International Due Diligence in Cross-Border Franchise Transactions

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When a franchise system expands internationally, due diligence that includes a thorough investigation of the business environment of the proposed target market and its legal landscape will provide clues as to the likely success of the expansion. Preliminary investigation will also shape the due diligence that must be conducted on the proposed local master franchisee, area developer, or joint venture partner.[1] Due diligence of the local business requirements, the local legal framework, and the local partner is particularly important in the international context because the stakes are often higher. Compared to a typical domestic franchise transaction in the United States, the amount invested is generally higher, the time to recoup the investment is longer, the pool of viable candidates is smaller, and the available resources to conduct any due diligence are often scarce. Regardless of these challenges, due diligence remains an essential and invaluable component of any cross-border transaction and the key considerations of that exercise are addressed here.

I. Due Diligence of Business Considerations

A franchisor may typically leave some business due diligence to its local partner, relying on the local partner's knowledge of the market and its industry expertise. If a franchise arrangement covers multiple jurisdictions, the

1. For ease of reference, "local partner" refers to the proposed local master franchisee, area developer, or joint venture partner in the target country.

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due diligence conducted should cover each target market and not just the home jurisdiction of the new local partner. No matter who conducts the investigation, the initial business due diligence on any new target market should, at a minimum, include the inquiries detailed below:

- *Composition of product or offering of service.* Does the product sold by the proposed franchise require modification to make it locally compliant or culturally acceptable? For example, some jurisdictions regulate whether a product can be labeled and sold as a particular type of food (i.e., halal or kosher). A franchisor may believe it is desirable, even if not required, to certify food preparation for cultural or religious reasons. If the product does not meet the specific certification requirements, it may have to be re-named or re-designed.

  Such required or desired adaptations may also affect a franchise that offers services as opposed to a product. To comply with religious customs or restrictions, for example, hotels in Israel need to modify some services on the Sabbath, such as the operation of swimming pools and health clubs. Moreover, a franchisor may need to inquire during its business due diligence whether locally prescribed business hours are more restricted than those in the franchisor's home jurisdiction or whether religious holidays or practices could impact the proposed operations of the franchised business. In some Muslim countries, for example, food and drink cannot be served in the daytime during Ramadan.
- *Suitability of offering.* How suitable is the product or service for the target market? Does the name of the brand translate poorly or is the product culturally insensitive or unpopular? How have competing brands in the marketplace performed? Is there adequate infrastructure to support the franchisor's business operations? Is there a demand for the product or service in the target market? Will the local customer be a viable client?
- *Import costs.* Will certain supplies or products used or sold in the franchise need to be imported into the target market? Are there tariffs or other local taxes imposed on the import or sale of products that make them too expensive for use by the franchised business in the target market? If so, are there readily accessible alternatives for these imported supplies or products?
- *Local costs.* For those franchises that rely heavily on local supply chains, are affordable suppliers available? Moreover, are there rebates to local or offshore suppliers? Employment of workers, licenses and permits, real estate costs, and/or the cost of goods in the target market may lead to significantly higher cost of sales. A franchisor should refrain from making assumptions as to the affordability and practicality of an international franchise transaction, particularly when its target market consists of multiple countries with a myriad of business and franchise regulations.

- *Political risks.* The franchisor will need to analyze whether the target market presents significant risks, such as political threats or the threat of civil unrest or terrorism. It is also valuable for a franchisor to consider the reputational harm, political and legal consequences, or social backlash its business may face in the franchisor's home country, if any, should it decide to enter into business in an unpopular country. The franchisor should assess how supportive the local market's government will be and what type of political or regulatory red tape it should expect in its effort to establish its business in the local market.
- *Payments.* Due diligence must address whether local exchange control regulations, tax laws, or both restrict the repatriation of profits to the franchisor's home jurisdiction or whether payments must be made in local currency of the target market. Franchisors should also familiarize themselves with central banks and/or other financial institutions of the target country.

The foregoing questions (among others) raised during any initial due diligence of a target market's business environment will almost certainly inform other potential issues or particularities of the target country that a franchisor may want to investigate further. In many instances, a franchisor may have to depend on the market insight and social awareness provided by a proposed local partner. This, of course, makes a franchisor's independent due diligence and investigation all the more important. Local market research should be based on the efforts of an entire team of advisors that support the franchisor, including accountants; business consultants; investigators; respected industry colleagues; local business contacts; and of course, local legal counsel, who will provide guidance on the due diligence of relevant legal issues.

