THE UNWELCOME PHONE CALL – RESPONDING TO REGULATORY AUDITS & INVESTIGATIONS

Christopher A. Nowak
Wyndham Hotel Group, LLC
Parsippany, NJ

Eric L. Yaffe
Gray Plant Mooty
Washington, DC

October 18-20, 2017
Palm Desert, CA

©2017 American Bar Association
Table of Contents

I. INTRODUCTION ......................................................................................................... 1

II. METHODS BY WHICH GOVERNMENT SEEKS TO OBTAIN INFORMATION .......... 1
   A. Informal Requests for Information ................................................................. 2
   B. Administrative Subpoenas ........................................................................... 3
   C. Civil Investigative Demands ...................................................................... 4
   D. Grand Jury Subpoenas ............................................................................... 5
   E. Search Warrants ...................................................................................... 6

III. CONSIDERATIONS FOR FRANCHISORS ................................................................. 7
   A. Setting Up Appropriate Policies and Procedures ......................................... 7
   B. Key Considerations .................................................................................. 8
      1. Whether Outside Counsel Should Be Hired ........................................... 8
      2. The Hiring of Subject Matter Experts ................................................... 9
      3. Insurance Coverage ........................................................................... 9
      4. Litigation Hold Letters ....................................................................... 9
      5. Disclosure to Relevant Parties ............................................................. 10
      6. Public Relations .............................................................................. 10

IV. THE INTERNAL INVESTIGATION .............................................................................. 11
   A. Compliance Programs ........................................................................... 11
   B. Response to Subpoenas or Other Information Requests .......................... 12
C. Interviews of Witnesses .......................................................................................... 14
   1. Upjohn Warnings .......................................................................................... 15
   2. Joint Representation of the Franchisor and Individuals ......................... 16
   3. Joint Defense/Common Interest Arrangements ........................................ 17

V. DEALING WITH THE GOVERNMENT .................................................................. 18

VI. INVESTIGATIONS SPECIFIC TO FRANCHISING ............................................. 20

VII. SPECIAL CONSIDERATIONS IN INVESTIGATIONS OF FRANCHISEES .......... 22

VIII. CONCLUSION .................................................................................................... 23
THE UNWELCOME PHONE CALL – RESPONDING TO REGULATORY AUDITS & INVESTIGATIONS

I. INTRODUCTION

You are the general counsel of a medium-sized fast casual restaurant franchise concept. It has been a typical day at the office, and you are leaving to go home. As you head out of the building, you notice two federal agents with badges at the reception area, and you approach them to inquire whether they need help. They pull out grand jury subpoenas for testimony and documents from you and the company, requiring that you and the company testify in two weeks, and, at the same time, produce documents concerning potential immigration issues at certain corporate and franchised locations of your company. They serve the subpoenas on you. You have never been served with grand jury subpoenas before. After the initial shock you head back to your office, drink a tall glass of water, slouch back in your chair, and start thinking about what to do.

This situation is not unusual. The federal government has greatly increased its resources over the years to combat civil and criminal white-collar matters, creating greater exposure than ever before for companies and their higher-level employees. In the franchise world, we have seen government inquiries concerning alleged wage and hour violations, tax fraud, food and health safety issues, occupational and health administration issues, immigration fraud, health care fraud, import and export control issues, data security and privacy, consumer protection, and many other matters. In this paper, we review the various methods typically utilized by the government in their investigations of potential wrongdoing, and how franchisors and franchisees should respond if they are the subject of a government investigation. Although much of this paper focuses on responses by franchisors to government investigations, many of the matters discussed apply equally to franchisees that are the subject of an investigation. In addition, Section VII discusses special considerations for franchisors when their franchisees are under investigation.

II. METHODS BY WHICH GOVERNMENT SEEKS TO OBTAIN INFORMATION

An investigation commences when the government has sufficient predication indicating that a civil or criminal violation of the law may have occurred. Predication can take various forms. It can come from a newspaper article, a tip from a whistleblower, information from a witness who observed an act taking place, the government’s own observation of events, consumer complaints, or a variety of other means. Once the government believes that civil or criminal wrongdoing may have occurred, one or more government agencies or entities with jurisdiction may investigate the matter. Jurisdiction may vest with the federal government, state government, or both, and within the government a single agency or multiple agencies or entities may have jurisdiction. For example, while the U.S. Food and Drug Administration may investigate an outbreak of food-borne illnesses emanating from certain corporate and franchised restaurant locations, the U.S. Senate Committee on Health, Education, Labor, and Pensions

---

1 This paper focuses on investigations conducted by federal government lawyers and agents. The methods used by state investigators in conducting investigations are generally similar to those used by federal investigators, and many of the principles applicable to responses to federal investigations apply to responses to state investigations. The laws, regulations, and methods utilized by state investigators can, however, vary from state to state, and thus lawyers representing companies and individuals subject to a state investigation should familiarize themselves with the nuances of that state’s laws and procedures. For a discussion of state investigations specific to franchising, see Section VI, infra.
may also choose to conduct its own investigation. When parallel investigations take place, this creates further complications for the entity that may be the subject of the investigations.

A. Informal Requests for Information

The government has a number of tools in its investigative toolbox. In the first instance, the government may make an informal request for information through a letter or even a telephone call. Although it is often wise for companies to fully cooperate with the government and provide the information requested, there is no legal requirement for them to do so. The company should carefully consider whether it is in its best interests to comply with the government’s request. If the government requests information that is typically kept private and confidential, such as customer information, there may be reason not to cooperate. In fact, cooperation in such an instance could lead to lawsuits by those whose information has been divulged. Similarly, the company may not want to provide trade secret, strategic, or other classified information to the government.

There are ways to still project a cooperative tone with the government, even while resisting its informal request for information. You could request that the government issue a subpoena to the company, which would compel the company to produce the information but insulate it from the potential liability that could result from disclosing the information voluntarily. You could also negotiate a confidentiality agreement with the government that would protect the company’s trade secret or other sensitive information from disclosure. Be aware, however, that there are times when a government request for information may be emergent. A robbery and violent crime has taken place in one of your franchised hotels and the police need customer information immediately. A customer has become violently ill after eating food at one of your franchises and was rushed to the hospital, and the authorities need the credit card receipt immediately to obtain critical identifying information. In these situations, you may determine that you need to cooperate with the authorities right away, and then ask them to follow-up with a formal subpoena for the information as soon as possible.

Voluntary cooperation can also occur in the form of interviews. Typically, government agents will knock on the door of an employee’s home early in the morning or late in the evening, seeking to interview her. This scenario occurs frequently and is fraught with danger for the employee and the company. The employee is usually not represented by counsel, has no true idea of the nature of the government’s investigation, and is often unaware that the interview can and will be used against her and/or the company and other employees.

In this situation, the government’s goal is to catch the employee unaware and before she has obtained counsel. The government believes it is more likely that the witness will fully cooperate and provide full information if she is unrepresented. While there may be some truth to the government’s position, many individuals are unaware that their words can easily be twisted by the government, that the precision of their statements can be critically important, and that if they guess or speculate in response to a question, the government may still take their statements as factual and, if later proven untrue, could prosecute them for obstruction of justice or making false statements to a government agent. Accordingly, it is usually wise for an individual whom the government seeks to interview to respectfully decline to be interviewed, retain counsel, and then determine with counsel whether an interview is in her best interests.
B. Administrative Subpoenas

Administrative subpoenas allow executive branch agencies to issue compulsory requests for documents or testimony without prior approval from a grand jury, court, or other judicial entity. They do not ordinarily require probable cause and consequently can be used at the outset of an inquiry for the purpose of gathering information to further a government inquiry or investigation.

