Hospitalitas

2011 Issue 5

News and Views for Your Hospitality and Franchise Business

BAKER DONELSON
BEARMAN, CALDWELL & BERKOWITZ, PC
EXPAND YOUR EXPECTATIONS℠

Fighting Fire with Fire: Federal Court Orders Cancellation of Firehouse Subs' Trademark after Jury Finds Fraud on the PTO

Jill Suwanski, 615.726.5558
jsuwanski@bakerdonelson.com

The Federal District Court for the District of South Carolina recently upheld a jury verdict against Firehouse Restaurant Group, Inc. (FRG), the owner of the "Firehouse Subs" sandwich chain, creating potentially significant challenges for the franchise system and providing a cautionary tale to franchisors and other federal trademark applicants. The dispute between FRG and another restaurant

continued on page 2

Greetings from *Hospitalitas*

Hospitalitas is the Baker Donelson newsletter for our clients and friends in the hospitality industry – hotels, restaurants and their suppliers. It is published several times a year when we believe we can deliver first class, useful information for your business. Please send us your feedback and ideas for topics you would like to know more about. True to our Southern heritage of hospitality, we'll work hard to make each visit with us something special and worth repeating.

Hardee's Successfully Defends Market Contraction Claims After Franchisee Blames "Lewd" Advertisements

Benjamin West Janke, 504.566.8607, bjanke@bakerdonelson.com

The advertising by the super-competitive QSR burger–themed chains clamors for viewer attention. When it plays to the young male demographic exclusively, at the risk of offending female patrons and viewers, does it justify abandoning the franchise? Specifically, would hamburger advertisements entitled "Patty Melts for You" and "Flat Buns," depicting scantily clad women, play in Peoria beyond the 18-49 male audience? Customers of a Hardee's franchise in nearby Ottawa, Illinois, a "primarily agricultural and union oriented community,"[1] took offense, as did a group known as "One Million Moms" who shut down the Hardee's email servers in protest. When the owners of the Ottawa franchise experienced a dip in sales and an alleged decline of the goodwill in the Hardee's brand and trademarks licensed to them as Hardee's market share and store count declined in the DMA of greater Chicago, the owners closed the doors and abandoned the franchise more than a year before the end of their five-year renewal.

In *Hardee's Food Systems, Inc. v. Jeffrey T. Hallbeck*, 2011 U.S. Dist. LEXIS 107038 (E.D. Mo. Sept. 21, 2011), Hardee's sued the owners of the Ottawa franchise seeking lost future franchise fees, but the franchisees counterclaimed that by running the allegedly lewd ads, Hardee's breached its advertising obligations under the five-year Renewal Franchise Agreement signed in 2005

continued on page 4

In this issue:

Fighting Fire with Fire, *continued*

named "Calli Baker's Firehouse Bar & Grill" in Myrtle Beach, South Carolina, began in 2008 when FRG sent the restaurant's owner, Heath Scurfield, sole member of Scurmont, LLC, a cease-and-desist letter demanding that Scurmont stop using the word "Firehouse" in the name of its restaurant. FRG claimed the use was infringing on FRG's "Firehouse" word mark. FRG had obtained a federal trademark registration for the "Firehouse" word mark (Registration No. 3,173,030) covering "restaurant services." Scurmont had not filed a federal trademark application but was using the "Firehouse" mark for its full-service restaurant. Because FRG had Myrtle Beach-area franchisees, FRG attempted to stop Scurmont's use. Scurmont, however, answered the alarm aggressively.

After receiving the cease-and-desist letter, Scurfield, individually and on behalf of Scurmont, filed a declaratory judgment action in federal court in South Carolina. FRG and FRG's two Myrtle Beach-area franchisees (collectively, the "*Firehouse* plaintiffs") then filed an infringement action against Scurmont in the same court. The court consolidated the cases into *Firehouse Restaurant Group, Inc. v. Scurmont, LLC*, No. 4:09-cv-00618-RBH. In response to the *Firehouse* plaintiffs' infringement action, which alleged infringement of 34 federally-registered FRG marks, Scurmont filed counterclaims requesting a declaratory judgment of non-infringement and cancellation of the *Firehouse* plaintiffs' registered "Firehouse" word mark due to fraud on the United States Patent & Trademark Office (PTO). FRG's application never mentioned its awareness of other restaurants using the "Firehouse" name.

