in the franchising sector, and there exists the “perfect storm” of potential for liability under the FCPA. This is particularly so when the unique aspects of how a franchise system expands are also considered.

As quoted in a recent article in Franchising World,
“Franchising has undergone titanic shifts over the past decades. Once the purveyors of single products or services, today’s franchise systems have morphed into mega distribution networks offering goods and services through multiple channels on a global basis. As the world becomes more regulatory-minded, legal issues facing franchise systems have become more complex and far reaching.”

One of these major legal concerns is compliance with anti-corruption legislation, like the FCPA. The FCPA is said to be the “single most significant compliance challenge” for companies operating internationally. Because of the upswing of FCPA enforcement actions over the past few years and the expansive jurisdiction and numerous potential causes of action created by the substantive provisions of the FCPA, including the potential for liability based on actions of agents or within the corporate family of entities, addressing FCPA compliance should be a core concern when crafting corporate strategy. Although no enforcement action has been taken against a franchisor based on the actions of its franchisees, franchises and similar business systems have been linked to enforcement actions in other ways. This paper aims to show how easily the potential for liability under the FCPA translates to expansion of the franchise system and to provide a compliance-based solution to mitigating this risk. To do so, in Section II, the paper will first examine the causes of action and jurisdiction created under the FCPA. Then, Section III will discuss the unique characteristics of the franchise relationship and how the franchisor’s reliance on third parties by virtue of the way franchising expands poses clear risk for potential FCPA violation and associated liability on behalf of the franchisor. Finally, Section IV offers a solution to mitigating the franchise’s unique FCPA risks from a compliance perspective. Essentially, by adopting a commitment to non-tolerance of bribery or otherwise corrupt practices, as well as adopting a system-wide, robust, and comprehensive anti-corruption compliance program, franchises expanding internationally can mitigate their unique risks regarding the commission or imputation of potential FCPA violation within their franchise system.

15. FCPA Risks for Franchisors, supra note 13.
II. THE APPLICABILITY OF THE FCPA

This section introduces the FCPA, which is the major domestic law regulating American businesses’ interaction in foreign countries. Then, the regulation’s jurisdiction, potential causes of action, and thus, the risk to companies associated with the broad potential for liability under the FCPA is discussed. While other domestic laws influence companies’ dealings in foreign countries, like import and export tariffs and tax laws, and other countries have their own applicable anti-corruption legislation, this paper concentrates on the impact of the FCPA as to how it creates risk specific to the franchise looking to expand internationally.

The purpose of the FCPA is to make it unlawful for certain categories of entities or individuals to make payments to foreign government officials in order to obtain or retain business. The statute was enacted in 1977 with the overarching goals of reducing corruption when doing business with foreign countries and leveling the playing field regarding foreign transactions. The FCPA contains anti-bribery provisions as well as books and records “accounting” provisions, designed to operate in tandem. Liability for violation of any provision of the FCPA can be imposed on both entities and individuals and can result in civil and criminal penalties. Both the DOJ and the SEC enforce the FCPA by investigating the actions of companies that fall under the reach of the FCPA’s jurisdiction to ensure compliance with the statute’s substantive provisions and imposing penalties for its violation through enforcement actions in federal court. The DOJ primarily focuses on the anti-bribery provisions, while the SEC primarily focuses on “issuers” and the accounting provisions.

A. The Substantive Provisions of the FCPA

As stated in the FCPA Resource Guide issued by the DOJ and SEC in 2012 (the Resource Guide), generally, through its anti-bribery provisions, the FCPA “prohibits offering to pay, paying, promising to pay, or authorizing the payment of money or anything of value to a foreign official in order to influence any act or decision of the foreign official in his or her official capacity or to secure any other improper advantage in order to obtain or retain business.” Specifically, the anti-bribery provi-
sions apply to the use of the mail or any means or instrumentality of interstate commerce corruptly in furtherance of making payment to any person with the knowledge that such payment will be used to improperly influence a foreign official for the purpose of securing business for the payor or payor’s principal. From the language of its anti-bribery provisions, the FCPA clearly creates a broad risk for liability regarding what could constitute bribery or corrupt practices. Essentially, the FCPA applies if its “Business Purpose Test” is met. This test states that the FCPA applies to any payment intended to induce or influence a foreign official to use his or her position “in order to assist … in obtaining or retaining business for or with, or directing business to, any person.” The key point to understand here is exactly how broadly the anti-bribery provisions can be applied under the FCPA.

As for the accounting provisions, these apply only to companies whose securities are listed in the United States. These provisions require the companies to which they apply, “a) make and keep books and records that accurately and fairly reflect the transactions of the corporation, and b) devise and maintain an adequate system of internal accounting controls.” Essentially, the accounting provisions “seek to prevent accounting practices designed to hide corrupt payments by requiring companies to maintain accurate books and records and adequate internal accounting controls.” It is important to note that intent (as in a purpose to defraud) is not required to prove a books and records violation and the accounting requirements extend to a parent companies’ foreign and domestic subsidiaries, meaning the parent company must assure its subsidiaries and affiliates are compliant with the requirements of the provision. This paper focuses mainly on the potential for liability to the internationally expanding franchise created through the anti-bribery provisions. Nevertheless, understanding the requirements and applicability of the accounting provisions is necessary for the franchisor to ensure accurate and thorough records are kept throughout its franchise system.