Because administrative agencies are statutory creations, a statute must authorize the issuance by the agency of administrative subpoenas. Congress has granted administrative subpoena authority to most federal agencies. The Inspector General Act of 1978\(^2\) is the single most significant source of administrative subpoena power, but there are now over 300 instances where federal agencies have been granted administrative subpoena power of one kind or another, giving the agencies broad power to use subpoenas to investigate wrongdoing by individuals and companies that fall under their purview.\(^3\) Statutes governing administrative subpoenas ordinarily describe the circumstances under which an agency may exercise its subpoena authority, the scope of authority, enforcement procedures, and sometimes limitations on dissemination of the information subpoenaed. Most agencies with statutory administrative subpoena authority also have a structured protocol of issuance in place, requiring pre-approval from various agency officials on the propriety of issuance based on scope, necessity, and other considerations.\(^4\) The recipient of an administrative subpoena for documents is typically given thirty days to respond to the subpoena.

Federal agencies depend upon U.S. district courts to enforce administrative subpoenas. Those courts, however, must enforce an agency’s subpoena authority unless the evidence sought by the subpoena is “plainly incompetent or irrelevant to any lawful purpose of the [requesting official] in the discharge” of his or her statutory duties.\(^5\) The majority of statutes authorizing administrative subpoena enforcement in federal district court authorize the court to impose contempt sanctions when a recipient continues to refuse to comply even after a court order of compliance.

Administrative subpoenas can be extremely expensive and disruptive for the person or entity to whom they are addressed long before the thresholds of overbreadth and oppression (the point at which a subpoena will not be enforced) are reached.\(^6\) For example, in October 2015, McDonald’s Corporation asked a district court judge to reject an administrative subpoena issued by the National Labor Relations Board (NLRB). The case involved the NLRB’s claim that McDonald’s was a joint employer of franchise workers, and the subpoena stemmed from already-discovered evidence suggesting that McDonald’s may have exerted control over the


\(^6\) See, e.g., In re Grand Jury Proceedings, 115 F.3d 1240, 1244 (5th Cir. 1997).
working conditions of its franchise employees. The subpoena sought emails and other documents from more than fifty McDonald’s executives and employees who worked directly with franchise owners. The subpoena also sought information on McDonald’s opposition to union-supported nationwide protests advocating a $15 minimum hourly wage for fast food workers, a fact that the NLRB believed could indicate a joint employment relationship.

In its opposition to the NLRB’s motion to compel, McDonald’s argued that the subpoena was unfair, costly, and burdensome, pointing out that it already had spent more than $1 million over a few months producing over 160,000 pages of documents in response to the subpoena. McDonald’s paid this amount to comply with the NLRB’s subpoena even though McDonald’s asserted that it would owe no more than about $50,000 if it were found liable for alleged labor violations at twenty-nine franchises in five states. Nevertheless, the district court judge ordered that the administrative subpoena be enforced in full, with minor exceptions.

C. Civil Investigative Demands

Another common way by which some federal agencies obtain information in connection with civil investigations is through civil investigative demands (CIDs). CIDs can be used to obtain documents, answers to interrogatories, and to obtain witness testimony through depositions.

CIDs are commonly used by the government to investigate false claims. These are instances in which an individual or company has submitted a false claim to the government and, as a result, has wrongfully obtained monies from a government payer. Any franchisor or franchisee that produces goods or provides services to the government, or utilizes the government’s Medicare or Medicaid programs for reimbursement for health care services, must be sure not to run afoul of the False Claims Act.

CIDs may take the form of subpoenas that require the recipient to produce documents. Such subpoenas typically provide a return date of twenty days. They are often quite comprehensive and intrusive, and may require the individual or company to provide many thousands of pages of documents. The subpoenas include the nature of the government’s investigation, the investigative agency, the date of the subpoena, and the name of the investigative agent. The subpoena will also usually set forth the form in which the government wants the documents, including electronically stored information. The recipient of the subpoena has a limited time—to typically no more than twenty days—to seek to quash, modify, or limit the scope of the subpoena by filing an appropriate motion in court.

7 NLRB v. McDonald’s USA LLC, No. 1:15-mc-322-P1 (S.D.N.Y. 2015).
8 CIDs are a type of subpoena that allows government agencies to demand information from targets of investigations. The information provided by targets may be in the form of documents, answers to interrogatories, or deposition testimony. An example of an agency rule, from the Federal Trade Commission, that provides for civil investigative demands, can be found at 16 C.F.R. §§ 3729 et seq. (West 2017).
11 See, e.g., Federal Trade Commission rules regarding investigations at 16 C.F.R. § 2.10 (West 2017); Consumer Finance Protection Bureau rules at 12 C.F.R. § 1080.6(e) (West 2017).
12 See, e.g., 16 C.F.R. §§ 2.6, 2.7 (West 2017); 12 C.F.R. §§ 1080.6, 1080.7 (West 2017).
13 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6(e) (West 2017).
Alternatively, or in conjunction with a document subpoena, a civil investigative demand may include interrogatories and require the recipient to produce answers within a set period of time. The questions are often quite broad and can require a considerable amount of time to be answered. Again, the questions may be objected to by a proper filing in court, but failing to do so before the time to answer may constitute a waiver of the right to object.

Finally, CIDs may include notices for the testimony of witnesses. The government is authorized to seek the testimony of the witness within as few as seven days from the date of the issuance of the notice, and the notice can call for the deposition to take place wherever it is convenient for the government. There is no limit on the number of witnesses whom the government may notice for their testimony. A CID can be a highly effective means for the government to obtain information relevant to its investigation.

D. Grand Jury Subpoenas

The government uses the grand jury as a tool to investigate potential criminal conduct and, when appropriate, to bring criminal charges against individuals and corporations. Federal grand juries are comprised of up to twenty-three individuals, a vote by twelve being necessary to indict (a true bill). If fewer than twelve persons vote for the person or company to be charged, there is no indictment (no bill).

Grand jury subpoenas for the production of documents are common in criminal cases. A motion to quash or modify the subpoena may be filed in federal court. Otherwise, all non-privileged documents must be produced. In rare instances, an individual may claim that the production of the documents themselves may implicate him in criminal activity, and thus he should not have to produce the documents. In such instances, the individual will seek what is known as act of production immunity.

Grand jury subpoenas may also seek the testimony of the individual served. The individual is required to appear at the courthouse or other designated location to testify before the grand jury. The court reporter, witness, prosecuting attorney or attorneys, and federal agents are the only individuals, besides the grand jurors themselves, who are allowed inside the grand jury room during questioning. Counsel for the witness is not permitted inside the grand jury room and cannot interpose objections, although counsel may sit outside the grand jury room, and the witness can take a break to talk to her attorney if she needs to do so. The grand jurors are usually given an opportunity to ask questions during or after the prosecutor’s examination. The witness is not entitled to receive a copy of her transcript, although the prosecutor may permit her to review the transcript before trial. The government and grand

---

14 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6(a)(3) (West 2017).
15 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6 (West 2017).
16 16 C.F.R. § 2.7 (West 2017); 12 C.F.R. § 1080.6 (West 2017).
19 That is, an individual may assert her Fifth Amendment right against self-incrimination and refuse to produce documents. See, e.g., Fisher v. United States, 425 U.S. 391, 400 (1976).
E. Search Warrants

The government may apply to a federal magistrate or federal district court judge for a search warrant. The judge will issue the warrant if, upon review of the government’s affidavit in support of the warrant, the judge finds probable cause to believe that the warrant will uncover evidence of criminal activity.