At the August 2011 trial, the jury found that Scurmont had not infringed on any of the FRG trademarks. The jury decided FRG had committed fraud on the PTO because it possessed an "intent to deceive" and had made material misrepresentations to the PTO. The jury's verdict hinged upon damning facts Scurmont unearthed regarding steps FRG took prior to filing its federal application for the "Firehouse" word mark. Scurmont demonstrated that FRG had been aware of a restaurant in Tampa, Florida, called Firehouse Grill & Pub that had begun using the "Firehouse" mark prior to FRG's use. Not only did FRG's owners know about the restaurant, but one of the owners, Chris Sorensen, had visited the restaurant in order to talk to the owner prior to filing FRG's application. No written coexistence agreement was offered by FRG, though, until almost three weeks after FRG filed its application. At that time, Sorensen presented the Tampa restaurant's owner, Bryan Carroll, with a written coexistence agreement and a check for $5,000. Carroll never signed the agreement or cashed the proffered check, and continued to operate the restaurant without a name change.

When filing a federal trademark application, a representative of the applicant must sign a declaration stating that "no other person, firm, corporation, or association has the right to use the mark in commerce in the identical form thereof or in such near resemblance thereto as to be likely, when used on or in connection with the goods/services of such other person, to cause confusion, or to cause mistake, or to deceive." Scurmont convinced the jury that FRG committed fraud on the PTO by signing that declaration, since FRG knew about the existence of Tampa's Firehouse Grill & Pub. Scurmont argued, and the jury agreed, that signing the declaration constituted an intent to deceive the PTO. The jury also found that FRG's misrepresentation in signing the declaration was material because "but for the misrepresentation, the federal registration

continued on page 3

NEWS BRIEFS

Navigating Overseas Compliance Issues
With "compliance" being the buzzword for corporate executives and legal counsel, there is renewed focus on reducing legal risks when exporting or selling overseas. The key is a robust compliance program that outlines the company's policy as well as internal procedures to implement the policy and a solid set of documents to evidence the compliance activities. Go to http://www.corporatecomplianceinsights.com/2011/compliance-program-must-haves-for-doing-business-abroad/ to read Baker Donelson attorney Doreen Edelman's "Compliance Program 'Must-Haves' for Doing Business Abroad," on the Corporate Compliance Insights website.

Baker Donelson Marks Entry into Texas and Florida
Baker Donelson has expanded its footprint significantly in the last two months, entering two new states through mergers with firms in Houston, Texas, and Orlando, Florida. Each acquisition – Spain Chambers in Houston and Orlando's Litchford & Christopher – added six attorneys to Baker Donelson.

Winter Franchise Business Network Meeting Set for January 10, 2012
Mark your calendars now for the Winter 2012 meeting of the International Franchise Association's Franchise Business Network on January 12. January's topics will include "Northern Exposure: Franchising in Canada" and a presentation from Smoothie King's general counsel. These quarterly lunch meetings are hosted by Baker Donelson in offices across Tennessee, Alabama, Mississippi and Louisiana.

Joel Buckberg Named to Who's Who
Joel R. Buckberg, head of Baker Donelson's franchise and hospitality practice groups, has been named to the International Who's Who of Franchise Lawyers 2011. He is one of only 323 attorneys worldwide included in the 2011 list, which recognizes the world's leading franchise lawyers based on feedback from clients and peer attorneys.

Divine Testifies Before Senate Judiciary Committee
Baker Donelson shareholder Robert Divine, a nationally-recognized immigration attorney, testified before the Senate Judiciary Committee on December 7 regarding the job-creating effects of the EB-5 immigrant investor program and the importance of renewing the regional center authorizing legislation. A copy of Mr. Divine's testimony is available on the Baker Donelson website.

Fighting Fire with Fire, *continued*

either would not or should not have issued." FRG had countered that, during an earlier opposition to the "Firehouse" word mark application, an attorney for the opposing party entered into evidence a list of 27 third-party users of the word "Firehouse" in connection with restaurants, and despite that, the examining attorney still issued the registration. The jury, and later the court, found that argument unconvincing because the fact remained that without signing the false declaration, FRG could not have filed the application and the registration could never have been issued. Since an application cannot be filed without the declaration, essentially, the jury found fault with the mere fact that FRG filed an application.

After the jury rendered its verdict, the *Firehouse* plaintiffs filed motions to reverse the jury verdict or start over with a new trial. The court rejected the motions, upholding the jury's verdict and providing detailed reasoning as to why it believed the verdict was sound. Significantly, the court also found the fraud to create an "exceptional" case in which the Lanham Act required the court to award reasonable attorneys' fees to the prevailing party. The court parsed Scurmont's request for attorneys' fees and determined the "reasonable" amounts requested to total $241,888.

If the jury's verdict and court's decision stand, FRG will face branding challenges. Only the "Firehouse" word mark was cancelled because Scurmont only requested cancellation of that mark, but could other senior users of the Firehouse name also file cancellation actions against other registered marks in the Firehouse family using that word? FRG must now assess its brand presence across the country and prepare a plan for protecting the cancelled word mark in each state, if possible.