B. The Broad Jurisdiction of the FCPA

The FCPA is set up with broad jurisdiction regarding to whom the restrictions of its provisions apply. The provisions of the FCPA apply to those with formal ties to the United States, “issuers” and “domestic concerns,” as well as having a broader territorial jurisdiction that covers per-
sons and entities (other than issuers and domestic concerns) acting while in the territory of the United States. An “issuer” under the FCPA is a company that has a “class of securities registered under Section 12 of the Exchange Act or is required to file periodic and other reports with SEC under Section 15(d) of the Exchange Act.” This means that, to be an issuer, a company need not be a U.S. company. Foreign companies listed on a U.S. exchange that have American Depository Receipts are also issuers. The second category of entities or persons the FCPA applies to are “domestic concerns,” defined in the Resource Guide as, “any individual who is a citizen, national, or resident of the United States, or any entity that is a corporation, partnership, association, joint-stock company, business trust, unincorporated organization, or sole proprietorship organized under the laws of the United States or its states, territories, possessions, or commonwealths or that has its principal place of business in the United States, including the entities’ officers, directors, employees, agents, or stockholders acting on behalf of a domestic concern, including foreign nationals or companies.”

Particularly applicable to companies with formal ties to the United States, principles of corporate liability apply regarding violations of the FCPA as well. Meaning that, a company can be held liable for the actions of its agents or subsidiaries, if the violations were committed within the scope of the parent-subsidiary relationship or the agent’s employment with the company and, at least in part, to benefit the company (and the requisite knowledge or willful blindness) on behalf of the company can be shown. The FCPA also has broader territorial jurisdiction that covers those “who take action in furtherance of a violation” while in the territory of the United States. Since its amendment in 1998, the FCPA’s anti-bribery provisions have been extended through this territorial jurisdiction to apply to “foreign persons and foreign non-issuer entities that, either directly or through an agent, engage in any act in furtherance of a corrupt payment (or an offer, promise, or authorization to pay),” and can extend to agents, employees, officers, directors, or stockholders of such persons or entities. Essentially, through its jurisdiction over those with formal ties to the United States or its territorial jurisdiction, the FCPA can reach just about any person or any entity with some connection to the United States that engages in some broadly defined corrupt act, as long as this corrupt act meets the Business Purpose Test.

As mentioned above, general principles of corporate liability and *respondeat superior* (or vicarious liability) apply to the FCPA. This means that, as stated in the Resource Guide, “a company is liable when its directors, officers, employees, or agents, acting within the scope of their employment, commit FCPA violations intended, at least in part, to benefit the company.” Ultimately, if it can be shown that an individual acting in violation of the FCPA did so within the scope of his or her relationship with the company in some way for the betterment of the company, the violation can be imputed onto the company (as long as the requisite knowledge or willful blindness on behalf of the company regarding the action can also be proven). The DOJ and the SEC commonly use parent-subsidiary liability when bringing FCPA enforcement actions. According to the Resource Guide, there are two ways a parent can be held liable for actions taken by its subsidiaries in violation of the anti-bribery provisions of the FCPA. First, a parent may have “participated sufficiently in the activity” to be directly liable for the conduct (i.e. directing the misconduct or participating in the bribe scheme), and second, through “traditional agency principles.” However, the agency standard the DOJ applies is actually more expansive than traditional notions of agency applied to cases involving parent-subsidiary liability. The Resource Guide states that the determinative factor in assessing whether the agency standard applies to impute an FCPA violation by the subsidiary (or its agent) onto the parent company is the parent’s general control over the subsidiary. In contrast, the determinative factor under traditional notions of agency liability is the parent’s control over illegal conduct. Essentially, “whether or not a parent specifically authorized, directed or controlled the actions of a subsidiary, if the government finds that an agency relationship of general control exists, the parent may be liable for FCPA violations committed by the subsidiary.” The enforcing agencies consider not only the formal structure of the entities’ relationship, but also the “practical realities of how the entities interact.” If an agency relationship is determined to exist, then the subsidiary’s action and knowledge are imputed to its parent.

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38. *Id.* at 27.
40. *Id.*
42. *Id.*
43. *Id.*
44. *Id.*
46. *Id.*
Another way an indirect violation of the FCPA can reach a company is through principles of successor liability. The Resource Guide makes clear that the enforcing agencies take the position that a company assumes the liabilities of any company with which it merges or that it acquires, including liability for FCPA violations\(^{47}\) (the potential for successor liability can be mitigated however through due diligence, integration, and taking remedial action, some of which will be discussed in Section IV).\(^{48}\) However, the Resource Guide also notes, “successor liability does not create liability where none existed before.”\(^{49}\) Therefore, if an issuer acquired a foreign company not previously subject to the FCPA’s jurisdiction, meaning the acquired company was not an issuer or a domestic concern and the FCPA’s territorial jurisdiction did not apply, then the mere acquisition of that foreign company would not retroactively create FCPA liability for the acquiring issuer. But, the acquiring company would need to ensure no future violation occurred after the acquisition, as such violation would be subject to the FCPA. Accordingly, because the FCPA has been interpreted by the DOJ and SEC (and affirmed in the courts\(^{50}\)) as having such expansive jurisdiction, not only must a company be aware of whether it falls under the jurisdiction of the FCPA, but it must also understand whether jurisdiction can be established in order to create liability on behalf of the company for actions of various third parties.\(^{51}\)

