WALKING THE LINE: BEST PRACTICES FOR ADVISING FRANCHISE CLIENTS ON AVOIDING EMPLOYMENT RISKS

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October 14 – 16, 2015
New Orleans, LA

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Table of Contents

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

II. OVERVIEW OF JOINT EMPLOYER ISSUE .............................................................. 2
    A. The Recent Evolution of the Joint Employer Standard .............................................. 2
    B. Recent NLRB Developments ................................................................................. 3
       1. The Action Against McDonald’s USA LLC ....................................................... 3
       2. The Browning-Ferris Case ............................................................................... 5
    C. Policy Underpinnings to NLRB’s Current Position ................................................ 9
       1. David Weil’s May 2010 Report ................................................................... 9
       2. The Fissured Workplace .............................................................................. 11
    D. NLRB Decisions Finding No Joint Employer Status Under the Pre- 
       Browning-Ferris Standard .............................................................................. 12
       1. AT&T v. NLRB ......................................................................................... 12
       2. In re Airborne Freight Co. ........................................................................... 12
       3. AM Property Holding Corp. .......................................................................... 14
    E. NLRB Decisions Finding Joint Employer Status Under the Pre-Browning-
       Ferris Standard .............................................................................................. 14
       1. Quantum Resources Corp. .......................................................................... 14
       2. Computer Associates International, Inc. ....................................................... 16
       3. In re Aldworth Co ....................................................................................... 16

III. SURVEY OF VICARIOUS LIABILITY CASES ............................................................. 17
    A. Means and Manner Test; Survey of Cases ............................................................ 17
       1. Billops v. Magness Const. Co. .................................................................... 18
       2. Greil v. Travelodge Int’l, Inc. .................................................................... 18
       3. Parker v. Domino’s Pizza, Inc. et al. ......................................................... 18
    B. Instrumentality Test; Survey of Cases ................................................................ 19
       1. Hong Wu v. Dunkin’ Donuts, Inc. ................................................................. 19
       2. Reese v. Dunkin’ Brands, Inc. ................................................................... 19
       3. Courtland v. GCEP-Surprise, LLC .............................................................. 19
    C. Specific Recent Vicarious Liability Cases Involving Employment Claims .......... 20
       1. Patterson v. Domino’s/Ochoa v. McDonald’s .............................................. 20
       2. Kerl v. Rasmussen .................................................................................... 22
       3. Vann v. Massage Envy Franchising LLC .................................................. 23
       4. Orozco v. Plackis ...................................................................................... 24
       5. Domino’s Pizza, LLC v Reddy ................................................................. 25

IV. IMPACT ON FRANCHISORS IF JOINT EMPLOYER STANDARD IS CHANGED ...... 27
A. Increase in Non-Traditional and Traditional Union Campaigns .......... 27
B. Franchisor Liability under the National Labor Relations Act (NLRA) ................................................................. 28
   1. Franchisor Liability Regarding a Franchisee's Employees .... 28
   2. Franchisor Liability Regarding its Own Employees ............ 30
C. Franchisor Required to Participate in Collective Bargaining ......... 30
D. Minimum Wage Legislation .................................................. 31
E. Appropriations Committee Legislation ..................................... 31
V. POTENTIAL ISSUES UNDER OTHER EMPLOYMENT STATUTES ....... 31
A. Title VII of the Civil Rights Act of 1964, the Family and Medical Leave Act, and the Fair Labor Standards Act ................................................................. 33
   1. Title VII ........................................................................... 33
   2. Family and Medical Leave Act ......................................... 35
   3. Fair Labor Standards Act Claims ....................................... 36
B. Occupational Safety and Health Act Claims and Worker's Compensation .......... 37
   1. OSHA Claims .................................................................. 37
   2. Worker's Compensation Claims ........................................ 38
C. Affordable Care Act ............................................................. 39
D. State Laws Seek to Clarify Franchisor-Franchisee Relationship .......... 39
VI. CONSEQUENCES ON FRANCHISING IF JOINT EMPLOYER STANDARD IS ADOPTED ................................................................. 40
VII. PRACTICAL APPROACHES TO MINIMIZING FRANCHISOR RISKS .......... 43
A. Review the Franchise Agreement ............................................ 43
   1. Definition of "Operations Manual" ..................................... 43
   2. Franchisor's Obligations ................................................ 44
   3. Franchisee's Obligations ................................................. 45
   4. Franchisor/Franchisee Relationship .................................. 45
   5. Obey All Laws ................................................................ 45
   6. Indemnification ............................................................. 46
   7. Insurance ....................................................................... 46
B. Review the Operations Manual .............................................. 46
C. Review Training Programs ................................................... 47
D. Other Practical Considerations ............................................. 48
VIII. CONCLUSION ......................................................................... 50
Appendix A – The NLRB Process for Unfair Labor Disputes
Biographies
WALKING THE LINE: BEST PRACTICES FOR ADVISING FRANCHISE CLIENTS ON AVOIDING EMPLOYMENT RISKS