Fortunately for FRG, the 2011 Franchise Disclosure Document (FDD) of its franchisor subsidiary, Firehouse of America LLC (FOA), does include a robust disclosure in its Item 13 – "Trademarks" section. The FDD discloses the Scurmont case and lists nine cities in which a restaurant operates using the Firehouse name. Tampa, Florida, is listed. This puts potential franchisees in those areas on notice of the issues of protectability and exclusivity of the FRG marks there. We do not assess whether and when that disclosure was made in the historical FDDs and UFOCs of FOA to solicit existing franchisees in those areas that may be affected by senior users, or whether any risk factor about the frailty of the house mark was sufficient.

This case illustrates the care all trademark applicants must take in performing due diligence prior to filing a federal application. The best practice is to order a search offered by a commercial search service to determine if any similar users exist prior to beginning use of a mark. Such searches typically cost between $450 and $600, plus attorney review time. If other users exist for similar goods or services, prudence suggests finding another trademark at that early stage before investment in branding and goodwill creates "identity inertia." The Firehouse case demonstrates that the costs of performing this analysis on the front end are minor compared with the costs a registrant could face later if the trademark was not cleared. For franchisors, this task is even more important because as a franchisor expands throughout the United States, the exclusive right to use the mark is extremely important and not having a registered mark adversely affects franchise sales and regulatory compliance, particularly in states with business opportunity law exemptions based on a registered mark.

This case may also cause trademark registrants to think twice about aggressively pursuing infringing junior users if their trademark house is not in order with senior users in all areas of the country. Of course, that becomes a problem since a federal registrant also has an obligation to police its mark to avoid abandonment. Again, to avoid these problems, the best practice is to avoid using a mark that has conflicting senior users, or approach and come to coexistence agreements with those senior users prior to filing an application.

Restaurant trademarks are some of the most difficult trademarks to clear if the name is in any way common, since there are so many small restaurants in operation that can typically meet the "interstate commerce" requirement. A restaurant owner with designs on franchising must prepare a strong trademark protection plan at the outset and preferably choose a very distinctive name in order to feel secure in knowing that its mark will remain protected throughout the United States.

Hospitalitas will report in a future issue if this decision is appealed and additional court opinions result.

Hardee's Successfully Defends Market Contraction Claims, *continued*

(a year after Hardee's five-year ad campaign began to run).

The franchise agreement required the franchisees to pay into the Hardee's National Advertising Fund (HNAF) "for the creation and development of advertising, marketing and public relations, research and related programs, activities and materials that [Hardee's], in its sole discretion, deems appropriate."[2] The agreement further provided that Hardee's would have the "sole discretion over creative concepts, materials and endorsements used in those programs and activities, and the geographic, market and media placement and allocation of advertising and marketing materials." The agreement also included an acknowledgement that the HNAF is intended to enhance the recognition and patronage of the Hardee's restaurants and a waiver of liability with respect to the maintenance, direction or administration of the HNAF.

One of the Ottawa franchise owners testified that he was aware of the ad campaign before he entered into the renewal agreement and that he was "unhappy" with the advertisements.[3] Hardee's stated purpose in producing these ads "was to appeal to a particular target demographic – 18-49 year old males – which [Hardee's] sees as important to the success of the Hardee's brand nationwide as it competes with larger chains of quick-service restaurants with large advertising budgets."[4]

The commercial entitled "Patty Melt," for the new "Patty Melt Thickburger," featured a model "beck[oning] the viewer with her finger," in a suggestive pose as a female voice reads: "Ten: Shhh, kiss me on the lips. Nine: Run your fingers through my hair. Eight: Touch me. Hold it; no wait, let's go straight to number one." The tag line is "Patty melts for you."[5]

The commercial entitled "Flat Buns," which ran for the Hardee's affiliate Carl's Jr., featured a female teacher dancing in a lewd manner as students begin rapping suggestively about "flat buns," with lyrics such as "flatter makes a better rear; stand sideways, girl, you disappear," and "in anatomy class, you got a butt minus."[6]

The ads ran in all market areas in which all of the Hardee's restaurants were operated by Hardee's Food Systems, Inc. itself, "whereas the decision whether to run the ads in other market areas was made by individual advertising cooperatives composed of the operators of Hardee's restaurants within the market areas – or by those owned by [Hardee's Food Systems, Inc.] itself and those owned by the franchisees."[7] The ads did not air in the Ottawa market, but when they ran in the nearby Peoria market, "the public became aware of them and [the franchise owners] received repeated complaints from residents in Ottawa's predominantly agricultural and union oriented community, about the unacceptable nature of these ads."[8]

The Ottawa franchise owners' claimed that by running the allegedly "lewd" advertisements, Hardee's "exercised its duties and discretion related to the HNAF in a manner so as to deny the [Ottawa franchisees] the expected benefit of the contract, in violation of the implied contract of good faith and fair dealing."[9] Hardee's moved for summary judgment.

