

## Chapter Seven: Respect for Human Rights in Franchising and Licensing Relationships

### Overview

#### *Brief overview of franchising and licensing relationships*

Licensing and franchising contracts have similarities, but also some significant differences. These relationships can range from a long-term relationship for a branded franchise to a brief, standard contractual relationship to license a patent for a minor piece of technology or intellectual property. By comparison with a license contract, a franchise is usually broader in scope, longer in duration, and more specific. It generally requires more capital up front, but there is more predictability in the nature and duration of the relationship between the franchisor and franchisee. A licensing contract is subject more often to revision and renewal, and usually does not entitle the licensee to the same level of support from the parent company.

A licensing agreement is a contract by which a licensor grants permission to a licensee to use its intellectual property, such as its patent, trademark or copyright. In return, the licensee will generally pay a flat rate or royalties, or some combination of both. This type of contract does not convey ownership of the intellectual property to the licensee. It is more limited in scope than a franchise agreement.

Franchise contracts are based on the idea that, by reproducing a proven business model, both parties to an agreement gain something of value. The franchisor grants a franchisee permission to use its intellectual property and its various systems and marketing campaigns. The franchisee, in return, agrees to conduct the business in accordance with the practices and policies of the franchisor. A franchise contract will often include the franchisor's instructions on how the business should be operated, a license permitting the franchisee to use the franchisor's system, mentoring and technical advice for the franchisee, and a shared obligation to develop and improve the business. Arguably, franchisors have more control over their franchisees than a licensor has over a licensee, because they can determine the structure of the management systems, require specific policies, and provide training.

#### *Human rights and franchising and licensing*

Businesses may consider human rights impacts for a number of reasons when they undertake franchising and licensing. For example:

- When a company name or brand is involved, (whether through licensing or franchising), stakeholders will often make no distinction between the licensee or franchisee and the company. They will have the same expectations of the brand, regardless of who delivers the product or service, or the type and tenure of the relationship. These expectations are increasingly relevant to the company's human rights reputation.
- Human rights impacts do not necessarily correlate with the duration or extent of a relationship. Companies may be exposed to human rights risks if they focus their

due diligence exclusively on longer-term or higher value relationships, because small contracts can also expose them to risk.

- Even in the case of an unbranded licensing agreement, use by the licensee of a company's intellectual property in a manner that has negative human rights impacts can link the licensor to the human rights impacts, as recent examples in the information and communications technology (ICT) and pharmaceutical sectors have shown. The unintended use of licensed materials by customers (including licensees and franchisees) that have negative human rights impacts is an area of growing concern that companies are beginning to address.
- Franchise agreements usually require a franchisee to start new operations, involving the acquisition of property and land, construction of facilities, employment of workers, contracting with local suppliers, and management of the environment. All these stages of business start-up have the potential to link the franchisor with any adverse human rights impacts.
- Intellectual property rights, and their application and enforcement, have implications for human rights that are relevant to business relationships in this area.<sup>83</sup> While protecting intellectual property rights is a valid objective that is often covered by national law, it may have a 'chilling effect' on freedom of expression when there are overly broad attempts to remove content or products from the public domain on claims of intellectual property violations. This human rights issue is becoming a key point of debate, notably in the ICT industry, that may have long-term implications for business relationships.

## The Business Relationship Cycle

### Selecting and Starting the Relationship

*Setting expectations and communicating them to business partners*

**It is important to communicate expectations and establish standards early, especially in long-term franchise agreements.**

Since franchises are often long-term relationships that bear the franchisor's trademark, communicating clear expectations about company values and requirements is important. One company noted that it is vital from the start to establish ethical values alongside

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83 There are certain overlaps between the content of human rights and intellectual property rights. "The human right to benefit from the protection of the moral and material interests resulting from one's scientific, literary and artistic productions safeguards the personal link between authors and their creations and between peoples, communities, or other groups and their collective cultural heritage, as well as their basic material interests which are necessary to enable authors to enjoy an adequate standard of living; intellectual property regimes primarily protect business and corporate interests and investments. Moreover, the scope of protection of the moral and material interests of the author does not necessarily coincide with what is referred to as intellectual property rights under national legislation or international agreements." General Comment No. 17 (2005), The right of everyone to benefit from the protection of the moral and material interests resulting from any scientific, literary or artistic production of which he or she is the author (article 15, paragraph 1 (c), of the Covenant), UN Committee on Economic, Social and Cultural Rights.

management, technical and financial standards of performance. The longer-term nature of a franchise relationship can also provide an opportunity to build relationships with franchisees around shared policy goals. By contrast, several of the companies involved in the research treated licensees like suppliers or service providers. Expectations of performance centred on meeting the company code of conduct for suppliers, and the code then became a point of reference for discussion of human rights issues. (See Chapter 4, discussion of codes of conduct.)