II. Due Diligence on Legal Matters

Apart from any business due diligence, a franchisor must also conduct legal due diligence on the potential impact that local laws may have on the expansion of the franchise system to the target market. Often these issues are vetted with local counsel, who is familiar with the analysis needed to address the typical matters presented. Advice from local counsel should also be sought on the changes that are necessary for or desirable to the franchisor's franchise agreement. Changes will inevitably be required because local statutes and public policy will often apply, regardless of the choice of law. Local counsel can provide valuable advice regarding provisions of a franchisor's agreement that may be difficult to enforce and should be able to suggest alternatives. Initial legal issues that should be investigated by the franchisor include the following:

- *Legality.* Is it legal to sell the goods or services in the target market? For example, pork products and alcoholic beverages cannot be sold in certain countries in the Middle East. Any attempts to sell items that that are prohibited could offend local mores and a franchisor could inflict significant damage to its brand domestically and abroad.

- *Trademarks.* The franchisor must inquire whether the system's principal trademarks are registered or available for registration.

  If the franchise's principal marks cannot be used in the target market, it may not be worth proceeding with the franchise offering. Permitting local partners in the target market to operate under different brands than those used in the franchisor's home market may defeat the objective of enhancing the franchisor's brand internationally.

  Some franchise systems, however, have launched under different brands in foreign markets. For example, in Australia, the U.S.-based brand of "Burger King" is known as "Hungry Jack's," and the U.S. brand "Church's Chicken" is known abroad as "Texas Chicken." In the United Kingdom, the U.S.-based brand of "Kwik Kopy" is called "Kall Kwik." Proceeding in this manner can be expensive. Moreover, operating the franchise systems abroad under marks that differ from the franchisor's principal trademark builds goodwill for a brand in which the franchisor may have no long-term interest.

  Finally, the franchisor must also inquire whether the franchisor's trademark must be registered before it is licensed to a third party to avoid violating local law in the target market. A franchisor should also investigate the typical duration of trademark registration in the target market, particularly if registration is required prior to the franchisor's ability to offer or sell the franchise.

- *Disclosure or registration.* A franchisor should know whether any local laws require any disclosures before signing a binding or non-binding letter of intent or before accepting any payment from a prospective local partner. The franchisor should also know whether disclosure is required before the franchise is advertised or before representatives of the franchisor speak to or meet with a prospective local partner candidate.[2]

  In addition, a franchisor should know whether local franchise laws require a regulatory filing or approval before a franchise agreement can be offered or executed or upon its execution. For example, in Malaysia, Indonesia, Vietnam, and South Korea, franchisors must register their franchise with a regulator before it can be offered. In China, filing is mandated past execution of the franchise agreement. In Mexico, documents, including trademark licenses or a summary of their terms, must be filed with the intellectual property registrar.[3]

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2. Countries having disclosure laws in Europe include Belgium, France, Germany, Italy, Romania, Spain, and Sweden; in the Asia Pacific—Australia, China, Indonesia, Japan, Macau, Malaysia, South Korea, Vietnam, and Taiwan; Africa—South Africa and Tunisia; and, in the Americas—Brazil, Canada, Mexico, and the United States. For more information, *see* International Franchising 2016: Legal and Business Considerations (Kendal H. Tyre, Jr. et al. eds., 2016).

3. *Id.*

- *Mandatory provisions*. Jurisdictions that have franchise laws often require that certain provisions be included in franchise agreements. Some of these provisions impact the fundamental elements of the franchise offering. Other requirements dictate the form of the franchise agreement. They include a prescribed minimum term of agreement,[4] a mandatory "cooling-off" period,[5] and a requirement that the agreement be written in the local language to be enforceable[6] or mandatory governance by local law.[7]
- *Franchise structure*. The franchisor should analyze whether the structure of the franchise violates any local laws, such as those related to pyramid selling. And if so, how could the structure be modified, if at all, to comply with local law?
- *Local presence*. The franchisor should know whether the target market requires it to establish a local subsidiary or branch in the jurisdiction or whether the franchisor must operate its own units of the franchise being offered for a certain period before it engages in franchising with other local parties.[8] The franchisor should also determine whether foreign investment or ownership laws restrict the franchisor from establishing a presence or investing locally. In certain target markets, local legislation restricts a franchisor's step-in rights to take over leases and assets to operate franchised units if the local partner is in breach or upon termination of the franchise agreement.