The overall “take away” regarding the obligations and liabilities created for companies and individuals under the FCPA is that the SEC and DOJ “investigate, settle and prosecute violations of the FCPA occurring both domestically and internationally, and as such, companies that operate directly or through affiliated or unaffiliated parties, particularly in developing and transitioning countries, may be vulnerable to FCPA enforcement and should ensure compliance.”\(^{52}\) This section introduced the FCPA through a discussion of its broad jurisdiction and the potential causes of action it creates for businesses and individuals who have connections to foreign markets. This introduction to the FCPA provides the foundation for understanding how the particularities of the franchise relationship and the way franchises expand create specific potential for risk of liability under the FCPA as the franchise moves abroad. This franchise specific risk will be discussed in the next section in order to show why the implementation of a robust and comprehensive compliance system reaching all levels of the franchise system is the answer to proactively

\(^{47}\) Id. at 28.

\(^{48}\) See PLC Commercial, supra note 41.


\(^{51}\) Such third parties include: the company’s employees, agents, or subsidiaries, plus its subsidiaries’ agents, as well as actions taken by any company with which it merges or acquires (and that company’s agents).

\(^{52}\) PLC Commercial, supra note 41.
mitigating the risks specifically applicable to franchises expanding internationally created by the FCPA.

III. MAJOR CONCERNS IN THE FRANCHISE SYSTEM CREATING RISK OF LIABILITY UNDER THE FCPA

This section will first examine differing approaches to international expansion applicable in the franchise system and how these approaches fit within the broad jurisdiction and potential causes of action created under the FCPA. Then, how each of these approaches impacts the franchisor’s potential for liability under the various applications of the FCPA will be discussed. This analysis will highlight how the broad jurisdiction of the FCPA applies easily to the unique aspects of international franchise expansion in order to clarify the importance of taking a proactive approach to addressing these risks. Because of the various ways the franchising system expands, its reliance on third parties for entry into foreign markets, and the typically incurred “red tape” when moving into foreign markets (i.e. licensing, approvals, regulatory authorizations and requirements), there is often temptation to “grease the skids” on the way in through providing “kick backs” or other payments to agents or other officials aimed at expediting the market entry process. Nonetheless, this shortcutting or otherwise easing entry into the foreign system is a sure-fire way for the franchisor to be implicated in violation of the FCPA, whether or not the violation occurred at the corporate level.

A. How Franchises Fit under the Jurisdiction of the FCPA

Franchises fit under the jurisdiction of the FCPA clearly as issuers if they are public companies expanding internationally. However, for those franchise entities that do not rise to the level of being an issuer, the domestic concern jurisdiction is still broadly applicable enough that it is easy to see how it likely applies to the domestic franchisor expanding internationally. As explained in depth in Section I, an entity is a domestic concern if it is an entity that is organized under, or a resident of, or has its principal place of business within the United States or any US territory. Thus, a domestic-based franchise, specifically its domestic based franchisor, constitutes a “domestic concern” under the FCPA.

The FCPA also creates a likely risk of violation specific to the franchisor through its broad interpretation of vicarious and agency liability discussed in Section I (the franchisor would also be subject to a potential for any other entity-based liability discussed in Section I, like successor liability). Thus, in the franchising system, like any other entity subject to the principles of vicarious or agency liability, any party related to the

55. See International Trade Compliance Tips for Franchisors, supra note 35.
franchisor either through employment or entity relationships that could be considered to be under the general control of the franchisor by the DOJ (or SEC) attaches the broad application of agency liability provided for under the enforcing agencies’ interpretation of the FCPA. Once the vicarious or agency liability is established, any violation by such a related party could then be imputed onto the franchisor.

B. Franchisees and the Potential for Agency Liability

What about risk specific to the franchising system through its relationship with its franchisees? While to date there have been no enforcement actions against franchisors based on actions taken by its foreign franchisees, franchises and similar business structures, like distributorships, have been otherwise connected to enforcement actions. It is not hard to see how franchisees could fit under the expansive jurisdiction of the FCPA and broad definition of agency applied when considering FCPA liability. If the enforcing agencies were to move their FCPA crackdown into the realm of franchising and consider whether the franchisor could be implicated in the conduct of its franchisees with regards to a potential FCPA violation, the likely considerations include the degree of control the franchisor exerted over the franchisee and the franchisor’s knowledge (actual or constructive or willful blindness) of the alleged misconduct. Franchisees typically fit the enforcing agencies’ interpretation of agency for FCPA purposes easily based on the general control test used for FCPA purposes. The basics of the franchise relationship are a license to use the franchise’s trademarks and system set up through the obligations of the franchise agreement. But, almost always, the franchisor exerts some continuing degree of control over the franchisee’s operations in order to ensure consistency across its brand. This level of control would likely be enough to constitute the exertion of general control by the franchisor over the franchisee, satisfying the enforcing agencies’ broad applicability of agency principles under the FCPA. As a result, the franchisor would be implicated in the actions of its franchisees based on the existence of the agency relationship. In addition, in domestic litigation involving franchises, the doctrine of vicarious liability is often invoked to implicate the franchisor in the actions of its franchisees. Numerous domestic courts have held that “the franchise relat-