The U.S. District Court for the Eastern District of Missouri, applying Missouri law, held that "no reasonable factfinder could find that [Hardee's] breached the implied covenant by its challenged actions. Under Missouri law, a covenant of good faith and fair dealing is imposed on every contract. When, as here, a decision is left to the discretion of one party, 'the question is not whether the party made an erroneous decision but whether the decision was made in bad faith or was arbitrary or capricious so as to amount to an abuse of discretion.'"[10] Since the court found that the Ottawa franchise owners failed to provide any evidence of bad faith on behalf of Hardee's in producing and airing the advertisements in question, the court dismissed the franchise owner's claims on summary judgment to dismiss the counterclaim. While the marketplace second-guessed the campaign, the court refused to do so and allowed the campaign to be the basis of a successful affirmative defense by the Ottawa franchisee to the franchisor's claim for wrongful termination of the franchise.

continued on page 5

Hardee's Successfully Defends Market Contraction Claims, *continued*

In the furor over the titillation of the advertising, the claim that the franchisee could terminate for Hardee's loss of market share and market presence was largely ignored.

The franchisees may not have had a lot of firepower behind their counterclaims under Missouri law, but Hardee's had ample defenses in reserve. The Missouri court did not discuss the provisions of the franchise agreement reserving "sole discretion" to Hardee's over the creative concepts of its advertisements, but such language may prove useful and necessary in similar cases and in other jurisdictions.

The case reminds franchisors of all varieties of brands and products to check the language in their franchise agreements that retains the ability to control and direct the chain's advertisements, particularly given the unpredictability of market reaction to aggressive, suggestive advertising that appeals to a narrow demographic, even if it is the primary customer group of the chain. Franchisees must overcome a heavy burden to obtain redress when advertising goes awry and causes customer loss, particularly in declining markets.

1. *See* Defendants' Second Amended Answer, Affirmative Defenses, and Counterclaim to Plaintiff's First Amended Complaint [R. Doc. No. 166], p. 14, ¶ 15 (hereinafter, "Franchisees' Counterclaim"), in *Hardee's Food Systems, Inc. v. Jeffrey T. Hallbeck,* 2011 U.S. Dist. LEXIS 107038 (E.D. Mo. Sept. 21, 2011).
2. *Hardee's*, 2011 US Dist. LEXIS 127169, at *9.
3. *Id.* at *7.
4. *Id.*
5. *See* Franchisees' Counterclaim, p. 12, at ¶ 13.
6. *See* Franchisees' Counterclaim, p. 12, at ¶ 14.
7. *Hardee's*, 2011 US Dist. LEXIS 127169, at *7.
8. *See* Franchisees' Counterclaim, p. 13, at ¶ 15, & Ex. "A," at p. 2.
9. *Hardee's*, 2011 US Dist. LEXIS 127169, at *6.
10. *Id.* at *8 (citing *Mo. Consolidated Health Care Plan v. Community Health Plan*, 81 S.W.3d 34, 48 (Mo. Ct. App. 2002).

Are Shuttle Drivers Franchisees or Employees? Ninth Circuit Wants Lower Court to Decide

Joel Buckberg, 615.726-5639, jbuckberg@bakerdonelson.com

Air travelers are familiar with the ubiquitous blue vans bearing the SuperShuttle logo that whisk travelers to the local destinations of their choice. Since 2001, the drivers of those vans have been franchisees under unit franchise agreements. The parent entity leases the vans to the driver-franchisees, who operate the vans themselves or through their employees. Previously, this service was operated by employees of the parent entity, SuperShuttle International, Inc. (SSI) or a subsidiary. Under California licensing regulation, a subsidiary of SSI holds the passenger stage corporation certificates from the Public Utilities Commission (PUC) necessary to operate the vans on a for-hire basis.

The drivers filed a class action suit to be classified as employees, not independent contractors, for state law purposes. They argued unsuccessfully at the trial court that the franchises disguised employment relationships and they were entitled to benefits of employees under the California Labor Code. The putative franchisor was alleged to treat its driver franchisees not as independent business people, but as employees. According to the drivers, the franchisor controlled the geographic areas served by the drivers, set the fares they charged, and demanded that they obey detailed standards of behavior and appearance while at work. Under the rules of the PUC, certificate holders could engage non-employee drivers to operate under certificates so long as the drivers remain under the "complete supervision, direction and control" of the certificate holder. One may wonder how "independent" someone could be in reality if under the complete supervision, direction and control of another party or person. The drivers claimed that misclassification deprived them of overtime and minimum wages, reimbursement of business expenses and deductions, meal period pay and other benefits enjoyed by employees that an independent contractor absorbs or pays.