I. INTRODUCTION

It would be logical to conclude that the genesis of this paper and subsequent presentation was a report submitted by Dr. David Weil, at the time a professor at Boston University, to the Wage and Hour Division ("WHD") of the United States Department of Labor ("DOL"), in May of 2010. The report, entitled Improving Workplace Conditions Through Strategic Enforcement, was an examination of what Dr. Weil described as the "fissuring" of the American workforce, which in turn, according to Dr. Weil, has caused a significant increase in "vulnerable employees." Dr. Weil is currently the Administrator of the Wage and Hour Division of the DOL and in 2014 authored the book, The Fissured Workplace.1

The fissuring of the workforce refers to the breakdown of the traditional large employer by that large employer reducing the number of its direct employees via, inter alia, independent contractors, staffing agencies and franchising. Vulnerable employees are employees that work at or near minimum wage, have no benefits and are employed by a smaller employer in a larger industry.

The aim of Dr. Weil’s report was to examine the perceived fissuring/vulnerable employee problem and then propose regulatory and enforcement solutions to protect the vulnerable employees. Unfortunately for the franchise model of business, Dr. Weil examined and used as examples the food and hotel franchise systems extensively in the report.

In proposing new strategies for DOL enforcement, Dr. Weil suggested that in a "fissured" industry, enforcement must focus on both "workplaces where labor standards violations occur [franchisees] and also at the higher level of industry structure, where ‘lead firms’ [a/k/a franchisors] play a key role in setting the competitive and employment conditions for employers at ‘lower levels’ [franchisees] of the industry structure."2 Within that new strategy, Dr. Weil proposed two tactics to reach the "lead firms" — (1) "specific outreach ... to major brands" that have a positive employment reputation, and reaching a cooperative agreement that the "major brand" be "committed to review employment practices with franchisees when other franchise standards are being reviewed," creating a model for other franchise systems; or (2) "target several major brands that had documented histories of systemic violations among their franchisees ... Once identified, the WHD could undertake broad and coordinated investigations in multiple parts of the country and across multiple franchisees, in order to establish the level of system-wide violations, and pursue statutory penalties for those violations."3

In short, Dr. Weil has proposed either a Dr. Phil approach or a General Patton approach. Based on the investigations and actions of the DOL agencies to date, it appears as though the more aggressive approach is being primarily utilized.

1 Dr. David Weil, The Fissured Workplace, Harvard University Press, 2014. ("The Fissured Workplace")

2 Dr. David Weil, Improving Workplace Conditions Through Strategic Enforcement, A Report to the Wage and Hour Division at pp. 76-77 (Boston University May 2010). ("Weil Report")

3 Id., p. 78.
There can be little doubt that the extensive reference of the franchise model in Dr. Weil's report has led to at least some of the increased scrutiny of the franchise system by the National Labor Relations Board ("NLRB"), the Occupational Safety and Health Administration ("OSHA") and other DOL boards and agencies. The primary weapon these agencies are utilizing is the joint employer doctrine. Days before this paper was submitted, the NLRB expanded the reach of the joint employer doctrine in the Browning-Ferris case, which will be described in more detail below.4

The aim of this paper and presentation is to provide practical advice to franchisors and their counsel on the best practices to reduce risk. To provide this advice, it is important to review the evolution of the joint employer doctrine, and vicarious liability for employment claims generally, by taking a close look at the use of the doctrine in the last few years and by determining the potential risks to the franchise model.5

II. OVERVIEW OF JOINT EMPLOYER ISSUE

A. The Recent Evolution of the Joint Employer Standard

The standard for determining whether or not a party is a joint employer prior to the Browning-Ferris decision was whether the party had direct and immediate control over the employee.6 In Sections II.D. and II.E. below, an analysis of how this standard has been applied illustrates the emphasis on the actual practices of the parties.

The new standard set forth by the NLRB in Browning-Ferris would extend the analysis to the ability of a party to exert indirect control over the employee. The potential for exerting that control would be sufficient. In sum, the NLRB advocates making a party a joint employer if its absence would be a major impediment to collective bargaining.

The NLRB general counsel's decision to bring complaints against McDonald's USA, LLC (discussed further in the following section) along with its franchisees makes sense in the context of the stated goal of addressing fissured relationships. The question then arises whether all franchise relationships should result in franchisors being held responsible for their franchisees' employees. The Advice Memorandum issued by the General Counsel on April 28, 2015 and discussed in Section IV.B1 below, seems to answer this question in the negative and signals that despite the fact that franchising plays a major role in the issues the NLRB is trying to address, some franchise system structures may still be able to avoid creating a joint employer relationship.7

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5 This paper does not address employee/independent contractor classification issues. For an examination of those issues, see S. Liss-Riordan, J. Perlman and G. Rubinstein, Are My Franchisees or Their Employees Actually My Employees?, 37th ABA Forum on Franchising, October 15-17, 2014, Seattle, Washington and A. Pressman and C. McMillian, Franchisee or Employee? The Risks of Misclassification in Franchise Relationships, 32nd ABA Forum on Franchising, October 14-16, 2009, Toronto, Ontario.
The following sections will highlight these and other recent NLRB developments that have brought the issue of franchisor joint employer status to the forefront of issues confronting franchising and its future. The underpinning of these developments, including Dr. Weil's 2010 report, are explored, followed by an examination in Section II.C.1. of how the standard that has existed until now has been applied.