56. U.S. Franchises Expanding Abroad Must Consider FCPA Risk, supra note 8; King, supra note 16.
57. U.S. Franchises Expanding Abroad Must Consider FCPA Risk, supra note 8.
58. Id.
60. Id.
tionship becomes an agency relationship when the franchisor exerts significant control over the subject matter of the litigation." Thus, given the long reach and broad applicability of the FCPA, it is not hard to fathom that enforcement agencies would constitute franchisees to be agents of the franchisor for purposes of FCPA liability. Establishing this agency would simply require the enforcing agency to establish: 1) the franchisee was under the general control of the franchisor when it took the action, 2) the low threshold that the conduct of the franchisee was a violation of the act, 3) the improper conduct was taken on behalf of the franchise with the purpose to “obtain or retain business or secure an improper business advantage,” and 4) that the franchisor was either willfully blind to or had knowledge of this conduct, whether directly or with “a belief that circumstances exist that such conduct is substantially certain to occur.”

Thus, when expanding abroad and approaching FCPA compliance, the smart franchise must balance maintaining enough control to protect their brand while still keeping the franchise “reasonably at arm’s length” in order to attempt to prevent the franchisee being considered an agent of the franchisor should an FCPA concern arise.

Other factors, beyond the ability to establish franchisees as agents of the franchisor, could contribute to the enforcement agencies taking an interest in FCPA enforcement within the franchise sector. These include: the structure of initial licensing as well as royalty fees common in franchise systems, the fact that it is always in the interest of the franchisor for the particular franchisee to succeed, any intent the franchisor may have appeared to impose upon its franchisees, and the necessary government interaction regarding the set-up of a new franchise system or location.

There are also factors specific to how a franchise expands internationally that make the system susceptible to a potential for FCPA violation. These include: the franchisor having a limited knowledge of the local customs and practices in foreign markets while dealing with existing entities or established business persons (potential franchisees) who do have local knowledge, increased dealings with foreign vendors and suppliers (in order to ensure the ability to source and supply products and services consistent with the established brand), the need for direct interaction with local government officials regarding licensing and registration requirements, purchasing or leasing franchise locations, dealing with customs and import/export requirements, and the use of agents to assist with entry

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63. U.S. Franchises Expanding Abroad Must Consider FCPA Risk, supra note 8.
64. FCPA Risks for Franchisors, supra note 13,
and expansion in the local market, as well as the specific structure of international expansion that is chosen. All of these various factors, as well as the likelihood that the actions of franchisees will impute onto the franchisor through the establishment of an agency relationship under the FCPA, highlight franchising’s specific potential for risk of liability under the FCPA. The impact of the chosen expansion method in particular will be discussed in the next subsection.

C. The Way Franchising Expands and the Associated Risk for Liability under the FCPA

By its nature as a system based on licensing, franchising expands through reliance on third parties. There are a few different avenues the franchisor looking to expand internationally can pursue. The most common approach to international franchise expansion is through the creation of a master franchise agreement, where the franchise either creates a wholly owned domestic subsidiary (its international sub-franchisor), creates or acquires an existing foreign company to be its foreign subsidiary (the controlled foreign corporation), or licenses an existing foreign entity to be its exclusive master franchisor within that country. The foreign master franchisor, typically under some control of the franchisor, then opens master franchisor operator locations or grants multiple foreign franchisee licenses throughout the foreign territory according to the franchisor’s franchise agreement. There are a variety of other methods of international expansion for the franchise system, including:

- Acquisition of an existing foreign franchise system and merging the two (think Burger King and Tim Horton),
- Direct franchising where the franchisor directly grants each foreign franchisee,
- Area or regional development where there is a master-sub-franchisor but the territory only covers a region or specific area instead of a whole country.