4. For example, Argentina's Civil and Commercial Code requires that the minimum term of a franchise agreement be at least four years with certain exceptions. *See* Mario Eduardo Castro Sammartino, *Franchising in Argentina*, *in* INTERNATIONAL FRANCHISING 2016, *supra* note 2, at 268.

5. For example, Section 18 of the Franchise Act 1998 of Malaysia requires a cooling-off period of not less than seven working days, during which the franchisee has the option to terminate the agreement. *See* Wong Sai Fong & Michelle C.Y. Loi, *Franchising in Malaysia*, *in* INTERNATIONAL FRANCHISING 2016, *supra* note 2, at 442.

6. For example, Indonesia requires that if a franchise agreement is written in a foreign language, the agreement must be translated into the Indonesian language for registration. *See* Nurdin Adiwibowo, Freddy Karyadi & Gustaaf Reerink, *Franchising in Indonesia*, *in* INTERNATIONAL FRANCHISING 2016, *supra* note 2, at 418.

7. For example, Indonesia, Malaysia, and the Philippines specifically require that local law govern the franchise agreement. *See* Kendal H. Tyre, Jr. & Diana Vilmenay-Hammond, *International Franchising–An Overview of Legal and Business Issues*, *in* INTERNATIONAL FRANCHISING 2016, *supra* note 2, at 21.

8. In China, Article 7 of the Regulation on the Administration of Commercial Franchises, adopted May 1, 2007, requires franchisors to have at least two direct sales stores and to have undertaken the business for more than a year (although this no longer needs to be in China). In Vietnam, Decree No. 35-2006-ND-CP requires a Vietnamese sub-franchisor to operate the franchise for at least one year in Vietnam before sub-franchising. *See* Paul Jones & Erik Wulff, *Franchise Regulation in China: Law, Regulations, and Guidelines*, 27 FRANCHISE L.J. (2007); Mai Thi Minh Hang, *Legal Framework for Franchising in Vietnam*, MONDAQ.COM (Mar. 15, 2015), http://www.mondaq.com/x/157420/Franchising/Legal+framework+for+franchising+in+Vietnam.

- *Industry regulation.* Are there industry-specific regulations that could introduce additional costs or impractical requirements that would impede the expansion of the business model in the target country?
- *Travel restrictions.* A franchisor should know whether visas are required for the local partner's personnel to visit the franchisor's home country for training and other required meetings as well as the requirements, if any, for franchisor's personnel to visit the target market.
- *Compensation and Competition.* A franchisor should conduct legal due diligence to inquire whether any local laws relating to termination or nonrenewal of agencies, distributorships, or franchises would require the franchisor to compensate the local partner at the end of the franchise relationship.[9] The franchisor should also investigate whether it will have the right to require its local partner to agree to a non-competition covenant because this type of provision may not always be permitted or may be heavily regulated in some countries.[10]

III. Due Diligence on the Local Partner— The Background Check

The business as well as the legal due diligence conducted by the franchisor will often benefit from insights provided by the local partner in the target country. Given this and given that the local partner is often the lynchpin to the on-going success of the franchise in the target country, a background check on the individual local partner and/or the principal officers of any proposed franchisee entity is a critical part of the franchisor's due diligence.

A background "investigation" or "check," in general terms, delves into an individual's general reputation and history. It may be as simple as a criminal

9. The amount of compensation that may be owed to the franchisee under an agency law varies from country to country. However, it is often left to the discretion of local courts, which typically consider the circumstances as a whole, including the franchisee's actual investment and a reasonable prediction of future profits. A standard award would be the equivalent of one year's total profits (averaged over four to five years) of the franchisee. Compensation for the goodwill of the business and any unused inventory could also be awarded. The amount of compensation may be higher if the parties have a long-term relationship and the franchisee shows extensive investment in the franchise. Ned Levitt, Kendal Tyre & Penny Ward, *The Impossible Dream: Controlling Your International Franchise System*, ABA 33rd Annual Forum on Franchising, October 13–15, 2010, at 20, http://www.dickinson-wright.com/-/media/documents/documents-linked-to-attorney-bios/levitt-ned/20the-impossible-dream.pdf?la=en.