The district court deferred to the PUC, which has broad authority to decide such issues in the context of operating regulated transportation companies under state certificates and

continued on page 6

Are Shuttle Drivers Franchisees or Employees?, *continued*

rules of operation. SSI's motion to dismiss the case was granted. *Kairy et al v. SuperShuttle International, Inc.*, 721 F. Supp. 2d 884(N.D. CA. 2009). On appeal to the U.S. Ninth Circuit Court of Appeals, SSI argued that the rules of PUC allow certificate holders to engage independent drivers but retain levels of control ordinarily exercised over employees. The PUC rules create an exception to the employee/independent contractor analysis performed in other employment law contexts, according to SSI. The drivers argued that the control elements could stop at safety and service related issues, well short of employment-type controls over the drivers. Regulation of the "minute details" of behavior and appearance, including the color of hosiery and facial hair length, goes beyond to employment level control.

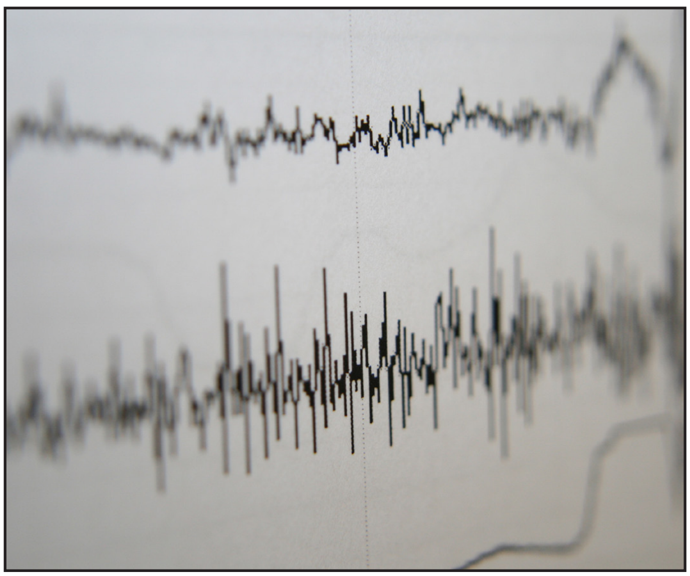
The PUC itself, in its amicus brief, demurred to "traditional decision-makers" on the issue of whether drivers are independent or employees, not wishing to make law in this complex area. The Ninth Circuit rejected the arguments of SSI, and held that under the relevant California statutes, PUC does not regulate the question of whether drivers are employees or independent contractors. Using the decision of the PUC in *In Re Prime Time Shuttle International, Inc.*, 67 CPUC2d 437, 1996 WL 465519(Cal. PUC, Aug. 2, 1996), the court found that the control and supervision issues were indeed related only to health, safety and service reliability aspects, such as driver reliability, safety of operations, shift length, van inspections and passenger recourse. Employment-type control goes well beyond what the PUC rules contemplate. On remand, the district court was authorized to determine whether the SuperShuttle drivers were employees or independent contractors. The PUC defers to courts on that important point and does not assert authority to decide employment law, per this Ninth Circuit decision. *Kairy v. SuperShuttle International, Inc.*, 2011 U.S. App. LEXIS 22161 (9th Cir. 2011).

As this matter plays out in the lower court, transportation operators considering franchising as a means of reducing direct labor costs and other risks may find no safe harbor on independent contractor status under public utility commission licensing and service rules similar to California's, despite the attempt to leverage health and safety controls into more comprehensive service model standards. Left out of the analysis by the Ninth Circuit, and awaiting more attention in the district court, is the dividing line between a franchise/independent contractor relationship and employment. Providers may take some comfort from the long-awaited decision in the FedEx driver litigation, in which the U.S. District Court for the Northern District of Indiana found the drivers to be independent contractors, not employees. (No.305-MD-527-RM, MDL 1700, Dec. 13, 2010). But state employment laws offer another hugely significant issue to consider in strategic evolution of multi-vehicle business models.