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68. Id.
69. Id.
70. International Franchising Methods, supra note 59.
71. Francis N. Rodriguez & Jessica A. McGrath, supra note 7.
72. International Franchising Methods, supra note 59.
73. Id.
• The franchisor opening its own operator locations within the foreign market,74
• The franchisor entering into a joint venture with an existing foreign franchise, or
• The franchisor acquiring only the assets of an existing foreign franchise and merging them into its existing system (through essentially buying an existing brand and trademark rights, in an asset acquisition that doesn’t take on the liabilities).75

There also has been an increase in international holding companies or other investment groups purchasing existing franchise systems, such as 3G Capital Group’s recent purchase of Burger King Holdings, Inc. or Berkshire Hathaway’s purchase of Dairy Queen.76

Essentially, when choosing how to structure the franchise’s international expansion, the potential forms sit on a spectrum. At one end is the use of master franchising that reduces FCPA risk for the franchisor because the franchisor exerts less control over the master franchisee who then has greater operating flexibility.77 But, with less control on the part of the franchisor comes less ability to regulate and protect its developed brand and brand consistency, and may incentivize the franchisee to shirk its obligations to the franchisor (such as adherence to compliance programs).78 On the other end of this spectrum sits direct unit franchising where the franchisor directly licenses individual foreign franchisees.79 The pros and cons here are reversed, the franchisor maintains more control over each franchisee, which allows for greater brand protection and the ability to ensure the franchisee is complying with the franchises’ system at the expense of the franchisor taking on a greater risk for the imputation of potential FCPA liability.80 Along this continuum lies the various hybrid structures mentioned earlier and each franchise system’s unique needs and concerns will determine its chosen structure. Nevertheless, the most prominent consideration (aside from brand protection) when choosing an expansion tactic is that, because of the differing entity structures, varying amount of control the franchisor maintains over the foreign franchisees, and concerns regarding agency or vicarious liability for the franchisor, the amount of risk and potential liability for FCPA violation created depends on the method of expansion the franchisor chooses when moving abroad.81 Thus, the chosen method of international expansion

74. Kenneth Levinson, Lee Plave, Donald Wray & Michael Fink, supra note 67.
76. Francis N. Rodriguez & Jessica A. McGrath, supra note 7.
77. U.S. Franchises Expanding Abroad Must Consider FCPA Risk, supra note 8.
78. Id.
79. Id.
80. Id.
81. Id.
becomes the first way the franchisor can mitigate its potential for liability if FCPA violations should occur within its entity structure. Because of the broad potential for liability relating to FCPA issues, this consideration should be a key aspect when choosing how to structure the franchise’s international expansion.

Some companies have tried to avoid the FCPA and successor liability by structuring their expansion as only an asset purchase, in order to avoid taking on the acquired entity’s liabilities and thus potential responsibility for any FCPA violation. In franchising, this could be done through purchasing a foreign franchise’s trademarks in order to allow the franchisor to move into the foreign market with established brand recognition. But, using an asset purchase to avoid FCPA and successor liability is not always successful because courts recognize this tactic and will impute the liability to the acquiring company anyway.

While acquiring or merging with an existing foreign franchisee seems to be the most straightforward approach to international franchise expansion, this structure of expansion is not seen as commonly in international franchising expansion, and alliances like that between Burger King and Tim Hortons are still uncommon in the franchising industry. This is likely because of brand protection concerns related to integration. However, this approach, which is more typical of what is seen in mergers and acquisitions, provides the ability to address FCPA concerns before closing and once the deal goes through. On the front side of the deal, through risk-based methodological due diligence to ensure the franchisor isn’t purchasing an FCPA violation via the application of successor liability, and on the back side of the deal, through integration and the adoption of a robust and comprehensive compliance program at all levels of the new entity. As such, international expansion of franchise systems through the more standard merger or acquisition will likely be an area that becomes more mainstream as franchising continues to move onto a global scale.

It is clear the DOJ and SEC, through various enforcement actions, have established their ability to impute liability for a subsidiary’s FCPA violation onto its parent by virtue of the parent-subsidiary relationship and the principle of vicarious liability. Thus, it is not hard to see that, in

82. Lindsey, supra note 75.
83. For more on this principle, see Lindsey, supra note 75.
this same vein, by using the FCPA’s broad applicability of the principle of agency liability, the DOJ or SEC could clearly translate the potential for liability based on entity relationships into holding a franchisor liable for the actions of its franchisees. Thus, in expanding the franchise system, not only must the franchisor consider how its corporate agents interact when foreign officials are involved, but also, depending on the chosen structure of the expansion of its franchise system, the franchisor must consider the actions of numerous parties potentially acting as the franchisor’s agents in the foreign country, from subsidiaries to master sub-franchisors to foreign franchisees. This is why the method of expansion into foreign markets must be a core consideration when the franchise is structuring its foreign expansion, in order to account for the potential for risk of FCPA liability due to the unique structure of the franchise relationship and the methods typically seen in international franchise expansion. Ultimately, choosing an expansion structure that provides for limited liability while ensuring the franchisor is able to protect its brand and system by determining to whom and how franchisee licenses are granted is the best strategic option for the franchisor looking to expand internationally. The chosen structure of the franchise’s international expansion also impacts how it addresses ensuring that its compliance program is adhered to at all levels of its franchise system. This extra layer of adherence is the key to addressing compliance within the franchise system and will be discussed further in the next section.

This section discussed the ways the franchise system expands internationally and how this structure of the franchise system sets up the franchisor to be exposed to an expanded potential for liability under the FCPA by looking at unique traits of franchise expansion and how they fit clearly within the broad jurisdiction the FCPA creates. The next section argues for why putting in place a robust and comprehensive compliance system that reaches all levels of the franchise system is the answer to mitigating this potential for risk of liability under the FCPA.