B. Recent NLRB Developments

1. The Action Against McDonald's USA LLC

   a. The Complaints filed by the NLRB General Counsel.

In July 2014 national attention focused on the issue of whether franchisors could be joint employers of their franchisees' employees. On July 20, 2014 the General Counsel of the NLRB announced that a number of the alleged violations of the National Labor Relations Act ("NLRA") related to protests by employees of McDonald's franchisees would result in the issuance of complaints by the NLRB that would name McDonald's USA, LLC (the franchisor) as a joint employer. After investigating the charges by the employees, the NLRB’s General Counsel determined that of the 181 cases filed beginning in November 2012, 68 were without merit, 64 were subject to ongoing investigation, and in 43 cases complaints were authorized if there was no settlement.

In an update issued by the NLRB's Office of Public Affairs on December 19, 2014, the NLRB noted that complaints had issued against McDonald's franchisees and their franchisor in 86 of the then 291 charges filed since December 2012 (an increase of 110 charges since the July press release). The allegations the NLRB had determined were meritorious included "discriminatory discipline, reduction in hours, discharges, and other coercive conduct directed at employees in response to union and protected concerted activity, including threats, surveillance, interrogations, promises of benefit, and overbroad restrictions on communicating with union representatives or with other employees about unions and the employee’s terms and conditions of employment."10

Like most franchise agreements, the McDonald's franchise agreement requires franchisees to adhere to the franchisor's standards and policies. These standards relate to food and beverage products, prescribed equipment, building layout and design, quality, service and cleanliness. The franchisee is provided with manuals which include operational procedures, inventory control methods, accounting procedures, business practices and advertising policies, and the franchisee is required to adopt these in operating its McDonald's restaurant. The franchisor provides training to the franchisee and its managers.


10 Id.
The franchise agreement requires compliance with the entire McDonald's system and the requirements of its manuals. Elements of the system include:

- Operation of the restaurant in a clean, wholesome manner
- Purchasing kitchen equipment that meets McDonald's specifications
- Construction in accordance with standard blueprints
- Avoidance of changes to the building, equipment or parking area
- Required repairs
- Maintenance of the parking area
- Operations 7 days a week, with the restaurant open from 7 am to 11 pm at a minimum
- Requirement that all employees wear uniforms, be neat and provide courteous service
- Use of packaging and ingredients and handling of food according to McDonald's specifications
- Prompt payments
- Compliance with applicable laws

In sum, the controls set forth in the McDonald’s Franchise Agreement do not differ materially from those in other franchise systems. Indeed, one of the hallmarks of franchising is to present a uniform experience to the customer no matter which location the customer patronizes. McDonald’s does lease locations to franchisees, but franchisors that do not have this structure still exercise similar control through required lease provisions and conditional lease assignments. Of course, the contents of the manuals and the potential for control are factors that could have influenced the NLRB General Counsel. For example, see the allegations made in Betts v. McDonald’s discussed in Section V.A.1 below. Moreover, the policies behind some of the NLRB’s current actions include finding methods to facilitate collective bargaining, which is likely another motivating factor.

To determine the basis for the NLRB General Counsel’s decision to name the McDonald’s franchisor as a joint employer, we must look to other cases, such as Browning-Ferris, discussed below.

b. The NLRB Rules that McDonald’s is Not Entitled to a More Specific Complaint.

On August 14, 2015, the NLRB issued an Order11 by a decision of 3-2 denying McDonald’s request to appeal an Order by the administrative law judge that denied McDonald’s

motion for a bill of particulars (or, alternatively, to strike the joint employer allegations and dismiss the complaint). McDonald's sought information on the facts upon which the NLRB General Counsel was relying to support the position that McDonald's is a joint employer, arguing that the failure to plead these facts puts McDonald's in a position of being unable to prepare its defenses for trial. The majority decision found that the allegations in the complaint were sufficient. The General Counsel alleged joint employer status based on McDonald's control over franchisees' labor relations policies.

Citing what it referred to as a serious due process problem, the dissenting opinion noted that the General Counsel was seeking to establish a more expansive joint employer theory, as signaled by the Amicus Brief in Browning-Ferris. The dissent compared the pre-Browning-Ferris and post-Browning-Ferris joint employer standards and found them as different as carrots and tomatoes. It concluded that these potential differences meant that a mere reference in pleadings by the General Counsel to joint employment was inadequate notice for finding a violation without more detail.

2. The Browning-Ferris Case.

a. Background of the Browning-Ferris Case.