Search warrants can be quite broad in scope and may allow the government to search a company’s files, computers, desks, and other areas where information may be stored. The government must provide a copy of the warrant to a responsible person within the organization, if possible, before conducting the search. They must also leave a copy of a list of the inventory they have taken upon leaving the premises. Search warrants are quite serious, even if the company itself is innocent of any criminal conduct, and can be very disruptive of a company’s business and employee morale. If a company is served with a search warrant, it is important that it immediately do the following:

1. Determine who within the organization will be the point person for questions and any issues that may arise. If possible, this should be determined as a matter of company policy ahead of time;

2. Immediately contact outside or in-house counsel, as appropriate;

3. Identify and obtain the contact information for the government agent in charge. Ask the agent for copies of the search warrant and the affidavit in support of the warrant. This will provide you with information about the scope of the items that the government is allowed to seize and the nature of the government’s investigation;

4. Identify whether it is a state, federal, or joint investigation and the agencies involved;

5. Ask the agent to seal the premises and delay the search until the company’s attorney arrives. If the agent refuses, monitor the search vigilantly but do not attempt in any way to obstruct or impede the search;

6. Ask the agent not to interview any employees until the company’s attorney arrives. If agents insist on questioning employees, inform them that they have a choice to either answer or to refuse to answer any question posed to them by the agents. The search warrant does not give them the legal right to interrogate employees;

7. Do not tell employees that they should not answer an agent’s questions. This may be seen as obstructing justice;

---

8. Send all nonessential employees home and advise the agent that you are doing so. The agent does not have authority to detain the employees, but may ask for employees’ contact information;

9. Ensure that, prior to any employees leaving, you have the following:
   i) Keys to the offices, desks, file cabinets, safes, and lockboxes covered by the scope of the search warrant (agents may force locks in order to examine physical areas covered by the warrant); and
   ii) The ability to access and copy computerized data;

10. Do not attempt to remove, destroy or hide company property or materials;

11. Advise the agent of any paper or electronic documents that are critical to your ongoing business operations. Ask the agent to copy or take mirror images of those documents so that you can retain a version of each of them. Also request that the agent make copies at your facility of all documents seized or make copies as soon as possible and provide these copies to you;

12. Advise the agent if you believe that any of the materials seized are privileged;

13. Record the search in progress with a video or still camera (not audio), if possible. Take notes of your conversations with the agent, and of any activity or actions, including items seized that might appear to go beyond the scope of the warrant;

14. The company’s data processing or information technology team can assist the agents in accessing the computerized information, but they do not have any obligation to interpret the data for the agents;

15. Consult with your attorney or your in-house or outside public relations personnel about issuing a press release or statement. Government execution of search warrants and seizure of information are often reported in the media; and

16. Send a litigation hold letter (see Section III.B.4 below) to all employees to ensure that all materials that relate to the government’s investigation are retained and not destroyed.

The government may ask the company to consent to the search. The company should not do so. If the company consents to the search, it will be waiving its right to challenge the scope and other aspects of the search at a later date.

III. CONSIDERATIONS FOR FRANCHISORS

A. Setting Up Appropriate Policies and Procedures

Franchisors and multi-unit franchisees should have policies and procedures in place in anticipation of a government investigation. Having procedures in place helps smooth the process when a government inquiry comes in, prevents inconsistencies in the handling of government investigations, and reduces the level of anxiety management and employees feel when having to respond quickly to government requests. The policies and procedures need not
be complex, but rather should provide general guidance to management and employees in the event of a government inquiry.

At a minimum, the policies and procedures should include the person or persons within the company who will be responsible for responding to government inquiries and their contact information; the name and contact information of the company’s primary in-house and outside counsel; and the general procedures for the handling of any government requests. More specifically, the policies and procedures ordinarily should advise employees: 1) to refer any government inquiries to the point persons within the company or in-house counsel; 2) not to provide any documents to the government without seeking guidance from the point person and/or in-house counsel; 3) that they may but need not talk to government agents who seek to ask them questions (and should always make sure they ask the agents for proper identification); 4) that they should not divulge any attorney-client or other privileged communications to the government; 5) that they should highly prioritize any requests from the point persons or counsel that relate to government requests for information; and 6) that the fact of the government investigation and any documents or information that the company is providing is highly confidential and they should not divulge such information to third parties.

B. Key Considerations

1. Whether Outside Counsel Should Be Hired

When the government does come knocking on your door, there are a number of matters for the company to consider. One of the first considerations is whether the company should handle the matter internally or refer it to outside counsel. The answer is, of course, that it depends. Routine or small matters where the company or its employees are not targets of the investigation ordinarily can be handled more cost effectively and efficiently by in-house counsel, and outside counsel may not be needed. Similarly, matters in which there is deep in-house expertise, and where in-house counsel has the internal resources to handle the matter, may not require outside counsel.

On the other hand, there are many instances where it is prudent for the company to retain outside counsel to assist it in responding to a government investigation. If the company or its employees are the subject or target of the government’s investigation, the company may have a conflict of interest if it were to try to respond to the government’s inquiries on its own. Moreover, in such circumstances, the government may not trust the company to provide it with reliable and accurate information. Outside counsel will generally be perceived by the government as more neutral and trustworthy in these situations. Further, if the matter is serious, outside white collar counsel who has dealt with the government in the past and is familiar with the type of investigation being conducted will be able to provide the company with critical guidance throughout the process and may be able to limit the company’s exposure.

Depending on the nature of the government’s investigation, the company may not be the only one that needs counsel. If the company’s decisions or actions are being questioned, and are the source of the alleged wrongdoing, the company’s managers or executives may need counsel. As a threshold matter, the question is whether the company’s counsel can and should represent the managers and executives as well. If the possibility exists that the company’s
position will be adverse to the position of the managers or executives, it may be wise to recommend that the employees retain their own counsel.\textsuperscript{24}

The company’s employees may request that the company pay for the attorneys they retain. In the first instance, whether the company is required to pay for the employees’ attorneys depends upon the company’s by-laws, operating agreement, and/or policies and procedures. Even if the company’s policies do not require the company to pay for its employees’ counsel in government investigations, state indemnification laws may require the company to pay for its employees’ counsel, and thus it is important for the company to review the law on indemnification in its state.\textsuperscript{25}

2. \textbf{The Hiring Of Subject Matter Experts}

In addition to hiring counsel, the company may need to hire consultants or subject matter experts in order to respond appropriately to the government’s requests and otherwise properly respond to the issues raised by the government. For example, if the government decides to investigate the company’s food distribution channels due to an E. coli outbreak that has caused many of the company’s customers to become sick, the company may need to hire an expert familiar with E. coli. If a franchisor becomes the subject of a government investigation due to a breach of its computer system leading to the theft of information on its customers, it may need to hire a data security expert. It is important for the company to ensure that it can thoroughly and accurately respond to government requests, and to understand that, in certain instances, this will require the company to hire subject matter experts. To protect the confidentiality of communications with the expert, the company should consider retaining the expert through outside counsel.

3. \textbf{Insurance Coverage}

The cost for the company to appropriately respond to a government investigation can be daunting. There may be thousands of documents to be reviewed, employees to be interviewed, legal research to be done, meetings and conferences with the government, white papers or other submissions to the government, and other costs. Accordingly, the company should closely review its insurance policies to determine whether insurance will cover the cost of the company’s response to the investigation as well as the fines, penalties, or other assessments the company may eventually be required to pay. In addition, the company’s directors’ and officers’ insurance policies may cover the cost of their individual responses and defenses, and thus, those policies should be carefully scrutinized as well. It is important that the company send a demand letter to its insurance company soon after it is on notice of the possible claims so that it does not waive its right to insurance coverage.\textsuperscript{26}

4. \textbf{Litigation Hold Letters}

When the company receives a subpoena, or other government demand or request, it is then on notice of the possibility of pending or potential litigation. At that juncture, it is important that the company send out a litigation hold letter to all employees who may have information

\textsuperscript{24} See \textit{Model Rules of Prof’l Conduct} R. 1.7 (2013).