Officer of Franchisor Held Liable as an "Employer" Under the Employee Polygraph Protection Act

Erica Mason, 678.406.8718, emason@bakerdonelson.com

What happens when circumstances mix franchising and the family business? Odd results that expand the notion of when a franchisor or its officer is an employer under federal employment statutes. In a case of first impression interpreting the Employee Polygraph Protection Act (EPPA) in the context of a franchisor-franchisee relationship, the District Court for the Northern District of Illinois granted the employee-plaintiff's motion for partial summary judgment, holding that the president of a restaurant franchisor could be held liable as an "employer" under the EPPA for his actions during a sexual harassment investigation meeting at which he indirectly solicited a franchisee employee to take a polygraph test. *Juana Sanchez, v. Prudential Pizza, Inc. and John Apostolou*, Civil Action No. 10-CV-6289, 2011 U.S. Dist. LEXIS 128349 (N.D. Ill. Nov. 2, 2011).



Plaintiff Juana Sanchez was an hourly employee for the Giordano's Pizza franchise at Prudential Plaza. Defendant John Apostolou (Father) is the primary shareholder of Giordano's Enterprises, Inc. (Franchisor). Basil Apostolou, son of John Apostolou, is the sole owner of Defendant Prudential Pizza, Inc. (Franchisee), who owns and operates the Giordano's Pizza franchise at Prudential Plaza. Basil Apostolou had worked for a number of years for the Franchisor, and the Franchisee's work space/designated work area was located within the Franchisor's corporate offices.

Ms. Sanchez reported to the Franchisee that her manager, Alex Marquez, sexually harassed her by making comments about his lascivious intentions. Basil Apostolou met with Mr. Marquez to discuss the plaintiff's allegations. During this meeting, Mr. Marquez denied any misconduct and offered to take a lie detector test to prove that he was telling the truth.

Basil Apostolou later held a meeting with Sanchez at the Franchisor's corporate offices. The Franchisor's in-house counsel was present for the meeting. Father arrived some time during the course of the meeting but did not stay for the duration. The evidence showed that, during this meeting, Father told Ms. Sanchez that Mr. Marquez was willing to take a lie detector test to prove his innocence, and asked Ms. Sanchez whether she was willing to do the same. Ms. Sanchez's employment was ultimately terminated.

Ms. Sanchez filed a lawsuit alleging she was unlawfully terminated in retaliation for complaining about Marquez's sexual harassment. The defendants contended that Ms. Sanchez was terminated because she had nine written counseling events for policy violations ranging from being tardy to being out of uniform.

Ms. Sanchez also asserted a claim under the EPPA, claiming that Father violated section 2002(1) of this statute, which forbids an employer from "directly or indirectly, require[ing], request[ing], suggest[ing], or cause[ing] any employee to take or submit to [a] lie detector test." See 29 U.S.C. §2002(1). Ms. Sanchez argued that Father's statement at their meeting constituted incontrovertible evidence that he "requested or suggested" that she take a lie detector test in violation of the EPPA. The defendants responded that Father was merely reiterating Mr. Marquez's offer to Ms. Sanchez, and that Ms. Sanchez could not show that Father was acting as an "employer" within the meaning of the EPPA.

The court first examined whether Father's statement to Ms. Sanchez violated section 2002(1) of the EPPA. Noting that where courts have been asked to apply the EPPA, they have interpreted it quite broadly, the court held that Father's admissions show that he questioned the veracity of Ms. Sanchez's claim and then made the statement that her alleged harasser was willing to take a polygraph. Thus, even when viewed in the light most favorable to Father, the court held that his statements constituted, at very least, an "indirect suggestion that Sanchez take a polygraph test." The court, however, noted that Father's statements cannot violate the EPPA unless he is an "employer" within the meaning of the statute.

Turning next to the question of whether an officer of the franchisor can be held liable as an "employer" under the EPPA, the court first looked to case law interpreting the EPPA's definition of

continued on page 8

Officer of Franchisor Held Liable as an "Employer," *continued*

"employer." *See* 29 U.S.C. §2001(2) (defining "employer" as "including any person acting directly or indirectly in the interest of an employer in relation to an employee or prospective employee."). The court noted that a number of courts have found this definition to be "unclear" and "ambiguous," and that these courts have looked to other federal employment statutes such as the Fair Labor Standards Act to determine the scope of the EPPA. Adopting the definition set forth in these cases, the court held that "any person or entity [that] acts in the interest of an employer in relation to an employee or prospective employee," is subject to suit as an "employer" under 29 U.S.C. §2005(c)(1) if, "as a matter of economic reality, that person or entity exerts some degree of control over the employer's compliance with EPPA." *Citing Rubin v. Tourneau, Inc.*, 797 F. Supp. 247 (S.D.N.Y. 1992); *James v. Professionals' Detective Agency*, 876 F. Supp. 1013, 1016 (N.D. Ill. 1995).