10. Australian law states that post-term restraints will not be enforceable if: (1) a franchisee requests a new agreement but is declined; (2) the franchisee is not in breach or has not infringed the intellectual property of, or a confidentiality agreement with, the franchisor during the term of the agreement; or (3) the franchisee has claimed compensation for goodwill because the agreement was not extended but the franchisor declined to pay such compensation or only paid a nominal amount (or the franchise agreement did not provide for an entitlement to such compensation). Jon Sier & Philip Colman, *Australia*, Getting the Deal Through: Franchise (Aug. 9, 2016), www.franchise.org/sites/default/files/ek-pdfs/html_page/Australia-laws_1.pdf.

history search. In other cases, it may involve not only a review of criminal records, but also a thorough investigation of civil records, assets and bankruptcy records, credit reports, and driving records. Background checks also usually include the verification of professional licenses held, educational degrees obtained, and information gleaned from personal and professional references. A background check could be based, in part, on a questionnaire prepared by the franchisor or even a drug test or a physical and psychological assessment. Other areas of inquiry include third-party supplier and vendor arrangements of a local partner that could impact the franchisor and its business.

Searches normally involve reviewing a seven-year history of the subject; the scope of the review depends on the particular need of the franchisor, the specific issues of concern in the target market, and the due diligence that has already been completed which results in areas of further inquiry in the background of the local partner.

As a general matter, when conducting an international background check, the franchisor must be guided by a series of laws that frame most investigations to ensure that a potential local partner in a target market does not trigger certain national security and anti-bribery legislation. These are perhaps the most important aspects of a background check in the international context and are highlighted below.

A. *United States Office of Foreign Assets Control*

The Office of Foreign Assets Control (OFAC) is an agency within the U.S. Department of the Treasury. It administers and enforces economic and trade sanctions based on U.S. foreign policy and national security goals.[11]

OFAC generally prohibits U.S. persons from engaging in transactions involving property or interests in property belonging to individuals and entities that are listed on OFAC's Specially Designated Nationals and Blocked Persons (SDN) list.[12] Any transaction with an SDN is referred to as a blocked transaction; these include making loans to an SDN, making investments in an SDN, raising money for an SDN, and facilitating any transaction by a non-U.S. person that would be a blocked transaction if conducted by a U.S. person.

Franchisors based in the United States must conduct searches on the current listings of SDNs to ensure that any potential franchise transaction does not involve these individuals and/or entities. To enter into a blocked trans-

11. OFAC sanctions are applied to targeted foreign countries and regimes; foreign entities and individuals; terrorists; international narcotics traffickers; those engaged in activities related to the proliferation of weapons of mass destruction; and other threats to the United States, its national security, foreign policy, or economy. OFAC violations may result in civil and criminal penalties, including imprisonment.

12. *Specially Designated Nationals and Blocked Persons List (SDN)*, U.S. DEP'T OF TREASURY, Mar. 14, 2017, \https://www.treasury.gov/resource-center/sanctions/SDN-List/Pages/default.aspx (last visited at Mar. 16, 2017).

action, a franchisor must apply for an OFAC license, which OFAC issues on a case-by-case basis, in limited circumstances.

B. *Foreign Corrupt Practices Act*

The Foreign Corrupt Practices Act of 1977 (FCPA) makes it unlawful for certain classes of persons and entities to make payments to foreign government officials to assist in obtaining or retaining business.[13] The FCPA applies to prohibited conduct anywhere in the world and extends to publicly traded companies and their officers, directors, employees, stockholders, and agents. Agents can include third party agents; consultants; distributors; joint-venture partners; and others, including franchisees.

The anti-bribery provisions of the FCPA prohibit the willful use of interstate commerce (whether through mail or by any other means) corruptly in "furtherance of any offer, payment, promise to pay, or authorization of the payment of money or anything of value to any person, while knowing that all or a portion of such money or thing of value will be offered, given or promised, directly or indirectly, to a foreign official" to:

(i) influence the foreign official in his or her official capacity,
(ii) induce the foreign official to do or omit to do an act in violation of his or her lawful duty, or
(iii) to secure any improper advantage in order to assist in obtaining or retaining business for or with, or directing business to, any person.[14]

Since 1977, the anti-bribery provisions of the FCPA have applied to all U.S. persons.[15] Franchisors should be vigilant when asked to make unusual payment arrangements, either to known or unknown parties, or for services to a bank account not located in either the country where the services were provided or the country where the recipient of the funds is located. In addition, the use of shell entities or aliases by the prospective local partner candidate should raise heightened scrutiny of the transaction to ensure that it is not a vehicle or used to hide corrupt payments. In certain countries, especially those in the developing world, which tend to suffer from more corruption than others, bribes may be customarily paid or demanded. When doing business in a country with a reputation for public corruption, franchisors

13. The U.S. Department of Justice (DOJ) and the U.S. Securities and Exchange Commission (SEC) are jointly responsible for enforcing the FCPA. The SEC's Enforcement Division has created a specialized unit to further enhance its enforcement of the FCPA.