\textsuperscript{26} See \textit{MBIA Inc. v. Fed. Ins. Co.}, 652 F.3d 152, 166-67 (2d Cir. 2011).
bearing on the government’s inquiry. The letter should specify, in sufficient detail, the
documents and information that the employee should retain based upon the government’s
subpoena or other request. The letter should include a description of the investigation matter,
explain that all information in the employees’ possession must be retained and not be deleted,
altered, modified, or destroyed, and that the company’s usual document retention policies in
connection with the subject matter will be suspended pending further notice. The letter should
also identify the person within the organization to contact in the event the employee has any
questions.

It is critical that litigation hold letters be sent out on a timely basis. Failure to preserve all
relevant evidence can lead to sanctions, including an adverse inference at trial against the
company (that the records would have yielded information adverse to the company’s interests),
financial penalties or, in the most egregious circumstances, a default judgment against the
company. Further, it is not enough for the company to send an appropriate letter to its
employees. The company must follow-up thereafter to remind the employees of their
obligations, and to ensure compliance with the letter. Such follow-up may include written
communications or face-to-face meetings in which the need for compliance with the litigation
hold letter is re-emphasized.

5. Disclosure to Relevant Parties

A government investigation can have major repercussions for the company and those
doing business with it. It is important that the company immediately notify key constituents in
connection with the company’s response to the investigation. To that end, the Board of
Directors and, if the company has one, the Audit Committee, will need to be informed at the
outset of the nature and scope of the government’s investigation. The company may also be
required by contract to notify others, including insurance companies, vendors, and customers.
Depending upon the seriousness and nature of the investigation, at some point all shareholders
or owners of the company will need to be notified as well.

6. Public Relations

Depending on the nature and scope of the government’s investigation, the investigation
could become public. Controlling the message in the press may be important to the company
inasmuch as whether the public perceives the company as a good corporate citizen, to be guilty
of wrongdoing, or to be responding appropriately to questions about its conduct, may affect
the company’s short and long-term prospects. Accordingly, it is important for the company, early
on, to develop a plan to handle press inquiries and, if necessary, to develop press releases and
other pro-active messaging. The company’s own in-house communications department may be

27 Zubulake v. UBS Warburg LLC, 229 F.R.D. 422, 437 (S.D.N.Y. 2004) (the court granted an adverse inference
instruction to the jury regarding the discovery misconduct and imposed financial penalties); In re: Prudential Ins.
Co. of Am. Sales Practices Litig., 169 F.R.D. 598, 616-17 (D.N.J. 1997) (lack of a document retention policy and
failure to preserve evidence resulted in $1 million sanction); Metro. Opera Ass’n v. Local 100 Hotel Emp. and
Rest. Int’l Union, 212 F.R.D. 178, 222-31 (S.D.N.Y. 2003) (the court granted plaintiff’s motion for judgment as to
liability and additional sanctions of attorneys’ fees associated with the defendants’ discovery misconduct).

20, 2014). This case involved a shareholder who brought a complaint seeking to compel the board of directors of
Wyndham Worldwide Corporation to bring a lawsuit on the company’s behalf. The court dismissed the
complaint. Mr. Nowak, a co-author of this paper, is the Executive Vice President and General Counsel of
Wyndham Hotel Group, LLC, a brand of Wyndham Worldwide Corporation.
able to create an appropriate communications plan. Many franchisors and multi-unit franchisees, however, do not have in-house communications expertise and will need to hire an outside public relations firm to assist it. In either case, the company's communications team should work closely with the legal team to make sure that all messages and press releases are consistent with the company's legal approach.

IV. THE INTERNAL INVESTIGATION

Whether the government’s investigation is criminal or civil in nature, in most instances the government will provide the company with an opportunity to conduct its own internal investigation and convince the government that it is not liable or guilty of wrongdoing or, alternatively, that it should not receive a stiff penalty for the alleged wrongful conduct. The company’s level of cooperation, its truthfulness, and its ability to conduct a thorough and skillful internal investigation will often have a significant impact on the government’s decision as to whether, and to what extent, it should seek to penalize the company for the alleged wrongdoing, and may impact the sentence imposed on the company in a criminal case.29

As a threshold matter, the company needs to decide whether to cooperate. In most instances, it will behoove the company to fully cooperate with the government because the government may well be able to obtain the information it needs through other sources, and because cooperation will likely lead to lesser sanctions than the government might otherwise impose. However, if the government appears to be on a witch-hunt with little or no evidence to support any allegations of wrongdoing or the government’s investigation may unearth highly sensitive or confidential information or otherwise greatly disrupt the company’s business, the company may choose not to cooperate. The company will still have to abide by all court orders and formal processes, but the company may choose not to turn over any information to the government that is not compelled by subpoena or other court order.

A. Compliance Programs

Counsel should assess the company’s compliance program in connection with the matter being investigated, and determine whether the program was being executed appropriately. A strong compliance program can be useful in trying to stave off or minimize the effects of a government investigation. Let’s say, for example, that you are an international franchisor in the business of selling automotive parts. Your franchisee in Peru is accused of paying a large bribe to a government official in order to secure permits for a prime real estate location in Lima. Your field representative in Lima was allegedly involved in setting up the transaction. The U.S. Department of Justice Civil Fraud Division has opened up an investigation to determine whether the company and its franchisee have violated the Foreign Corrupt Practices Act (FCPA). The FCPA prohibits the intentional offering of something of value to a foreign official in exchange for a business opportunity or advantage.30

An initial question for the franchisor is whether it has a robust FCPA compliance program. If the franchisor is conducting international business that involves the shipment of goods into foreign countries, the securing of real estate locations in those countries, or other matters that may involve touch points with foreign government officials, having a strong FCPA compliance program is important. When determining whether to assess penalties against the

company, the government will consider whether the company has policies prohibiting the violation of the FCPA; whether the Board or upper management has set the right tone for compliance with the FCPA and other laws; whether there is anticorruption language in the company’s agreements with its franchisees, vendors, and others; and whether it provides training to its employees on how to comply with the act.\textsuperscript{31} If the company has a compliance program that it takes seriously and vigorously attempts to enforce, a one-time violation may lead to a small sanction or perhaps no sanction at all. If, however, the company has no FCPA compliance program or has a program on paper but one that it does not execute or enforce, the government is likely to be far less sympathetic. The penalties can be severe.\textsuperscript{32}

The FCPA is but one example of an area in which a franchisor may be wise to have a strong compliance program. The areas where compliance programs are needed will vary from franchisor to franchisor. For some, health care regulatory compliance programs will be important, while for others food safety, financial data security and privacy, or environmental compliance programs will be important. Strong compliance programs are important because they can prevent wrongdoing or liability from occurring in the first place and, should the company or its employees engage in prohibited conduct, greatly increase the likelihood that the government will not impose significant penalties.

\textbf{B. Response to Subpoenas or Other Information Requests}

A robust compliance program, while extremely helpful, is rarely enough. The government will still want to make sure that the company has not engaged in intentional wrongdoing, and will conduct an investigation to determine whether that is the case. Accordingly, even if the company has an effective compliance program that is recognized as such by the government, it is likely that the company will, at a minimum, receive a subpoena or other request for information from the government and that the government will take any other investigative steps it deems prudent to ensure that it reaches an appropriate result.

When a request for information from the government is received and the company intends to fully cooperate, there are several things to consider. First, it is important for in-house or outside counsel to introduce themselves to the agent who has requested the information. The relationship that you develop with the agent and/or prosecutor is critically important as the investigation proceeds. Counsel should establish a relationship built on trust. If at any point the government no longer trusts counsel for the company, the government will be more apt to pursue its investigation aggressively and on its own without relying on input from the company’s counsel. On the other hand, if the government trusts the company’s counsel, counsel can have a substantial and continuing influence on the government’s investigation.

The company should carefully and thoroughly review the subpoena or document request. The document will likely contain detailed definitions and instructions, including the date by which the government expects the documents to be produced; the way in which electronically stored information should be produced; and whether the company can produce charts or other listings of information in lieu of original documents.