Applying this definition to the facts in this case, the court held that, given the undisputed facts that: (1) the meeting took place at the Franchisor's corporate office; (2) the owner of the Franchisee/employer, Father, and the Franchisor's in-house counsel were all present during this meeting; and (3) the meeting was conducted in order to investigate a complaint of sexual harassment involving the Franchisee's manager and hourly employee, Father was acting "in the interest of the employer" in relation to Ms. Sanchez. Therefore, the court held that, because Father was acting in the interest of Ms. Sanchez's direct employer, he acted as an "employer" within the meaning of the EPPA when he made an indirect suggestion that she submit to a polygraph examination. The court granted Ms. Sanchez's motion for partial summary judgment on her EPPA claims against the Franchisor.

Conventional wisdom recommends that franchisors distance themselves from employment issues at the franchise level, and avoid direct or even indirect entanglements with franchisee decision-making on sensitive issues involving discrimination. This case is one more example of why conventional wisdom trumps the natural inclination to provide assistance to franchisees, even family members.

The New Tag Team – Antitrust and FCPA

John G. Calender, 202.508.3474, jcalender@bakerdonelson.com

Is your company seeking new markets outside the U.S. and North America, or engaging more actively in industry trade associations, conferences and events? The attraction of foreign markets and enhanced industry participation carries a cautionary element: the need to develop and implement more sophisticated compliance apparatus. Compliance professionals now mention their concern with the Foreign Corrupt Practices Act (FCPA) in the same breath as compliance with antitrust/competition laws. This is not surprising, given the significant growth in federal efforts at FCPA enforcement and the major financial penalties, jail sentences, business disruption and costs that can be imposed for non-compliance. Due to this major growth in FCPA enforcement by the U.S. Department of Justice (DOJ), antitrust and FCPA have become the new "tag team" for federal compliance enforcement activity, with either area able to deliver a potent body blow to any business.

Recent examples of some "tag team" action include:

- Avon Cosmetics is reporting over $175 million in legal and investigative costs due to an FCPA investigation that started in connection with activities in China and now has expanded worldwide. Avon has also fired several high level executives and been hit with shareholder derivative actions.
- The Connecticut Attorney General recently fined three hotel groups over an alleged price-fixing scheme for hotel rooms involving informal information exchanges or "call-arounds."
- Las Vegas Sands Corp. reports it is being investigated by the DOJ and the Securities and Exchange Commission for alleged FCPA violations arising out of business operations in China. It has already been fined by the Chinese government and is facing shareholder derivative actions.
- Major hotel chains (including Radisson, Starwood and Thistle) are reportedly being investigated by the United Kingdom for price-fixing.

There are many similarities between FCPA and antitrust/competition enforcement, and both should be emphasized in compliance training. Both laws share a core concept: prohibition of conduct that injures competition, with the FCPA focusing on bribery or payments to government officials to secure an "improper advantage" or in order to assist in obtaining or retaining business, and the United States antitrust laws

continued on page 9

The New Tag Team – Antitrust and FCPA, *continued*

focusing on injury to competition. As briefly summarized below, many of the principal themes stressed in antitrust compliance programs apply equally to FCPA compliance training.

Substantial civil and criminal fines – While antitrust violations have resulted in huge fines, the U.S. government is now seeking even larger fines for FCPA violations.[1] In 2010, the DOJ imposed almost $1.8 billion in FCPA fines and penalties, over three times as much as the DOJ's Antitrust Division imposed during the same period for antitrust offenses. And foreign governments are imposing major penalties for violations of their versions of the FCPA. For example, Siemens recently was fined $1.6 billion by the U.S. and Germany for bribery violations and reportedly incurred over $1 billion in investigative and legal costs.

Substantial jail terms – The Antitrust Division has made incarceration of individuals a priority and has imposed record jail sentences for antitrust violations, some as long as 48 months. Similarly, the Criminal Division is seeking and obtaining substantial jail time for individuals convicted of violating the FCPA, even for seemingly small violations. For example, one corporate executive received a 57-month jail term for bribes paid to obtain a Haitian telecommunications contract. Another corporate executive was sentenced to 87 months for paying bribes to Panamanian officials for a contract to maintain lighthouses and buoys.

Undercover surveillance and stings – Undercover surveillance, stings, informants and wiretaps have been frequently used by DOJ to collect incriminating evidence of antitrust violations. The most notorious examples are the Archer Daniels lysine price-fixing tapes where co-conspirators at price-fixing meetings were secretly videotaped while joking that the empty seats at the meeting table were for the FBI and the Federal Trade Commission. Similar techniques are now being used in FCPA enforcement, the most high profile example being the "shot show" sting operation where

21 employees of defense and security products were arrested at a Las Vegas trade show for attempting to bribe FBI agents posing as foreign government officials.