14. 15 U.S. Code § 78dd–3(a)(1–2). The Foreign Corrupt Practices Act is available at https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act (last visited at Mar. 16, 2017).

15. With the enactment of certain amendments to the FCPA, specifically the second amendment, also known as the International Anti-Bribery Act of 1998, which was designed to implement the OECD Anti-Bribery Convention, the anti-bribery provisions of the FCPA also apply to "foreign firms and persons who cause, directly or through agents, an act in furtherance of such a corrupt payment to take place within the territory of the United States." *Foreign Corrupt Practices Act*, DEP'T OF JUSTICE, https://www.justice.gov/criminal-fraud/foreign-corrupt-practices-act; *see also* Lucinda A. Low & Timothy P. Trenkle, *U.S. Antibribery Law Goes Global: Standards Tightening Up*, BUS. L. TODAY (July/Aug. 1999), https://apps.americanbar.org/buslaw/blt/8-6antibribery.html.

must be particularly suspicious of any activity that may suggest the paying of any bribes. Local counsel in the target country can provide further details regarding the likelihood of officials or agents demanding or soliciting bribes in particular circumstances.

C. *U.K. Bribery Act*

Franchisors should also be aware of the Bribery Act 2010 (the Act), an act of the Parliament of the United Kingdom. The Act has a near-universal jurisdiction, allowing for the prosecution of an individual or company with links to the United Kingdom, regardless of where the crime occurred.[16]

The Act introduced a new strict liability offense for companies and partnerships that fail to prevent bribery. This places a burden of proof on corporate entities to show they have adequate procedures in place to prevent bribery. It also provides for strict penalties for active and passive bribery by individuals as well as corporate entities. The Bribery Act creates four primary offenses:

- the offering, promising, or giving of an advantage;
- the requesting, agreeing to receive, or accepting of such an advantage;
- the bribery of a foreign public official; and
- the failure by a company to prevent a bribe being paid to obtain or retain business or a business advantage.

In high risk countries, regions, or areas, and in certain businesses that are at a high risk of bribery, it is paramount that franchisors retain a professional investigator not only to check the background of the potential local partner, but also to conduct background checks on any local agents or consultants hired to represent the franchisor locally, instead of relying on a questionnaire completed by prospective agents.

Because the U.K. Bribery Act creates a strict liability corporate offense for failure to prevent bribery (as opposed to vicarious liability), subject to being able to establish that a company has "adequate procedures," a franchisor must also ensure compliance by any "associated persons," which includes anyone who performs services for or on behalf of the commercial organization. As a result, as part of the franchisor's due diligence, it should investigate whether the proposed local partner has any policies and/or procedures in place that could guard against a violation of the Act or other similar legislation.

A franchisor faces the risk of potential liability if its international partner makes improper payments to local government officials to obtain favorable regulatory treatment or other government approvals, a type of conduct

16. The penalties for committing a crime under the Act are a maximum of ten years' imprisonment, along with an unlimited fine, and the potential for the confiscation of property under the Proceeds of Crime Act 2002 as well as the disqualification of directors under the Company Directors Disqualification Act 1986. *Bribery Act 2010*, http://www.legislation.gov.uk/ukpga/2010/23/pdfs/ ukpga_20100023_en.pdf.

that can be common in certain parts of the world. A franchisor should periodically review its local partners' operations and interactions with government officials to ensure that they are not engaging in conduct that might expose the franchisor to possible liability. Such a review will largely consist of interviews of the franchisor's and local partner's employees with potential knowledge of the manner in which the local partner interacts with foreign government officials (for example, customs and tax officials and health inspectors) and, where appropriate, targeted document and email review.[17]

Franchisors must recognize that although their anti-bribery policies and procedures (and those of their prospective franchise candidates) may be compliant with the FCPA, this does not automatically ensure that such policies and procedures are compliant under the Act, and vice versa. Steps must be taken to ensure proper due diligence is undertaken to remain compliant with the various laws and regulations aimed at combatting corruption, bribery, and general fraud in international transactions.