IV. THE ANSWER: A ROBUST AND COMPREHENSIVE COMPLIANCE PROGRAM

The previous sections pointed out that because of the explosive growth and expansive reach of the franchising sector and the growing trend regarding FCPA enforcement; it is easy to see how the DOJ and SEC could move the FCPA enforcement quest into the realm of the franchise system. Then, the discussion introduced the FCPA, explained how it creates risk for companies expanding internationally who do not pay attention to its broad jurisdiction and causes of action, and analyzed how the specific ways franchises expand internationally pose a heightened risk of exposure to FCPA violation. This section provides an answer to mitigating this risk of FCPA violation for the franchisor through the adoption of a robust and comprehensive compliance system through all levels of the franchise organization. First, the reasons why the compli-
ance program is the answer is discussed. Next, what the compliance program looks like specific to the franchise system is considered. Finally, the aspects of compliance unique within the franchise system, the fact that the franchisor has to ensure its adherence all the way through its numerous franchisees, and how the franchisor addresses this kind of “third layer” to its compliance program are explained. Ultimately, the goal of this section is to glean the core aspects a franchisor should adopt in order to craft a robust and comprehensive compliance system that fully addresses the risks regarding FCPA compliance that are unique to international expansion of the franchise system.

A. Why the Adoption of a Robust and Comprehensive Compliance Program that Reaches All Levels of the Franchise System is the Answer to Mitigating the Risk of FCPA Violation in International Franchise Expansion

Because of the specific risks, due to the inherent reliance on third parties within the franchise system and the associated potential for agency or vicarious liability under the FCPA when expanding internationally, the franchisor must take a proactive approach to ensuring compliance and mitigating these risks, or risk incurring hefty penalties and fines. The adoption of a robust and comprehensive compliance system is the answer to mitigating these risks because it allows the franchisor to take a methodological approach to ensuring compliance with the FCPA at all levels of the franchise system. In the franchise system, the key to mitigating risk of FCPA violation is by ensuring compliance throughout not only the corporate entity or family of entities, but also at the franchisee level. The responsibility to ensure compliance at the franchisee level is the most significant difference specific to international expansion in franchising compared to the risks of FCPA violation associated with other entity structures when making foreign acquisitions or otherwise expanding internationally. While the added layer of potential agency or vicarious liability created by the franchisor-franchisee relationship is the core concern to address when adopting a robust and comprehensive compliance program, it is not the only reason to do so.

Another major reason the compliance program is the answer to mitigating risk under the FCPA for the internationally expanding franchisor is the fact that beyond just being smart business practice, doing so increases transparency and shows compliance efforts on behalf of the franchisor. If the enforcing agencies undertake an investigation, these agencies take a more favorable view towards the company when compliance measures are in place and instituted system wide.86 Along these same lines, where a company can show adherence to its compliance program and the FCPA violation is based on the action of an individual, the agen-

86. The FCPA & What Every International Franchisor Must Know, supra note 19.
cies commonly will then focus on the individual in its enforcement actions and spare the company (like in the investigation involving Morgan Stanley and executive Garth Peterson87). To translate this into the franchise system, not only may the franchisor be able to avoid being “on the hook” for the actions of an individual bad actor in violation of the FCPA, but also, if a franchisor can show it has a robust and comprehensive compliance program in place and its adherence to this program, it may be able to avoid or minimize the potential for agency or vicarious liability for actions taken at the subsidiary or franchisee level. As quoted in the Franchise Times, “Equally as important as developing a responsible corporate culture, corporate compliance programs can mitigate consequences of unlawful organizational behavior for purposes of establishing the required punishment strictures under the Federal Sentencing Organizational Guidelines.”88 Meaning that, investigating agencies take into account the compliance efforts of a company when determining whether and against whom to take enforcement action and levy penalties based on violation of the FCPA.

The last major argument addressed here for the franchisor taking a proactive approach to FCPA compliance by instituting a franchise-wide compliance program is simply the age old adage that “prevention is better than cure.” Not only can an FCPA violation, whether direct or imputed through principles of agency or vicarious liability, lead to the imposition of detrimental fines, the time and cost associated with investigation by any enforcing agency are high as well, whether due to court battles trying to defend against the allegations or simply the production costs associated with cooperating with such an investigation. Not to mention the reputational costs associated with being labeled as a business known for engaging in corrupt practices, especially considering the media’s inclination to sensationalize bad acting on behalf of businesses.

Whether it is the rationale based on the potential for agency liability associated due to the franchisee relationship, the argument that compliance is simply sound business practice, or the “prevention is better than cure” idea (or all three), it is clear that a proactive approach through instituting a franchise-wide robust and comprehensive compliance program is the answer to mitigating the franchisor’s risk of liability regarding potential FCPA violation within its system. The next subsection will discuss what such a compliance program looks like in the franchise system.