Browning-Ferris Industries ("BFI") owns and operates a recycling facility. At the recycling facility, BFI has 60 direct employees. To fully staff the recycling facility, BFI entered into a temporary labor services agreement with Leadpoint to provide approximately 150 additional employees to work at the recycling facility. Pursuant to the labor services agreement, the Leadpoint employees are screened, hired, disciplined and supervised by Leadpoint employees. However, the temporary labor services agreement provides BFI with the ability to involve itself on matters of hiring, discipline, scheduling and wages. More specifically, the agreement (1) imposes a ceiling on the wages that Leadpoint pays (i.e., Leadpoint cannot pay more than BFI), (2) provides BFI with the right to "discontinue the use of any personnel" hired by Leadpoint, (3) requires Leadpoint applicants to undergo drug tests and prohibits Leadpoint from hiring individuals BFI has already deemed ineligible, and (4) permits BFI to control the pace of productivity of Leadpoint employees and the timing of Leadpoint employees' shifts.

The Teamsters seek to represent all 200 plus employees at the recycling facility. The Regional Director issued a Decision and Direction of Election finding that Leadpoint was the sole employer of the employees. The union sought review of the Regional Director's decision and the NLRB granted the request.

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13 Id. at pp. 2-3.
14 Id. at p. 19.
15 Id. at p. 18.
16 Id.
17 Id. at p. 19.
b. The NLRB General Counsel Files an Amicus Brief that Addresses the Franchise Model.

The General Counsel of the NLRB submitted an Amicus Brief dated June 26, 2014. While not addressing the merits of the particular case, the General Counsel argues for a change to the existing joint employer standard applied by the NLRB and provided a glimpse into the thought process that led to the filing of the McDonald's cases.

According to the amicus brief, before 1984, the NLRB used a much broader standard for determining whether a joint employer relationship existed. Under that earlier standard, an entity could be a joint employer if (a) it exercised direct or indirect control over working conditions of the employee; (b) it had the potential to control those working conditions; or (c) meaningful bargaining could not exist if it were not the joint employer of the employee. According to the brief, beginning with the Laerco Transportation\(^{19}\) and TLI, Inc.\(^{20}\) cases, the NLRB applied a narrower standard (although, as the brief notes, it purported to apply its then-existing standard). This narrower standard involved an analysis of whether the control of an entity over the employee was direct and immediate. Therefore, what had previously been considered as very strong indicia of joint-employer status became instead the minimum standard for finding such status.

An example of the application of the post 1984 standard was reflected in Flagstaff Medical Center\(^{27}\) in which no joint employer relationship was found because the putative joint employer merely recommended employees for hire and did not have the final decision making authority over hiring.

In addition, the decisions address the actual practice of the parties rather than the potential for control. Finally, there is a requirement that the control be substantial rather than limited and routine.

In its amicus brief, the NLRB General Counsel argued for a return to the broader, pre-1984 standard to reflect (in his opinion) the original intent of the NLRA and to advance its policy and purposes. The NLRA, he argued, was enacted to address problems related to the inability of employees to bargain successfully for improvements and the refusal of employers to bargain collectively. A return to a broader standard would entail an analysis that includes three elements that would be indicative of a joint employer relationship: (i) indirect control over certain terms and conditions of employment; (ii) potential controls would be sufficient; and (iii) the potential to control could be based on industrial realities rather than specific contractual obligations.

The General Counsel addressed franchising specifically in the brief and explains that this distribution structure can avoid joint employer status under the current standard, and thus inhibit meaningful collective bargaining. The brief alleges that franchisors in some cases exert

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\(^{18}\) Browning-Ferris, supra, note 5.

\(^{19}\) 269 N.L.R.B. 324 (1984).


significant control over the day-to-day operations of their franchisees and effectively control wages paid to the employees of the franchisees by controlling everything except wages. Technological advances only increase franchisors' control through their ability to monitor sales, work schedules, inventory, customer order fulfillment and similar matters through software reporting programs. According to the brief's citations, franchisors consider the avoidance of unionization and collective bargaining to be one of the advantages of the franchise model.

Therefore, the General Counsel recommended a finding of joint employment if “under the totality of the circumstances, including the way the separate entities have structured their commercial relationship, the putative joint employer wields sufficient influence over the working conditions of the other entity’s employees such that meaningful bargaining could not occur in its absence.” In the General Counsel’s opinion, control over the following are factors to weigh in the determination of whether a franchisor is an essential party to collective bargaining:

- Wages
- Employee personnel issues
- The number of employees necessary to perform a job or task
- Establishing employee work hours, schedules, work week length and shift hours
- Employee grievances, including administration of a collective-bargaining agreement
- Authorizing overtime
- Safety rules and standards
- Production standards
- Break and/or lunch periods
- Assignment of work and determination of job duties
- Work instructions relating to the means and manner to accomplish a job or task
- Training employees or establishing employee training requirements
- Vacation and holiday leave and pay policies
- Discipline
- Discharge
- Hiring
c. The NLRB’s Browning-Ferris Decision.