D. *Third Party*

Franchisors conducting business internationally should be aware of the risks posed by third-party relationships of local partner candidates. The federal government is increasingly seeking to impose liability on corporations for the acts of third parties, such as distributors and subsidiaries in the FCPA and other contexts.[18] As a result, it is important that when conducting background checks on potential local partners, the franchisor investigate these third-party arrangements of any candidate.

Under the FCPA, third-party risks are present when a third party (e.g., a distributor or an agent) represents a company in its interactions with foreign government officials. These types of risks do not often arise with vendors and suppliers because they do not act in a representational capacity. For example, a supplier that provides a local partner with vending machine supplies for its employees and that bribes customs officials to transport its products does not act in a representational capacity for a customer-company. The supplier may pay bribes but none of its customers will be subject to FCPA liability for its bribery of customs officials. However, a vendor that ships goods for a specific customer acts as a representative of the customer-company when it bribes customs officials to transport its specialty shipment across country borders. Consequently, FCPA liability could result in that

17. *See* Gregory M. Williams & Robert A. Smith, *Franchisors and the FCPA: Balancing Compliance Risk and Cost Concerns*, IFA INT'L BLOG (Feb. 8, 2016), http://www.franchise.org/franchisors-and-the-fcpa-balancing-compliance-risk-and-cost-concerns (last visited on Mar. 16, 2017).

18. A company may be held liable for the acts of its partners on the theory that the company was willfully blind to the improper payments. Indeed, a majority of the FCPA enforcement actions are based on third-party payments. *See* Gregory M. Williams & Robert A. Smith, *The Federal Government Is Increasingly Seeking to Impose Liability on Corporations for the Acts of Third Parties, such as Distributors, Subsidiaries, and Franchisee*s, IFA INT'L BLOG (Feb. 8, 2016), http://www.franchise.org/franchisors-and-the-fcpa-balancing-compliance-risk-and-cost-concerns.

circumstance. Given the risks involved, when analyzing a local partner's arrangements with third parties and vendors/suppliers, a franchisor should screen and investigate these relationships to mitigate any potential risk.

Finally, vendors and suppliers of a local partner can create real and significant reputational risks for franchisors. Franchisors would be prudent to avoid local partners that have relationships with vendors or suppliers that rely on child labor or engage in human trafficking.[19] In recent years, governments, non-governmental organizations, and the media have increasingly highlighted the role global commerce and the expanding international supply chain have had in proliferating forced and bonded labor across the globe. Real-life examples of modern-day slavery exist in the food we eat, the clothes we wear, and the consumer products we purchase.[20]

E. *Reputational Due Diligence*

A franchisor should research the general business reputation of a potential local partner; several sources are available to assist in this effort, including the following:

- *General business reputation.* A search of foreign news sources media associated with the shareholders, principals, and officers of a company under review is generally available on the Internet; to the extent that such sources are not available online, a franchisor should coordinate local searches for news items with local counsel, local investigators, and the local partner.
- *Social media.* To the extent available, searches should be made of the individual local partner or its franchisee entity as well as its principal shareholders and officers on various social media, such as Facebook, Twitter, LinkedIn, etc. If a company account does exist, franchisors should request a list of all such social media accounts, as well as details on who is responsible for such accounts and who has access to them, and any policies and procedures regarding what can be posted to such social media outlets. A franchisor should also discover what social media and press have to say about the potential local partner and assess, if necessary or depending on the service or product the franchisor sells, whether the prospective local partner's social media presence is sufficient.
- *Criminal records.* Each target country has varying laws about the type of criminal records that are available and who is allowed to access them.

19. On March 26, 2015, the United Kingdom's Modern Slavery Act 2015 became Europe's first legislation tackling such modern day labor issues as child, forced, and bonded labor. The Act introduced measures compelling United Kingdom companies to disclose their efforts to combat modern day slavery in their supply chains. Similar legislation was enacted in California, but no U.S. federal legislative measures have gained traction. *See* California Transparency in Supply Chains Act, CAL. CIVIL CODE § 1714.43 (2012).

20. FORCED LABOUR IN THE GLOBAL ECONOMY (Genevieve LeBaron & Neil Howard, eds. 2015), http://cameronthibos.com/bts/BTS-2-Global-Economy.pdf.