Counsel assisting in the investigation should learn as much as possible about the case from the agent or prosecutor, which will inform counsel as to the types of documents in the

\textsuperscript{31} \textit{See}, \textit{e.g.}, CRIMINAL DIV., U.S. DEP’T OF JUSTICE & ENFORCEMENT DIV., U.S. SEC. & EXCH. COMM’N, A RESOURCE GUIDE TO THE U.S. FOREIGN CORRUPT PRACTICES ACT (2012).

company’s files that will assist the government in its investigation, enabling counsel to attempt to narrow the scope of the subpoena or document request. Because the government may be largely unfamiliar with the company’s files and recordkeeping, its document requests are often extremely overbroad and burdensome. Competent counsel can work with the government to attempt to narrow the subpoena to areas in which the government is truly interested, which will allow the company to more efficiently and cost-effectively respond to the requests.

Although the return date on the subpoena is often unreasonably short, most government agents and prosecutors are willing to extend the return date, especially when the number of responsive documents is likely to be large. At times, the government may request a rolling production of documents, allowing the company to produce documents in response to some of the queries earlier and produce others at a later date. Extending the subpoena’s return date can be critically important to the company. Often, considerable time will be needed to review all of the documents for relevance and privilege. Having time to review the documents is often a helpful means for you and the company to ensure that you can learn the extent of the company’s exposure and what defenses to the government’s claims may be available.

It is important that responsive documents be collected carefully and thoroughly. A failure to do so can cause legal problems for the company, including the possibility of claims of obstruction of justice. A plan should be developed early on for the proper collection of all documents. Paper documents should be retrieved from all custodians. As to electronically stored information, the company must decide whether it has the in-house capability to search for and collect the documents and, if so, whether its in-house information technology department should be tasked with the project. Alternatively, the company can hire an outside litigation support firm to assist it in the search for and collection of responsive electronically stored information.

It is generally advisable to work with the government to determine the search terms to use to find electronic information responsive to the subpoena. If you fail to do so, and the government is dissatisfied with your document production, the government may ask for a list of the search terms you used and could request that you conduct additional searches. An agreement ahead of time with the government can save your company considerable time and money.

In cases where subpoenas seek large volumes of information, predictive coding can be used in lieu of or in addition to search terms. Predictive coding software utilizes mathematical model programming to review electronic documents and then locate the documents that are relevant to the case. The company’s counsel and their assistants first select a sample of relevant documents. The predictive coding software reviews those documents and then is given a new set of documents to determine which are relevant and should be reviewed. Counsel and their assistants then review the program’s decisions to determine whether they appear to be accurate and acceptable. If so, the program will continue to be used to conduct further searches. If not, the process will be repeated until the program learns how best to determine how to collect relevant documents and an acceptable level of confidence has been achieved.

Once all paper and electronic documents have been collected, it is critical that they be well-organized and prepared appropriately for production. The documents to be produced should be stamped with sequential numbers so that you can keep track of what was produced and can easily discuss them with the government and others. Privileged documents and documents you determine are non-responsive should be maintained in separate files. Keep in mind that should you later find additional responsive documents, they must be produced. You
should make sure to have a written record of all steps you have taken during the process of collecting and producing documents in case you have to re-create those steps at a later time. When producing documents to the government, you should lay out the Bates-stamp range of the documents you are producing; memorialize any agreement you have with the government concerning the narrowing of the subpoena (if you have not communicated with the government about that topic already); and highlight any decisions you have made or issues concerning the documents of which the government should be aware, so that there are no surprises. You want to make sure that there are no misunderstandings between you and the government.

Finally, you should mark documents that contain sensitive, private, or trade secret information as confidential when you produce them to the government. You should also discuss with the government the maintenance of such documents as confidential. There are various statutes and regulations that require the government to maintain the confidentiality of documents produced to it under certain circumstances.33

C. Interviews of Witnesses

In most serious government investigations, counsel will want to interview witnesses within the company—and perhaps people outside the company—to ascertain exactly what occurred. There are a number of reasons for this. Many of the documents that you have gathered may be ambiguous, and witness interviews may be necessary to help you understand the meaning and context of the documents. Witnesses may also help you understand weaknesses within the company that can be corrected so that wrongdoing or liability does not occur in the future. And, of course, interviews of witness can also help you understand exactly what happened, how the alleged wrongdoing occurred, and who was involved. In many instances, the government will ask you to conduct interviews and then disclose, either orally or in a white paper, the results of your interviews and your findings. Despite the folklore, the government does not have unlimited resources, and is often happy to have you assist them in their investigation.

Generally, you will not want to interview witnesses until you have had an opportunity to thoroughly review the documents (although in emergency or time-sensitive matters you may have to interview witnesses early in the process). Reviewing the documents and interviewing witnesses can give you an advantage over the government because the government may not have had the opportunity to review as many documents and talk to as many witnesses as you. This allows you to begin to shape your response to the government early and perhaps influence the government’s thinking as it decides what course of action to take.

The list of witnesses with whom you will want to talk could be extensive. It may include C-suite employees, middle managers, and/or lower level employees. You should set up each interview in a setting that will be comfortable for the witness and not be intimidating. If the interview is being conducted by outside counsel, in-house counsel may or may not want to be present. Sometimes, employees will feel more comfortable and be more open if in-house counsel is not present. At other times, employees may feel more comfortable having a company employee in the room. This is an issue that will need to be discussed prior to the interviews taking place. In any event, it is important that someone other than you be present as a witness to the interview and to take detailed notes of the substance of the interview. Accordingly, in-house counsel or a paralegal or other firm attorney should serve as the notetaker. It is important to have a written record of the interview to, among other things, minimize

any misunderstandings as to what was said and be able to share the information with the government in an organized manner if appropriate. The company should also keep track of the documents used in each interview.

The issue of attorney representation of the witness in the interview may become important. Just as the government prefers to interview individuals without their attorneys present, you may feel the same way. At times, people are more willing to provide more thorough and complete information without counsel present. Nevertheless, at the outset of the interview, it is important that the witnesses clearly understand the purpose of the interview and your role in the process, so that they can make a considered choice as to whether to obtain counsel. If the witness is clearly a target of the government’s investigation, you may want to recommend that the witness retain her own attorney.

1. **Upjohn Warnings**

The Supreme Court has highlighted the importance of a witness in an internal investigation being fully informed as to the nature of the interview. In *Upjohn v. United States*, the Court found that warnings (referred to as Upjohn warnings) should be given to witnesses at the outset of interviews. The warnings should make clear that: 1) counsel taking the interview represents the corporation; 2) the communications with the employee are privileged; and 3) the privilege is held by the corporation, not the employee. The American Bar Association suggests that the following Upjohn warning be given:

I am a lawyer for Corporation A. I represent only Corporation A, and I do not represent you personally. I am conducting this interview to gather facts in order to provide legal advice for Corporation A. This interview is part of an investigation to determine the facts and circumstances of X in order to advise Corporation A on how best to proceed. Your communications with me are protected by the attorney-client privilege. But the attorney-client privilege belongs solely to Corporation A, not you. That means that Corporation A alone may elect to waive the attorney-client privilege and reveal our discussion to third parties. Corporation A alone may decide to waive the privilege and disclose this discussion to such third parties such as federal and state agencies, at its sole discretion, and without notifying you. In order for this discussion to be subject to the privilege, it must be kept in confidence. In other words, you may not disclose the substance of this interview to any third party, including other employees or anyone outside of the company. You may discuss the facts of what happened but you may not discuss this discussion.