88. Why Franchise Organizations Need Corporate Compliance Programs, supra note 12.
B. What a Robust and Comprehensive Compliance Program that Reaches All Levels of the Franchise System Looks Like

From the preceding discussion and analysis as to why the adoption of a robust and comprehensive compliance program reaching all levels of the franchise system is the answer to mitigating the risks for FCPA violation associated specifically with international franchise expansion, a number of key elements and considerations can be assimilated that the franchisor should utilize when instituting its compliance program. The compliance program, at its most basic level, should focus on three general principles relating to ensuring compliance to the FCPA as the franchise expands internationally. These principles are: 1) understanding the potential franchisee’s qualifications and associations, including both its business reputation and any existing relationship with foreign officials, 2) understanding the business rationale for engaging the specific expansion structure and particular potential franchisee, and 3) implementing some form of ongoing monitoring and auditing of the franchise relationship with the international franchisee. However, even before the compliance program is crafted, approaching compliance comes first from the cultural level within the franchise system. In addition to creating this culture of compliance and the particular elements crafted into the compliance program, the method of adoption and implementation of the compliance program is how the franchisor ensures it is robust and comprehensive, and that adherence reaches all levels of the franchise system. Essentially, as stated in an article addressing risk in franchising and 7-Eleven’s recent scandal regarding undocumented workers at a number of its New York and Virginia franchise locations, “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.”

First, it is essential that the commitment to anti-corruption and high standard of business ethics be woven into the core of the franchise system’s culture, meaning true “buy in” at all levels, not just a website tab on the franchisor’s corporate page that provides a kitschy anti-corruption motto, so that compliance becomes a clear priority throughout the organization. This requires the adoption of a “zero tolerance” policy by the franchisor, meaning the franchisor regularly evaluates the risk of corruption at every level as well as addressing compliance with such a com-

90. Id.
91. Fox, supra note 65; see also Why Franchise Organizations Need Corporate Compliance Programs, supra note 12.
92. Burke, supra note 89.
mitment at every level by evaluating its agents’ conduct, instituting a no consequence internal reporting hotline, and taking action when any violation is found (including firing or severing ties with the non-compliant agent and taking steps to address and correct the violation internally.) 93 It may seem that taking a zero-tolerance approach and instituting a system wide compliance program would indicate the franchisor having a level of control over its franchisees that beckons the establishment of vicarious liability on behalf of the franchisor, but when the control is to protect the system and not to manage day to day operations, the franchisor is seemingly able to avoid such liability. 94 The enforcing agencies, when investigating FCPA compliance, will take into account whether a company instituted and adhered to appropriate internal disciplinary procedures for compliance violations. 95 Another Franchise Times article echoes this regarding compliance in the franchise system, “One of the best protections is to put procedures in place for dealing with incidents, such as bribery, should they arise. If there are good compliance procedures in place, even if there are incidents of corruption, the government is not as likely to prosecute the company, if a company can show it has made a substantial effort to prevent and detect such behavior, then the enforcement agencies may decide to prosecute the individual rather than holding the entire company accountable.” 96 Getting this cultural buy in at all levels requires not only taking a “zero tolerance” approach and following through when violation or non-compliance occurs, but also educating the franchise’s agents at every level not only as to the extent of risk created by even the slightest violation of legislation, such as the FCPA, but also what actions constitute corruption or bribery and cause liability under such legislation, including the fact that what may be considered a cultural norm in the foreign country is irrelevant when it comes to creating a cause of action under the FCPA. 97 Addressing compliance at the cultural level is only the first aspect of the franchise’s proactive approach to mitigating its risk for FCPA violation.

Second, the approach to the adoption of the compliance program itself is key to ensuring adherence thereto at all levels of the franchise system, meaning ensuring that all individuals or entities within the franchise system, whose actions could be imputed to the franchisor, comply with the anti-corruption compliance program. When crafting the program, the franchise should consider that in past settlements and guidance releases, the DOJ and SEC have made clear that they look favorably on

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96. Mattson-Teig, supra note 6.
97. Burke, supra note 89.
compliance programs that are both designed to maximize prevention of wrongdoing and detection of violation within the company, and are adequately enforced within the company. This highlights the importance of remembering that compliance is not an aspect of the business that is “one size fits all” or “check the box,” but instead, to be effective, must be tailored to the particular organization’s specific needs, risks, and challenges regarding its international expansion. The approach to ensuring compliance in its international expansion requires the franchisor to do a risk assessment of each particular location the franchise intends to expand, undertake its due diligence based on this risk assessment, and craft its approach to compliance based the particular risk associated and what is discovered through the risk-based due diligence process. This risk assessment should include looking for any red flags regarding any third party agents the franchise may be working with when entering the new foreign market. In addition, when the expansion involves a merger or acquisition, an additional layer of due diligence specific to the target company pre-closing, as well as integration of the compliance based culture post-closing is necessary in order to avoid any potential imputation of successor liability onto the franchisor. The Resource Guide summarizes how a company should approach compliance by stating, “In the end, if designed carefully, implemented earnestly, and enforced fairly, a company’s compliance program—no matter how large or small the organization—will allow the company generally to prevent violations, detect those that do occur, and remediate them promptly and appropriately.”