Each target country also has its own discrimination laws that govern how a third party may use the information within a criminal record. Some countries, for example, will let employers turn down applicants only if their criminal history prohibits them from working with vulnerable populations, such as children. To assist in the aspect of the reputational due diligence, a franchisor should be aware that the U.K. government has compiled a list of target countries and their processes for getting a criminal background check on someone who lives or has lived in the target country.[21]

- *Civil Lawsuits.* A franchisor should aggressively try in its reputational due diligence to discover, to the extent possible, whether a local partner has been a recurring defendant in civil lawsuits. An individual with an extensive history of being accused of having committed fraud, misrepresentations, or other actions relevant to its trustworthiness is not the type of local partner with whom a franchisor wants to enter into business. A franchisor should make all efforts to solicit the help of local counsel in its examination of its prospective local partner.
- *Reference checks.* Fortunately, checking international references is more straightforward. A franchisor can contact each reference that a franchise applicant has listed and ask questions about the applicant's background, character, and competency. The franchisor may need to use a translation service if the reference does not speak the same language as the franchisor.
- *Other resources.* Other areas for investigation by the franchisor include the regulatory action history of local partners. Again, the availability of this information may be analyzed by local counsel in the target country or obtained directly from the local partner via a questionnaire or interview.

F. *Financial Due Diligence*

A franchisor should research the available financial information of a potential local partner; several sources are available to assist in this effort, including the following:

- *Credit reports.* As with international criminal records, getting an international credit report on an individual can be tricky.[22] Each target country has its own way of reporting credit,[23] debt, and responsibility. In addi-

21. *See Criminal Records Checks for Overseas Applicants*, U.K. Home Office, https://www.gov.uk/government/publications/criminal-records-checks-for-overseas-applicants.

22. See *How Do Credit Scores Work in Other Countries?* Huffington Post.com, The Blog (July 31, 2012, 1:48 PM), http://www.huffingtonpost.com/creditcom/how-do-credit-scores-work_b_1723362.html.

23. See Erin El Issa, *Will My Credit Score Follow Me if I Move to Another Country?*, Nerd Wallet.com (Aug. 8, 2016), http://www.nerdwallet.com/blog/tips/credit-score-canad-move-expat-country-abroad/.

tion, many target countries have privacy laws about who can review credit reports. Franchisors will have to contact each credit reporting agency to determine whether they can access this information.[24]

- *Bankruptcies*. A franchisor should try to find records, if any, of a prospective local partner's former bankruptcies or tax liens. Access to bankruptcy search engines, such as Pacer in the United States or Canada's Bankruptcy and Insolvency Records Search, can assist a franchisor in such financial due diligence.
- *Other information*. Although it is not always possible to obtain the following, a franchisor should make an effort to review: personal financial statements, business financial records, bank statements, tax records, source of funds, capitalization table, annual budgets, plans and projections, all auditor's and management letters, accounting policies, receivables, inventory, and equipment.

IV. Conclusion

Conducting cross-border due diligence on the business environment of the target market as well as the local legal issues remains a vital part of a franchisor's decision to enter a new jurisdiction. A thorough investigation of the background of the proposed local partner, area developer, or joint venture partner is just as important. International background checks on prospective local partner candidates will likely be more expensive, take longer, and yield less information than the same effort would produce in a domestic context. Given the scarcity of resources in many markets, it is prudent to allow for more time to complete the due diligence process and also be transparent with the prospects with regard to the due diligence process and what is expected of them. To the extent that public sources are limited, a franchisor should be prepared to ask local partner candidates to produce a number of documents related to the due diligence exercise, including copies of passports or national identification cards, address history, and evidence of citizenship, to name a few items. Franchisors should also be prepared to ask the local partner to provide references for additional potential references and create a questionnaire for the prospect. Given the length of the process and the franchisor's probable need to rely heavily on information provided by the candidate, a franchisor should consider taking the due diligence in phases so as not to overwhelm the prospect with requests. To the extent a franchisor's inquiries do not reveal a depth of information, the franchisor may have to cover a broad range of topics in a shallow fashion and make the most of the information provided, recognizing that cross-border due diligence is a difficult exercise that may not yield the same results as a domestic investigation.

24. *How Do Credit Scores Work in Other Countries*, *supra* note 22.

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