On August 27, 2015, the NLRB issued its decision in *Browning-Ferris.* In its decision, the NLRB, in its words, returned to the traditional joint employer doctrine and held that two or more entities are joint employers of a single workforce if (1) they are both employers within the meaning of the common law; and (2) they share or codetermine those matters governing the essential terms and conditions of employment. The effect of this “traditional” approach is to expand the reach of the joint employer doctrine. Interestingly, the decision was made by the same 3-2 vote of the Board as the *McDonald’s* decision.

The NLRB held that in evaluating whether the employer has sufficient control over employees to qualify as a joint employer, the NLRB will, *inter alia,* consider whether an employer has exercised control over terms and conditions of employment indirectly through an intermediary, or whether it has reserved the authority to do so. The NLRB held that “essential terms indisputably include wages and hours [and] other examples of control over mandatory terms and conditions of employment found probative by the Board include dictating the number of workers to be supplied; controlling scheduling; seniority and overtime; and assigning work and determining the manner and method of work performance.” The NLRB held that “the right to control, in the common-law sense, is probative of joint-employer status, as is the actual exercise of control, whether direct or indirect.”

The NLRB stated that the expanded standard is designed “to better effectuate the purposes of the [National Labor Relations] Act in the current economic landscape.” The NLRB describes the current economic landscape as one becoming significantly impacted by temporary, subcontracted employment. The NLRB cited that, as of August 2014, 2.87 million of workers were employed through temporary agencies. The NLRB concluded that its previous joint employer doctrine had failed to keep pace with changes in the workplace and economic circumstances.

Notably, the NLRB did not directly address franchise systems or how the expanded joint employer doctrine will be applied to franchise systems. As a result, there is a tension that exists between this decision and the Advice Memorandum provided to the Freshii franchise system, which is discussed below.

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22 362 N.L.R.B. 186.
23 *Id.* at p. 15.
24 *Id.*
25 *Id.* at 16. Importantly, the NLRB declined to adopt the “industrial realities” test urged by the NLRB General Counsel. The Board emphasized that the common law test is the relevant inquiry. *Id.* at 12-13, fn 68.
26 *Id.* at 11.
C. Policy Underpinnings to NLRB’s Current Position

1. David Weil’s May 2010 Report

As mentioned at the outset of this paper, on May 2010, David Weil of Boston University submitted a report to the WHD entitled Improving Workplace Conditions through Strategic Enforcement. This report is instructive in analyzing the underpinning of current positions of the WHD and other government agencies. The report was the culmination of four years of research and argues that changes in the structure of the economy and in employment relationships require changes in strategic enforcement and how its effectiveness is measured.

The report is divided into six sections covering enforcement trends, a survey of the workplace landscape, analyses of three specific industries (apparel, food and beverage and lodging) and recommendations for enforcement strategy.

One of the assumptions underlying the report is that the employment landscape has changed. The basic employer/employee relationship has devolved due to the use of subcontracting, outsourcing and franchising. “Like rocks weakened and split apart by the passage of time, employment relationships have become deeply ‘fissured’ in many sectors that employ larger numbers of vulnerable workers.”

In addition, the report noted that employment has shifted from the manufacturing sector to more service-orientated businesses, and these are often smaller, decentralized units. Add to this the decline of unionization and the report concludes that changes should be made to enforcement approaches involving prioritization, deterrence, sustainability and system-wide impact. In particular, the identification of widespread noncompliance by franchisees in a system may cause a franchisor to be more willing to increase specific programs to encourage compliance throughout its franchise system.

Franchising is just one type of fissured economic relationship that the report identifies. Of interest is that the report assumes that franchising consists of small workplaces linked together by large branded organizations, assuming that all franchisors are large and ignoring the impact of this analysis on start-up and smaller franchisors. It also correctly points out that vicarious liability concerns cause franchisors to distance themselves from the day-to-day operations of franchisees’ businesses.

The report identifies priority industries for enforcement: food and beverage, lodging, residential construction, janitorial services, moving companies/logistics providers, agricultural products, landscaping/horticultural services, health care services, home health care services, grocery stores and retail trade-mass merchants, department stores and specialty stores. Many of these sectors are franchised.

In addressing the specific industry of food and beverage (referred to in the report as “eating and drinking”), the report acknowledges that franchising is helpful in solving business

27 Weil Report, supra note 2.

28 Id., p. 9.

29 Id., p. 10.
issues of expansion by utilizing the capital of franchisees for brand expansion, creating management systems across the brand that allow small businesses to operate more profitably and allowing the brand to respond to local conditions more easily.\(^\text{30}\)

But one of the costs of franchising, according to the report, is that the relatively small investment of the franchisee provides a disincentive to compliance with labor laws that a company-owned unit will not have. Moreover, franchisors may be purposefully unaware of franchisees’ compliance issues because of vicarious liability concerns. Therefore, it suggests a number of strategic enforcement initiatives:

- Focus investigations on franchisees, especially large franchisees
- Include the brand in the enforcement strategy to encourage cooperation by the franchisee
- Compel the creation of a monitoring arrangement through a chain-wide agreement

Noting that the systemic nature of violations in the food industry raises larger concerns, the report also muses about establishing a “lead firm” to set higher standards of compliance for smaller business entities operating in competitive markets, and the implications for a joint employer to allow the WHD to use additional tools in the industry to address non-compliance.