**Consumer expectations can stimulate consideration of human rights in these business relationships.**

Franchising and licensing for consumer brands adds an important driver to the business relationship because of rising consumer interest in the human rights impacts associated with the consumer brands they purchase. Consumers are interested in the quality of products and how the goods they consume are produced, and by extension in labour conditions and other human rights issues related to production. They want products to be made safely and humanely. (See the discussion of transparency and traceability in Chapter 11.) Consumer concerns create leverage that companies can use to start a conversation on human rights with their franchisees and licensees, or to justify the inclusion of human rights requirements via contract or management mechanisms.

*Understanding the issues – Assessing human rights impacts in franchising and licensing relationships*

**Company assessments are often more detailed when the company name is associated with the business relationship.**

Licensing and franchising generate additional revenue from intellectual property, licensed processes or the brand, but where they involve the company name, they also generate reputational risk. That can cause the franchisor or licensor to sharpen its risk assessment processes, including those that relate to human rights. One company reported that it had imposed specific requirements on the contractors and subcontractors of a large branded facility, to ensure that their treatment of migrant workers complied with company labour requirements. Another indicated that it became particularly vigilant when licensees marketed certain products or employed the company trademark. Whenever they license a trademark, companies require more detailed adherence to the company's code of conduct. This concern seems to be driven by reputational risk. It is less clear from the research what level of assessments companies require when their name or trademark is not used.

Where franchisees manage a wide range of corporate activities (sourcing, production, marketing), companies noted that assessments need to consider the full scope of issues, benchmarked against national law as well as company policy. One company is developing a suite of human rights due diligence tools, focused on human rights impacts it has identified among franchise operators.

With respect to licensees, several companies noted that their assessments resemble those applied to suppliers, and they often use a pre-certification process. If a potential business partner does not qualify in the certification process, they are not awarded a licensing

contract. One company reported that it paid more attention to the assessment of licenses that had the potential to affect consumer health and safety, compared to “trinkets and trash” licensing of branded apparel or non-consumables. Some companies reported that, when they lacked resources to assess licensing and supply chain partners, they might give a pass to business partners working with other big companies, on the assumption that those companies had already reviewed their performance.

### Licensing and Indigenous Peoples’ Rights

One area where licensing relationships intersect with human rights is when licensing may have impacts on indigenous peoples’ traditional knowledge and traditional medicines. This draws attention to the fact that research and development (R&D) departments may need to address issues, including human rights issues, that they had considered distant from their concerns.

There are deep divisions in the international community over what standards and regulations should govern the protection of traditional knowledge, and how the benefits and income generated by traditional medicines and products patented and licensed for large-scale production by private companies should be shared. One side considers that the intellectual property protection of traditional knowledge and medicines facilitates and advances their transmission, and that their commercial development benefits the indigenous peoples who identified and possess them. The other considers that the intellectual property rights regime, as applied, undermines and exploits indigenous cultures and ecosystems, to the almost exclusive benefit of private companies. The global discussion is a complex one, involving the World Trade Organisation (WTO), the World Intellectual Property Organisation (WIPO), the Food and Agricultural Organisation (FAO), and the Union for the International Protection of New Varieties of Plants (UPOV).

The Convention on Biological Diversity recognises the sovereign rights of states over their natural resources and seeks to promote the fair and equitable sharing of benefits from the use of genetic resources and associated traditional knowledge. The Convention’s access and benefit sharing agreement shifted protection of traditional knowledge and medicine to the national jurisdictions of states. As a result, companies need to exercise due diligence to ensure they do not infringe national law. The multilateral Trade Related Aspects of Intellectual Property Rights (TRIPS) agreement (under the WTO) established for the first time a minimum standard for global free trade, including free trade in intellectual property.

Several cases of alleged misappropriation of traditional knowledge have attracted attention in the past twenty years. These have often involved the exploitation of genetic resources for medicinal use. Companies have been accused of infringing access and benefit sharing requirements in South Africa, Peru, Bolivia and a number of Asian countries.