Upjohn warnings ensure that the attorney-client privilege that exists between counsel and the interviewee will be maintained. It also allows the company to waive the privilege, which the company may need to do as part of its cooperation with the government and to obtain a lenient penalty or sentence. Finally, if counsel does not make it clear to the witness that he or she only represents the company, the witness may understandably believe that counsel

---


represents her and that the privilege belongs to her and cannot be waived without her consent.\textsuperscript{36}

2. \textbf{Joint Representation of the Franchisor and Individuals}

For the witness who should have counsel, or who desires to have counsel, one question is whether the company’s attorney should also represent the witness. Franchisor counsel often represents affiliated companies, officers, and employees in litigation for a variety of reasons. In the context of internal or government investigations, different issues are involved and there may be greater reason for separate counsel to be retained for the witness, especially if she appears to be or may become a subject or target of a government investigation. While in some instances the parties’ interests may be aligned and joint representation will help rather than harm them, it is still important at the outset for counsel to consider whether joint representation is advisable. This will depend on a number of factors, including whether the parties’ interests, even if currently aligned, could diverge in the future; whether the parties may have different interests should settlement or plea negotiations with the government occur; and whether counsel can provide competent representation to all of the parties. In considering a multiple representation engagement, counsel should carefully review the ABA Model Rules of Professional Conduct (the Model Rules), the Canons under the Code of Professional Responsibility, and variations of the professional standards in the local jurisdiction involved.

Rule 1.13(2)(g) of the Model Rules states: “A lawyer representing an organization may also represent any of its directors, officers, employees, members, shareholders or other constituents, subject to the provisions of Rule 1.7. If the organization’s consent to the dual representation is required by Rule 1.7, the consent shall be given by an appropriate official of the organization other than the individual who is to be represented, or by the shareholders.”

ABA Model Rule 1.7 states:

\textbf{Rule 1.7: CONFLICT OF INTEREST: CURRENT CLIENTS}

(a) Except as provided in paragraph (b), a lawyer shall not represent a client if the representation involves a concurrent conflict of interest. A concurrent conflict of interest exists if:

(1) the representation of one client will be directly adverse to another client; or

(2) there is a significant risk that the representation of one or more clients will be materially limited by the lawyer’s responsibilities to another client or a third person or by a personal interest of the lawyer.

(b) Notwithstanding the existence of a concurrent conflict of interest under paragraph (a), a lawyer may represent a client if:

(1) the lawyer reasonably believes that the lawyer will be able to provide competent and diligent representation to each affected client;

(2) the representation is not prohibited by law;

\textsuperscript{36} \textit{Id.}
(3) the representation does not involve the assertion of a claim by one client against another client in the same litigation or other proceeding before a tribunal; and

(4) each affected client gives informed consent, confirmed in writing.

Under Rule 1.7(b), even if a conflict of interest exists, the lawyer may still represent multiple parties if the multiple representations are not prohibited by law, the lawyer believes she can represent all parties competently, and the lawyer obtains the informed consent of all affected parties in writing. Nevertheless, in a government or internal investigation, multiple representations can be tricky, and the lawyer should consider a number of issues before deciding to represent a company and one or more of its employees, including, but not limited to: 1) whether the government will be concerned about collusion between the company and its employees if all are represented by the same attorney, which could create discord between the government and the company; 2) whether there is a possibility that the discovery of further evidence will create a conflict between the company and the employees; or 3) whether the company or its employees may change their positions concerning the matter at some point, which could create a conflict of interest. If a conflict arises, counsel may have to recuse themselves from representing any party, which could be quite costly to the company. On the other hand, joint representation is an efficient way to proceed, in that it is likely to help keep the company's legal costs down and make the sharing of information and development of a cohesive strategy much easier. Accordingly, counsel must think through all of the issues carefully when determining whether to represent not only the company but also one or more of its employees in an investigation.

3. Joint Defense/Common Interest Arrangements

Even if employees are being represented by other counsel, counsel for all parties (or a subset of the parties) can enter into a “Joint Defense” or “Common Interest” agreement that would permit counsel to share information and develop legal strategies together without waiving the attorney-client privilege. Typically, disclosure of an attorney-client confidence to a third party waives the attorney-client privilege. However, if parties enter into a joint defense or common interest agreement, then the disclosure of confidences among the parties to the agreement will not waive the privilege.37 Under these arrangements, multiple clients facing an investigation have separate, rather than identical, counsel. The parties agree, in order to share information and mount a joint defense, to maintain the confidentiality of all information exchanged. In general, the privilege can be asserted if: 1) the communications were made in the course of a joint defense/common interest effort; 2) the communications were designed to further the effort; and 3) the privilege has not been waived.38

There are a number of advantages and disadvantages for franchisor counsel to consider in determining whether to enter into a Joint Defense Agreement. Through the sharing of information with others, counsel can obtain a better understanding of the government’s investigation and thereby develop a more robust and comprehensive response to the government's inquiry. Counsel can develop, together with others in the joint defense group, a common and potentially more coherent legal strategy. Moreover, significant cost savings can

37 Schmitt v. Emery, 2 N.W.2d 413, 416 (Minn. 1942) (extended joint defense privilege to civil cases); Chahoon v. Commonwealth, 62 Va. (21 Gratt.) 822, 836-42 (1871) (established joint defense privilege in criminal cases).

occur through a joint defense arrangement if the company is not paying for the attorneys representing others in the group. The sharing of information can enable counsel to reduce investigation costs; research, expert, and other costs can be divided among the members of the group. When a franchisee is the subject of a government investigation, the franchisor may consider entering into a common interest agreement with the franchisee so that the parties can fully and frankly discuss the issues raised by the government's investigation without fear that their discussions will be disclosed. The discussions, which generally take place between counsel, will be protected by the attorney-client and work product privileges.

On the other hand, there are a number of risks to entering into a joint defense or common interest arrangement that franchisor counsel must consider. The government may view the arrangement with disfavor, especially if the company has indicated that it intends to fully cooperate with the government in the investigation. The government may consider a joint defense arrangement as the company’s attempt to control witnesses from whom the government seeks cooperation and candor. The company may also want to distance itself from potential individual wrongdoers within its ranks, and be in a position to inform the government that the acts of the wrongdoers were isolated and do not reflect a broader culture or pattern of wrongful conduct within the company. If the franchisor’s counsel is working with counsel for the wrongdoers, the government may question the sincerity of the company’s position.

There are other risks as well. The confidential communications that are shared among counsel and their clients could be used against the company at a later point in time, despite the existence of the agreement. There could be a dispute over whether the information was already known independently by others or whether it was learned only through joint defense discussions. Further, because there is no obligation for the attorneys or their clients to share information, some clients may use the arrangement to learn facts helpful to their case while withholding information from other participants in the joint defense arrangement. In addition, privileged information or documents may be inadvertently disclosed to the government or third parties.

Parties may choose to withdraw from the joint defense arrangement and are generally required to inform the other parties of their decision. This may happen, for example, when an individual decides to plead guilty or settle with the government. The communications divulged during the individual’s participation in the joint defense arrangement will remain privileged despite the individual’s withdrawal from the agreement, although the party may choose to waive the privilege with regard to any communications with her own attorney even if the attorney disclosed those communications to the joint defense group.

Thus, an attorney representing a franchisor needs to carefully consider the pros and cons of entering into a joint defense arrangement with others. These arrangements should not be entered into blindly, and often it may not be in the best interests of the franchisor to enter into such an arrangement during a government investigation. Franchisor counsel should keep in mind that, even if it decides not to enter into a joint defense or common interest arrangement, it may still discuss logistics and even strategy with counsel for others. Counsel will simply need to be careful not to disclose confidential and privileged communications during such conversations.

V. DEALING WITH THE GOVERNMENT

As discussed, in many instances the franchisor will cooperate with the government in its investigation. When dealing with the government, counsel must be transparent and honest at
all times. The government, after all, is attempting to decide whether the company has engaged in wrongdoing and, if so, what, if any, penalty it should impose. Hiding information from or not being honest with the government will not help the company's cause and may put the company in greater jeopardy than it would otherwise be in.