The compliance program and its policies and procedures should be designed to: 1) deter employees, agents, and franchisees from engaging in behavior that could lead to violation of the FCPA, 2) detect improper behavior should it occur, 3) incentivize and provide an internal mechanism for reporting improper conduct that occurs or becomes known, and 4) outline how senior management should respond to conduct that potentially violates anti-corruption legislation. Specific to the franchisor, language regarding the franchise’s code of conduct and adherence to the compliance policy, as well as addressing FCPA compliance, should be included explicitly in the franchise agreement. For a detailed explanation of the key aspects the DOJ or SEC look for in any anti-corruption and bribery compliance program, as well as examples of what these look like in real life, see the Resource Guide. This Subsection’s analysis has in-

101. PLC Commercial, supra note 41.
102. Id.
103. Arthur, supra note 98.
stead focused on the aspects unique to international expansion of the franchise system.

In crafting and implementing its compliance program, the franchise should consider the elements discussed above as well as those elements applicable within any entity, like showing a top down commitment, utilizing the elements of the Sentencing Guidelines, and cooperating with any undertaken investigation.104 By doing so, the franchisor can ensure a robust and comprehensive approach to instilling compliance throughout its system, thus mitigating not only the potential for violation within its franchise system, but also the potential that a third-party violation be imputed onto the franchisor.

C. How the Franchisor Ensures Adherence to its Compliance Program at the Franchisee Level

It seems clear that in any entity, the adoption, implementation, and adherence to a robust and comprehensive compliance program is the answer to mitigating risk of FCPA violation within the organization that could be imputed back to the entity. Therein, particular to franchising, ensuring compliance all the way through the franchisee level is the key to insulating the franchisor from FCPA liability. Building on Subsection 3 above, beyond cultural integration, the most direct way the franchisor can make sure the program reaches franchisees is through the terms of the franchise agreement. The franchise agreement should expressly include provisions regarding: 1) adherence to the FCPA (and county specific anti-corruption legislation), 2) adherence to the franchisor’s compliance program, and 3) non-tolerance of FCPA violation, including the ability to terminate the franchisor-franchisee relationship if a violation occurs. Making franchisees aware that the franchisor’s compliance efforts “have teeth” by sharing how the franchisor evaluates compliance and that the franchisees’ own compliance efforts will be assessed regularly to ensure their adherence to the compliance program creates incentive for the franchisees to “buy-in.” Documentation of this training and evaluation is also an important aspect to creating a record of implementation and effort on behalf of the franchisor should an agency or vicarious liability claim ever arise against the franchisor regarding FCPA violation. These records would serve to show diligence on behalf of the franchisor regarding the adoption and implementation of its compliance programs and anti-corruption efforts. The franchisor could also show best efforts and automate its franchisee compliance by engaging an external company to engage in compliance audits.105 By taking a “zero tolerance” approach to anti-corruption as well as implementing a system wide robust and comprehensive compliance program that incorporates the elements

previously discussed, as the franchisor expands internationally, the franchisor can mitigate both the risk of an FCPA violation occurring as well as imputation of liability for any such violation onto the franchisor.

This section provided an answer to the unique risks regarding FCPA compliance that the franchise expanding internationally faces because of the franchise’s inherent reliance on third parties within its system, by posing that the adoption of a robust and comprehensive compliance program reaching all levels of the franchise system is the answer to mitigating these franchise specific risks that potentiate liability under the FCPA. The section also discussed what such a compliance system looks like for the franchisor and provided a number core considerations to guide the implementation of such a program across the franchise system in order to mitigate the franchise specific risks created by the FCPA for the franchise expanding internationally, particularly when this expansion is through either the acquisition of an existing foreign entity (like the previously referenced Burger King and Tim Horton’s deal) or set up of a master franchisor.

V. CONCLUSION

By adopting a commitment to non-tolerance of bribery or otherwise corrupt practices, as well as adopting a system-wide, robust, and comprehensive anti-corruption compliance program, franchises expanding internationally can mitigate their unique risks regarding the commission or imputation of potential FCPA violation within the franchise system. Because the DOJ has made clear its priority of ensuring compliance with the FCPA, echoed by the influx of enforcement actions levied annually and the exponential growth and expansion of the franchise sector due to vast success seen in most franchise systems, a franchise expanding internationally is at risk to incur a FCPA violation, and consequently investigation. This paper provided an explanation of the expansive jurisdiction and potential causes of action created by the substantive provisions of the FCPA as well as an analysis of how this risk for liability under the FCPA translates specifically within the franchise system by virtue of its reliance on third parties, before providing that the solution to mitigating these risks to the franchisor through the adoption of a franchise-wide robust and comprehensive compliance program. Therein, it is clear that, although no enforcement actions have been taken against franchisors for the actions of their franchisees yet, the risk of liability under the FCPA easily translates to the franchise system through the potential for vicarious or agency liability. Thus, the potential for applicability to the franchise expanding internationally and the lack of guiding precedent as to how the enforcing agencies will treat franchise systems means it is critical that franchisors take a proactive approach to addressing compliance and mitigating their potential for liability under the FCPA by adopting a robust and comprehensive compliance program across the franchise’s system,
which emphasizes that bribery or other methods of easing entry into new foreign markets is neither encouraged nor tolerated.

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