**A partner’s capacity to manage human rights issues is an important dimension of assessment.**

Because franchisees may be required to manage a wide range of requirements, assessments often focus on the quality of the business partner’s management system. Some require partners to support their systems with training and audits. The objective is to continuously improve their capacity, not least to enable franchisees to cope with the appearance of new and emerging human rights issues, particularly ones that were not covered by the original franchise agreement.

**Formalising the Relationship**

**The duration of many franchise agreements makes it necessary to manage human rights issues throughout the relationship, rather than relying on the contract.**

As franchisees are often producing or selling products or services using company trademarks, central requirements of their contracts often require them to comply with local law, uphold quality, and refrain from injuring the trademark. One company noted that, since the relationships – and contracts – are often long-term and complex, companies are reluctant to load more into the contract. Instead, franchisees are provided with training and other resources that enable them to adapt their operations when new issues arise, including those of relevance to human rights. This is an example of creating leverage based on managing the relationship rather than relying solely on the contract. The contracts for longer-term or more significant licensing agreements often require licensees to comply with the company’s supplier code of conduct.

**Managing the Relationship**

**Companies use many forms of leverage to focus franchisees’ attention on human rights issues.**

As many franchise relationships are longer-term, the relationship dynamics can be very different from short-term relationships based principally on contracts. As one respondent put it, “if you rely on the contract to alter behaviour, you’ve already lost”. Given the potential reputational risks associated with franchising, a franchisor is motivated to help franchisees work through problems and increase their capacity; termination is not the preferred option, except when faced with egregious abuse.

Extended franchise relationships also need to be flexible, able to adapt to change and raise standards over time.

Franchisees may need franchisors to support them in building their capacity to respond to their human rights expectations. One way to incentivise appropriate behaviour among franchisees is to provide governance, processes and tools that motivate them to continuously improve their standards and performance. “Translation” of human rights into operational targets and management systems is critical, as one respondent

noted, because it creates a clear list of requirements that both parties can track and report. Companies can also develop a shared approach to human rights issues by joining industry or multistakeholder initiatives in which both franchisors and franchisees have an interest.

### **Companies routinely track the human rights performance of franchisees.**

Given the importance of franchise relationships, companies often have monitoring systems in place, similar to the social compliance systems they use for suppliers. These typically include audits to identify non-compliance with agreed standards, corrective action, and follow up. Results and follow up actions are typically tracked. “Audit fatigue” and cost concerns can cause resistance to corrective action. As noted in Chapter 8 (on Suppliers and Service Providers), the “social compliance model” provides an approach to identifying and addressing human rights impacts, which may require some adjustment in light of the Guiding Principles. For long-term relationships, capacity building may ultimately be a more sustainable approach.

Licensees who have a contractual obligation to comply with company codes of conduct may also be subject to monitoring. As with assessments, companies are often prioritising their monitoring among licensees in light of resource constraints. In many cases, the primary driver is reputational risk.

### **Grievance mechanisms are a work in progress.**

Companies may install a telephone hotline, website access (or both) and may also request a franchisee to run its own hotline. Respondents said that the main point is to ensure that franchisees have systems that can receive and address employee and community grievances. As noted in Chapter 4, hotline mechanisms are only one element of operational grievance mechanisms defined in the Guiding Principles.

## **Ending or Renewing the Relationship**

### **Terminating a relationship usually requires several steps.**

Franchise agreements are usually long term. Termination is rare, but not unheard of. When it happens, it is often tied to markets and performance, but one company noted that it had terminated franchisees on human rights grounds. (The franchisee had been discriminatory and had failed to respect freedom of association.) Faced by less serious breaches, sale to another franchisee, taking control, or buyout are options. When licensing agreements require compliance with a company code of conduct, breach of the code may be a justification for termination but, as in other types of relationships, it is usually not the preferred option.

### **Complying with a Licensor's Social and Environmental Requirements**

Business for Social Responsibility (BSR), a global network of over 250 companies that are developing sustainable business strategies and solutions, recently produced a guide for licensees in consultation with the Licensing Industry Merchandisers' Association. *Good Practices for Complying with Licensor's Social and Environmental Requirements*<sup>84</sup> provides information on how to meet the expectations of licensors and brands with respect to social and environmental standards in supply chains. The guide covers: licensors' expectations; social and environmental compliance in licensees' business relationships with suppliers; assessing risk; communicating with licensors; remediation steps to help improve working conditions; and collaboration with others around social and environmental challenges related to licensing.

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84 At: <http://www.bsr.org/our-insights/report-view/good-practices-for-complying-with-licensors-social-and-environmental-requir>.