Similarly, the report analyzes the various structures under which hotels are owned and managed, and concluded as follows with respect to the implications for enforcement:

- Focus investigations on the brand or management company level rather than on a specific hotel
- The enforcement strategy should address all three levels of the industry – owners, brands and managers
- Investigations of the top 5 hotel brands have the greatest deterrence effect on all branded hotels.

Some specific suggestions as to enforcement techniques are revealing. One instance cited by the report is the successful inclusion of the Korean American Association of Greater New York in the process of addressing violations in the green grocer industry. It resulted in the negotiation of a code of conduct with the Association for its members. Noting that the Asian American Hotel Owners Association is heavily involved in the independent hotel sector, one suggestion is to reach out to this group to develop initiatives directed to its constituency.

Another type of investigation plan could focus not only on a food service outlet about which there have been complaints, but also other units owned by the same franchisee, those of other franchisees in the system and the franchisor itself. This could be accompanied by publicizing the investigation through releases to traditional media and the Internet.

\(^{30}\) Id., p. 48.
2. The Fissured Workplace

Dr. Weil further expanded the ideas presented in his 2010 Report in his book published in 2014 The Fissured Workplace, again focusing on highly franchised industries such as lodging and food and beverage as examples of fissured employment models.

According to The Fissured Workplace, fissuring resulted from the intersection of three corporate strategies. The first was the drive to increase revenues which led companies to focus on core competencies and shift responsibility for other operations. The second was an effort to reduce costs by shedding employment responsibility. Finally, the third strategy was to develop a glue to make the overall plan work. That involves the creation and enforcement of brand standards which is greatly assisted by advances in technology that make monitoring the actions of others easier.

The author notes that fissuring has benefits for consumers and investors, but also has significant social costs. He posits that there are many reasons we should care about fissuring. It undermines compliance with the law. Problems with production coordination result in more accidents and injuries. The economic effect of fissuring has been to shift the surplus from production efforts from the work force to the investors, creating a widening disparity.

As noted above, Dr. Weil focuses on a number of industries and included a detailed analysis of franchise models for food and beverage, commercial cleaning and lodging, and how wage and hour and other violations are endemic to the structure. Janitorial franchises are singled out because franchisees are required to service contracts negotiated by the franchisor, and those contracts often do not result in compensation that meets minimum wage requirements. When faced with the question of how an industry structured in this manner can survive, he gives three reasons: (1) the franchisor still makes money; (2) there is a high turnover rate of franchisees who buy into the system; and (3) franchisees violate labor standards to make ends meet.

Dr. Weil calls for legislation to address the problems he identifies, with a focus on ending egregious forms of fissuring that are solely designed to end-run employers' workplace obligations. Existing workplace legislation should also be reformed to broaden responsibility of the larger companies that engage in fissuring activities. If a company is controlling the quality, production and delivery of services, then according to Dr. Weil, that control should extend to responsibility for employment issues. Finally, Dr. Weil calls for altering wage determinations in fissured workplaces.

He acknowledges that legislation can only have an indirect effect on this goal. Therefore, he advocates enforcement through existing laws in a more effective manner. As noted in his 2010 Report, rather than focus on the traditional methods of back wage recovery and inspections alone, enforcement agencies should be encouraged to target all outlets owned by a franchisee, to perform a brand analysis impacting other franchisees as well and to examine the brand itself. On a positive note, he encourages enforcers to reach out to leaders with positive reputations and histories of compliance to enter into co-operate agreements which

31 The Fissured Workplace, supra note 1.

32 Id., p. 11.
involve commitments to cascade information through company-owned outlets and franchisees, as well as a commitment to review the employment practices of franchisees.

D. NLRB Decisions Finding No Joint Employer Status Under the Pre-Browning-Ferris Standard

Following are summaries of decisions under the prior standard for evaluating whether a joint employment relationship has been established applying the direct and immediate control standard. In these cases, no joint employer relationship was found. The decisions focus on the issue of direct and immediate control, and do not mention an analysis based on other policy issues such as the potential for control or the employees' ability to bargain for better protection if the putative joint employer was also determined to be responsible.

1. AT&T v. NLRB

AT&T's subsidiary AT&T Communications ("AT&T") occupied a building owned by Tower Center Associates and for which cleaning services were provided by Executive Cleaning Services ("ECS").