The Department of Justice has issued guidelines for how prosecutors are to deal with corporations, many of which have been laid out in memoranda drafted by various U.S. Deputy Attorney Generals entitled "Principles of Federal Prosecution of Business Organizations." These factors are similar to those that other agencies take into account when determining whether to seek to prosecute, or otherwise charge or fine corporations. The factors include:

a. the nature and seriousness of the offense, including the risk of harm to the public, and applicable policies and priorities, if any, governing the prosecution of corporations for particular categories of crime;

b. the pervasiveness of the wrongdoing within the corporation, including the complicity in or condoning of the wrongdoing by corporate management;

c. the corporation’s history of similar conduct, including prior criminal, civil, and regulatory enforcement actions against it;

d. the corporation’s timely and voluntary disclosure of wrongdoing and its willingness to cooperate in the investigation of its agents;

e. the existence and adequacy of the corporation’s pre-existing compliance program;

f. the corporation’s remedial actions, including any effort to implement an effective corporate compliance program or to improve an existing one, to replace responsible management, to discipline or terminate wrongdoers, to pay restitution, and to cooperate with the relevant government agencies;

g. collateral consequences, including disproportionate harm to shareholders, pension holders, and employees not proven personally culpable, and the impact to the public arising from the prosecution;

h. the adequacy of the prosecution of individuals responsible for the corporation’s misconduct; and

i. the adequacy of civil or regulatory remedies.

In September 2015, then Deputy Attorney General Sally Yates announced new guidance, emphasizing the Department of Justice’s priority to identify culpable individuals in corporate investigations. The guidance was not intended to supplant the principles set forth above, but rather was intended to expand upon existing Department of Justice practices.

40 U.S. Dep’t of Justice, Memorandum from Deputy Att’y Gen. Sally Quillian Yates to Assistant Att’y Gen. and U.S. Att’ys (Sept. 9, 2015).
In the memorandum, Yates required prosecutors to fully leverage their resources to identify culpable individuals at all levels in corporate cases.\textsuperscript{41} No cooperation credit will be awarded to the corporation if full and complete information on individuals is not provided.\textsuperscript{42} Higher level officials within the Department of Justice are required to approve any result in which no action is taken against individuals.\textsuperscript{43} And whether to bring a civil suit against an individual must be based on considerations other than an individual’s ability to pay.\textsuperscript{44}

The Yates memorandum has potentially broad-ranging implications for corporations, including franchisors that face government investigations. The franchisor’s internal investigation, at least in Department of Justice investigations, will plainly be more extensive and costly because it is now tasked with unearthing individual culpability. The investigation is also likely to be prolonged, since the government must determine the extent to which individuals, as well as the corporation, engaged in misconduct. Conflicts between the company and its employees are now more complex, as is the decision on whether the company should voluntarily disclose or self-report any wrongdoing it finds.

Dealing with the government, whether with the Department of Justice or other federal agencies, plainly involves a number of critical decisions for the company and its counsel. If the company finds other misconduct during the government’s investigation, should it voluntarily disclose the wrongdoing to the government? To what extent should the company change its current compliance programs and remediate any wrongdoing? Should the company cooperate in the first place? Should the company disclose the misconduct of any individuals to the government? Certainly, in the case of possible criminal sanctions against the company, the company’s full and complete cooperation will be expected by the government, and the company’s failure to fully cooperate could lead to severe penalties, debarment from government programs, and other harsh results. Cooperation, on the other hand, can mean that the government will be willing to enter into a non-prosecution or deferred prosecution agreement with the company, or a substantially smaller penalty than might otherwise obtain.\textsuperscript{45}

VI. INVESTIGATIONS SPECIFIC TO FRANCHISING

Franchise companies are subject to specific federal and state laws and regulations.\textsuperscript{46} On the federal side, the Federal Trade Commission (FTC) oversees and enforces laws that promote fair competition and protect the public from unfair and deceptive business practices in the advertising and marketing of goods and services.\textsuperscript{47} While there is no private right of action

\begin{itemize}
\item \textsuperscript{41} Id. at 2.
\item \textsuperscript{42} Id. at 3.
\item \textsuperscript{43} Id. at 5.
\item \textsuperscript{44} Id. at 6.
\item \textsuperscript{45} A deferred prosecution agreement is an agreement between the prosecution and a defendant pursuant to which a prosecutor agrees to grant amnesty in exchange for the defendant agreeing to fulfill certain conditions, usually including cooperation.
\item \textsuperscript{46} This paper does not delve in-depth into the enforcement of FTC Franchise Rule compliance or state franchise regulations, as those topics have been covered extensively in prior forum papers. See, e.g. Martin Cordell, Mark B. Forseth and Brian B. Schnell, \textit{The Ultimate Remedy: Managing Regulatory Enforcement Actions}, ABA 34th Annual Forum on Franchising W-23 (2011) and Shelly Harris-Horn, Theresa Leets, Susan Meyer and Shelley B. Spandorf, \textit{Effective Strategies for Working with State Franchise Regulators}, ABA 35th Annual Forum on Franchising W-18 (2012).
\end{itemize}
under the FTC Act, unfair and deceptive practices are considered unlawful under the Act, and the FTC may seek equitable relief, civil penalties, or rescission and restitution.48

The Bureau of Consumer Protection is the division of the FTC that investigates and prosecutes franchisors for violations of the Act. The Bureau has promulgated a number of trade regulations, including the FTC Franchise Rule, which govern pre-sale disclosures, including financial performance representations.49 When a complaint is filed with the Commission concerning an alleged violation of the Franchise Rule or other laws, the FTC staff decides whether to initiate an investigation. If an investigation is initiated, it is nonpublic, and thus the identity of the complainant (such as a franchisee) and the particular franchisor that is the subject of the investigation, are not revealed by the FTC.50

The FTC may choose to investigate using voluntary or non-compulsory investigative procedures, such as an access letter requesting that the franchisor voluntarily produce documents to the Commission, interviews with knowledgeable individuals, or mystery queries at the franchisor’s trade show booths. If the FTC sends an access letter to the franchisor, it must notify the franchisor of the conduct constituting the alleged violation and the law applicable to the alleged violation.51

The FTC also has the ability to issue civil investigative demands in its investigations of potential violations of the FTC Act by a franchisor.52 The CID may request the production of documents and tangible things, require answers to interrogatories, or seek the depositions of individuals with knowledge of the conduct at issue. As in the case of other CID’s, counsel for the franchisor may seek to quash the CID, or at least limit the scope of the CID through discussions with government counsel. In any event, counsel for the franchisor will want to thoroughly investigate the matter internally in order to be in the best position possible to argue to the government for leniency or that the prosecutor should decline to pursue the matter altogether.

If, however, the FTC determines that there has been a violation of Section 5 of the Act (unfair and deceptive practices) or the Franchise Rule, it has a number of options available including, among others, seeking to have the franchisor enter into a consent order agreement or filing a complaint in the United States District Court seeking civil penalties, injunctive relief, or restitution for consumers.53 In deciding whether to seek a consent decree or bring a formal action, the FTC will consider a number of factors, including the duration of the alleged wrongdoing, the nature of the alleged wrongdoing, the extent of injury to the affected parties, the franchisor’s ability to pay restitution or civil penalties, and the Commission’s likelihood of success.