Leniency and amnesty – The Antitrust Division has a well-established and well-publicized amnesty program that provides substantial benefits for the first company to report an anticompetitive conspiracy. The DOJ has now begun to emphasize the benefits of voluntary disclosure in FCPA matters, with the DOJ stating that it gave "meaningful credit" to companies that voluntarily disclosed and cooperated in the form of lower fines. Moreover, the whistleblower/bounty-hunter provisions of Section 922(a) of the Dodd-Frank Act provide significant financial rewards to whistleblowers who provide original information to the government, and this will likely increase the incentive for companies to self-report in the hope of obtaining some leniency.

International cooperation and enforcement – Recent antitrust enforcement has been marked by international cooperation, including coordinated and simultaneous world-wide dawn raids to execute search warrants. There has been a significant increase in coordinated international enforcement and cooperation in the FCPA/bribery area as well. More countries are becoming active enforcers of bribery laws, including the United Kingdom, Germany, Norway and Switzerland. The United Kingdom has just enacted its own FCPA counterpart, which in some respects is more stringent than the U.S. FCPA.

Follow-on private actions – Follow-on private treble damage class actions by allegedly injured parties with standing are a given in the antitrust area. Private actions based on FCPA violations or investigations are increasing. For example, follow-on securities class actions and/or derivative actions alleging breaches of fiduciary duty have been filed after the announcement of FCPA violations or investigations. In addition, competitors have filed lawsuits claiming the alleged bribery constituted unfair competition under state law and common law theories and unlawful commercial bribery under the federal Robinson-Patman Act.

Watch the company you keep – Antitrust compliance programs stress the need for utmost caution in dealing with competitors, especially in the trade association context. In the FCPA area, the company you keep must also be

continued on page 10

The New Tag Team – Antitrust and FCPA, *continued*

carefully managed, with special attention paid to intermediaries, consultants, partners or agents who deal with government officials. The FCPA imposes liability if you know your agent may be paying a bribe or if you consciously disregarded certain warning signs or red flags. These red flags are well-established and should be stressed in a compliance program, just like the antitrust red flags that arise in dealing with competitors.

The "everybody does it/we have always done it this way" defense doesn't work – Many antitrust compliance programs contain clear restrictions on contacts with competitors and limits on trade association participation and activity. Employees sometimes respond to those restrictions by saying "everybody does it" and "we have always done it that way." This is often a common response to FCPA training as well, especially in countries where bribery is the accepted way of doing business and there is a culture of corruption. FCPA training should stress that compliance is important to protect both the company and the individual employee, especially in this era of increased international enforcement with sophisticated investigative techniques and long jail terms. While everybody may be doing it, many are getting caught and facing substantial penalties and substantial jail time.

Significant investigative costs and business disruption – Just as in the antitrust area, FCPA investigations can open a Pandora's Box and unleash a parade of horribles beyond substantial penalties. This parade can include enormous investigative costs paid to outside professionals for internal investigations, with the government requiring an extensive in-house investigation of all contacts and dealings with foreign government officials world-wide, not just in the country where the offense was discovered. As discussed above, Siemens reportedly incurred over $1 billion in investigative costs, and Avon is projecting FCPA-related investigative costs of $175 million.

Loss of business and reputation – Companies that violate the FCPA often face the prospect of significant loss of business and reputation, just as antitrust violators are often regarded suspiciously by customers victimized by a price-fixing conspiracy. Many companies now routinely include contractual provisions requiring their third parties to comply with all applicable bribery laws and providing audit rights to ensure compliance. Given the enormous investigative costs and potential liability, no company wants to get swept up in a massive and expensive FCPA investigation because of the actions of one of its business partners. Moreover, companies can be suspended or face debarment from government contracts for FCPA violations.

Importance of a strong compliance program – As in the antitrust area, a strong and effective FCPA/anti-bribery compliance program can prevent and detect potential violations, and provide some credit in the event of enforcement action. Many of the essential components of an effective FCPA compliance program are similar to those in antitrust compliance programs, specifically: a clearly articulated and written compliance code, full management support with a strong and ethical tone (and consistent action) at the top, periodic training for all employees, risk assessments, periodic audits, internal procedures to report and address violations and due diligence of intermediaries, agents, and business partners. Importantly, given the enormous primary and secondary blows that either FCPA or antitrust enforcement can inflict on a business, compliance programs should stress the importance of avoiding the appearance of impropriety and the importance of seeking immediate legal advice if questionable activities are encountered.

1. The FCPA is jointly enforced by the DOJ Criminal Division and the Securities and Exchange Commission, while price-fixing prosecution is the province of the DOJ Antitrust Division.