In this case, the issue was whether AT&T had immediate control over ECS' employees. The determinative factors were participation in the following:

- Hiring and firing of employees
- Direct administration of any disciplinary procedures
- Maintenance of records of hours, handling payroll, or providing insurance
- Direct supervision of employees
- Participation in the collective bargaining process

Although AT&T employees occasionally assigned work to ECS employees, AT&T did not have control over the day-to-day activities of ECS employees. Participation by AT&T in the collective bargaining process alone did not make AT&T a joint employer.

2. In re Airborne Freight Co.

Enterprise Express Inc. ("Enterprise") entered into an agreement with Airborne Freight Co. ("Airborne") to provide cartage services for Airborne in Rhode Island and the southern part of Massachusetts. Airborne canceled its cartage agreements with Enterprise with respect to two facilities. Teamsters Local 251 claimed Airborne was a joint employer of Enterprise's employees and sought to negotiate responsibility for the effects of the cancellation of the cartage agreements. Airborne refused.

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33 67 F.3d 446 (2d Cir. 1995).

34 338 NLRB 597 (2002).
The NLRB adopted the administrative law judge's order and refused to categorize Airborne as a joint employer. The administrative law judge found that the standard for determining joint employment is whether the putative employer exercised actual control over the employees. The potential right of control was found to be less important.

Whether Airborne exercised actual control over employees involved a determination of whether it "share[s] or codetermine[s] those matters governing the essential terms and conditions of employment." The essential terms and conditions of employment are those involving matters such as hiring, firing, disciplining, supervision, and direction of employees.

The judge noted that evidence of minimal and routine supervision of employees, limited dispute resolution authority and routine work assignments were insufficient to establish a joint employer relationship. On the other hand, evidence of substantial control over hiring, promotion, and the base wage rates, hours and working conditions of employees, coupled with evidence of close and substantial supervision of employees, and the constant presence of supervisors with a detailed awareness and control of employees' daily activities would have been sufficient to establish a joint employer relationship.

Following is a list of the important factors that convinced the NLRB that Airborne was not a joint employer:

- Airborne entered into contracts which, by their terms, carefully defined a cartage company as an independent contractor that had full and complete control over hiring, firing, discipline, work assignment, and all other terms and conditions of employment of its own employees.

- In Rhode Island, once a contractor obtains a bid for a specific geographic area, it and it alone determines the number and size of routes it will run, the number of employees it will hire, the individuals whom it will hire, and the wages and benefits it will offer to its employees. There was no evidence that Airborne had any influence over these decisions.

- Airborne's ability to cancel the cartage agreement without cause on 60 days' notice did not give Airborne de facto control over the contractor's operations.

- With two exceptions, Airborne did not have control over the vehicles used by the contractor.

- Although the vehicles bore Airborne's logo and the drivers wore uniforms that include Airborne's insignia, these were only for advertising purposes.

- Airborne's reservation of the right to change the existing price structure if the employees were unionized did not signify that Airborne had ultimate control over the employees' wages.

- The fact that Airborne provided Enterprise employees with manuals was not sufficient to establish a joint employer status.
3. **AM Property Holding Corp.**

AM Property Holding Corporation ("AM Property") acquired a building at which the employees of the contractor that provided cleaning services were members of the local Service Employees International Union. Before purchasing the building, AM Property decided not to use the services of the existing cleaning contractor, and instead contracted with Planned Business Services, Inc. ("PBS") to clean the building. Initially, PBS employees were not unionized. However, the employees later decided to unionize, and they became part of the United Workers of America. The employees eventually went on strike, and in the midst of the strike, AM Property relieved PBS of its duties to clean the building, and hired Servco Industries, Inc. ("Servco") to perform the same services. AM Property was sued as a joint employer for its anti-union activities.

The NLRB determined that AM Property was not the joint employer of the employees of either PBS or Servco. It noted that joint employment is only found where entities "share or codetermine those matters governing the essential terms and conditions of employment." This analysis depends on actual practices and not merely the language in the contract.

In this case, the contract allowed AM Property to approve hires by PBS and Servco. To be a joint employer, however, AM Property must have actually played a role in supervising and directing employees. Since AM Property's supervision over the employees was routine and limited, AM Property was not a joint employer.

**E. NLRB Decisions Finding Joint Employer Status Under the Pre-Browning-Ferris Standard**

The following cases represent factual situations in which joint employer status was established under the prior standard, direct and immediate control. Of particular interest is the Aldworth case which illustrates how the standard can be applied quite differently at the various levels of review: the administrative law judge, the NLRB and the courts. Appendix A illustrates the involvement of each of these parties in the NLRB's process for handling unfair labor disputes.

1. **Quantum Resources Corp.**

Quantum Resources Corporation ("Quantum") provided maintenance and development functions to the Florida Power and Light Company ("FP&L") at land utilization areas adjacent to FP&L power plants.

The following were key to the NLRB's determination that FP&L was the joint employer of Quantum's employees:

- Reporting: a Quantum foreman reported to FP&L supervisors about daily operations and management matters

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35 350 NLRB 998 (2007).
Clerical Employees: Quantum clerical employees worked side-by-side with FP&L's clerical employees, and reported interchangeably to FP&L and Quantum supervisors. Quantum field technicians performed their monitoring and inspection work according to FP&L schedules and specifications, and regularly reported to FP&L personnel.