As in the case with investigations initiated by the FTC, state investigations are often triggered by a complaint from an existing franchisee. State investigators will generally focus on the nature of the complaint and whether similar complaints have been lodged against the

48 See 15 U.S.C.A. §§ 45(m), 53(b), 57b(b) (West 2017).
49 16 C.F.R. § 436 (West 2017).
51 16 C.F.R. § 2.6 (West 2017).
52 15 U.S.C.A. § 57b-1(b) (West 2017); 16 C.F.R. § 2.7(b) (West 2017).
53 16 C.F.R. § 2.31-2.34 (West 2017); 15 U.S.C.A. §§ 45(m), 53(b), and 57b(b) (West 2017).
franchisor in the past. Typically, state investigators will only take action if the complaint relates to fraud or misrepresentation in the offer and sale of the franchise. This includes allegations of unlawful financial performance representations, an understatement of the initial investment required to become a franchisee, or the failure to provide a disclosure document. The states have limited resources to pursue franchise matters, and thus tend to pursue the most serious transgressions or instances in which there have been numerous complaints filed against a franchisor in the past. The information gathered during the course of an investigation, and even the existence of the investigation, is generally kept confidential.

There are several principles to keep in mind when dealing with state franchise investigations. As in all investigations, it behooves franchisor counsel to respond carefully and fully to the investigation, and to conduct a vigorous internal investigation to get to the bottom of the problem. Cooperation will likely be key to developing a good relationship with the state regulator or enforcement agency and minimizing your client’s exposure. If your client determines on its own that it has violated a state law/regulation, then you should consider self-reporting. Generally, the state will treat a self-reporting franchisor more leniently than it will a franchisor who fails to report and takes action only when it is caught by the state. In addition, you should have your client immediately correct any wrongdoing that has occurred as the state will, no doubt, want to ensure that the violation will not be repeated in the future.

A state can decide to file a franchise enforcement proceeding. In some instances, administrative proceedings may be available, either held by a franchise administrator or an administrative law judge, that could, following a hearing, lead to a stop or cease and desist order to suspend the franchisor’s registration in the state or to end the violation. Alternatively, a state may bring a state court action to enjoin the franchisor’s conduct.

Not all matters end up in litigation. State agents may attempt to resolve the matter informally and, in such instances, will try to broker a resolution between the franchisor and franchisee. In some instances, especially where the franchisee seeks to obtain rescission damages or other monetary relief, the state may seek to have the franchisor agree to a consent order rather than bring an enforcement action. Franchisor counsel, after doing extensive due diligence, needs to work with his or her client to develop an appropriate strategy to respond to the state. Often, entering into a consent decree may be more palatable than fighting an enforcement action.

**VII. SPECIAL CONSIDERATIONS IN INVESTIGATIONS OF FRANCHISEES**

Franchisees, like franchisors, are sometimes the subject of state and/or federal investigations. Government investigations of franchisees have involved the failure to report sales tax, immigration fraud, wage and hour violations, employment discrimination, food and safety violations, and many others. While the investigations are usually on a smaller scale than the investigations of franchisors, the implications for franchisees can be quite serious. Franchisee counsel needs to consider the same issues as franchisor counsel in determining how to respond to a government investigation.

The investigation of a franchisee can have implications for the system as a whole, and thus franchisor counsel needs to closely monitor any government investigation of franchisees of which it becomes aware. If there is a food safety concern involving franchisees in a particular

---

geographic area, and the word spreads to the public at large about the issue, the impact on the system will likely not be confined to the geographic area where the food safety problem exists. The public often thinks of the brand as a whole, not just franchise locations, and consumers may well attach any problem to the brand rather than to particular franchise locations.

This creates challenges for the franchisor. If a problem at franchise locations could spread to the system as a whole, the franchisor may want to step in, expend resources to respond to the investigation, and even take control of the strategic direction of the internal investigation and response. But such a decision would create risks for the franchisor. The franchisor may be perceived as having more control over the franchisees' business, leading to an increased risk of the franchisor becoming vicariously liable for these and other acts of its franchisees. There is also a risk that if the franchisor takes control of the investigation and any dealings with the government, the publicity will be increasingly focused on the franchisor and the system as a whole rather than the franchisees. The franchisor can, alternatively, try to act behind the scenes on behalf of its franchisees, but this is not always easy and can create difficulties in the management and control of the response to the government. Regardless of the extent of the franchisor's involvement in the investigation of its franchisees, it is important that the franchisor does not provide legal advice to the franchisee. Franchisor counsel does not want to be viewed incorrectly as the franchisees' counsel, which could lead to serious conflict of interest and other ethical problems.

VIII. CONCLUSION

Government investigations of franchise companies are serious matters that require thoughtful and appropriate responses to the government’s requests. As a general rule, the company will cooperate with the government, but the lawyers representing the company must fully apprise themselves of the scope of the government’s authority, the nature of the investigation, and the range of options available to the company to appropriately advise the company on how it should respond to the government’s inquiries. In order to limit the company’s exposure, lawyers usually must conduct a thorough internal investigation themselves, gather and review appropriate documents and interview key employees, and research and understand the key legal principles applicable to the matter being investigated.

55 Kerl v. Dennis Rasmussen, Inc., 682 N.W.2d 328, 341 (Wis. 2004) (noting that most courts that have addressed the matter “have adopted the traditional master/servant ‘control or right of control’ test to determine whether the relationship between the franchisor and the franchisee should give rise to vicarious liability”); Ciofo ex rel. Booker v. Shock, No. 193310, 1997 WL 33347978, at *1 (Mich. Ct. App. May 16, 1997) (stating that “[t]o determine whether a . . . franchisor and franchisee had a principal-agent relationship sufficient to impose vicarious liability on the franchisor, we examine the defendant’s control of the franchisee in terms of the defendant’s right to take part in the day-to-day operation of the franchisee’s business”).

23
Christopher A. Nowak

Chris Nowak is executive vice president and general counsel for Wyndham Hotel Group, responsible for overseeing the company’s involvement in all legal matters, both domestic and international, and providing strategic direction and counsel to the company and its executives in regards to those matters.

Nowak has more than twelve years of experience and has held a number of leadership positions in both Wyndham Worldwide and Wyndham Hotel Group, having served most recently as senior vice president, legal for Wyndham Worldwide. Previously, he was group vice president, legal, responsible for supporting domestic and international legal matters for Wyndham Hotel Group.

Prior to his role at Wyndham Worldwide, Nowak served Wyndham Hotel Group in numerous roles, and has been involved in hotel franchise transactions, development transactions, franchise compliance and disclosure, as well as consulting on privacy and marketing matters and structuring joint venture transactions within the U.S and abroad.

He has also served Wyndham Worldwide as group vice president – international law and strategic sourcing, where he was responsible for international compliance matters and international transactions, strategic sourcing transactions, and various other matters, including government relations.

Before joining Wyndham, and its predecessor, Cendant Corporation, Nowak was an associate with the law firm of Hogan & Hartson LLP in Washington, D.C., where he practiced franchise and antitrust law.

Nowak is a member of the American Bar Association and is admitted to practice in Virginia, the District of Columbia and New Jersey (limited license). He is a graduate of the State University of New York at Albany and Catholic University School of Law.

He is based in Wyndham Hotel Group’s Parsippany, N.J. offices.

Eric L. Yaffe

Eric Yaffe is the Managing Officer of the Washington, D.C. office of Gray Plant Mooty and is Co-Chair of the firm’s White Collar and Investigations Team. He recently concluded a two-year term as Chair of the District of Columbia’s Board on Professional Responsibility (2014-2016). Eric’s practice focuses on franchise litigation, complex commercial litigation, and white collar civil and criminal matters. He represents corporations, including many domestic and international franchisors, in litigation in federal and state courts around the country.

Prior to entering private practice in Washington, D.C., Eric spent nine years as a federal prosecutor with the United States Department of Justice, first as an Assistant United States Attorney in the District of Columbia, and then as a Trial Attorney in the Office of Public Integrity and as Deputy Chief of the Department’s Campaign Finance Task Force. He has tried over fifty cases and has handled over thirty appeals in his career. Eric currently serves as an adjunct professor of trial advocacy at American University’s Washington College of Law. He received his J.D. from the University of Chicago Law School and his B.A. in economics and government from Oberlin College.