Programs: Quantum employees were required to participate with FP&L employees in FP&L's Quality Improvement Program, which held meetings that discussed ways to improve employees' performance.

Job Description: Quantum's job descriptions originally were written by FP&L, and any changes in the employee's job responsibilities or titles required FP&L approval.

Hours of Work: hours of work and holidays for Quantum employees and FP&L's other personnel largely coincided. On one occasion, FP&L closed down a worksite for 2 weeks so that the Quantum employees who operated in that location could take their vacations.

Overtime: All overtime scheduled for Quantum employees required approval by FP&L managers.

In addition, the NLRB also noted the following findings:

- FP&L exercised substantial control over the hiring of Quantum employees.
- FP&L had substantial power to discipline and to discharge Quantum employees.
- FP&L set the wage ranges within which Quantum employees were paid.
- Modification of the established wage ranges for employees and across-the-board wage increases required FP&L approval.
- All overtime worked by Quantum employees required FP&L authorization and approval.
- FP&L assigned work to Quantum employees.
- FP&L effectively established the work schedule and paid holidays of Quantum employees.
- FP&L provided workers' compensation insurance coverage for Quantum employees.
2. **Computer Associates International, Inc.**

Computer Associates International, Inc. ("Computer Associates") designs, develops and markets computer software. It entered into a management agreement with Cushman to provide operating engineers for a Computer Associates' facility. Local 30, International Union of Operating Engineers, AFL-CIO alleged that Computer Associates was the joint employer of the operating engineers and had violated their right to unionize.

The NLRB focused on the following factors in finding Computer Associates to be a joint employer:

- Whether Computer Associates was involved in the hiring of the employees
- Whether Computer Associates exercised day-to-day supervision of the employees
- Whether Computer Associates exercised routine supervision over the employees
- Whether Computer Associates was present in the workplace
- Whether Computer Associates had the ability to authorize overtime
- Whether Computer Associates held any formal or informal grievance hearings involving the employees
- Whether Computer Associates represented itself to third parties as an employer of the employees
- Whether the language of the Management Agreement gave Computer Associates significant power to hire employees

Despite the NLRB's determination that Computer Associates was a joint employer, on appeal to the DC Circuit, the court noted that the union had stipulated that Cushman was the sole employer of the operating engineers in its petition for certification of representative filed with the NLRB. In the absence of a showing of changed or unusual circumstances, this was binding on the parties. The NLRB neither identified changed circumstances nor offered an alternative theory to overcome the presumptive validity of the designation in the certification of representative,

3. **In re Aldworth Co. Inc.**

Aldworth Co., Inc. ("Aldworth") contracted to provide truck drivers, helpers and warehouse personnel to Dunkin' Donuts Mid-Atlantic Distribution Center, Inc. ("Dunkin' Donuts").

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\(^{37}\) 332 NLRB 1166 (2000).

\(^{38}\) 338 NLRB 137 (2002).
Aldworth's employees began union organizational efforts, and upon learning of such activities, Aldworth reacted with counter-organizational efforts directed at the entire workforce.

The administrative law judge determined that Dunkin' Donuts was the joint employer of Aldworth's employees based on three factors. The NLRB concurred with the conclusion but only on the basis that Dunkin' Donuts enmeshed itself in the management of the employees. Dunkin' Donuts was involved in decisions relating to employment tenure, discipline, assignment of work and equipment, recognition and awards, and day-to-day direction of employees. Most significantly, Dunkin' Donuts played a direct and key role in certain events alleged to be unfair labor practices.

The NLRB disagreed that two other factors were indicative of joint employer status. First, Dunkin' Donut's inclusion of the Aldworth employees in its 401(k) plan was not relevant. The federal tax code specifies that if an employer maintains a 401(k) plan for any employees, then that plan must extend to all employees in order for the employer to qualify for tax incentives. Moreover, the plan must be available not only to those who are directly employed, but also to those whose services are leased from another employer. Therefore, in order for Dunkin' Donuts to qualify for tax advantages under its 401(k) plan, it was required to extend this plan to Aldworth employees. Dunkin' Donuts did not have a real choice as to whether to include the Aldworth employees in its 401(k) plan and, therefore, the NLRB concluded this was not a basis for establishing joint employer status.

Second, the NLRB stated that Dunkin' Donuts actions taken to comply with government regulations were not indicative of joint employer status. Dunkin' Donuts had no choice but to comply with federal OSHA standards and other workplace requirements.

III. SURVEY OF VICARIOUS LIABILITY CASES

Whether or not a franchisor is vicariously liable for the acts of its franchisees or their employees is an analysis similar to the determination of whether the franchisor is a joint employer. This section is not a comprehensive overview of the landscape of vicarious liability, but it is helpful to compare the method of analysis. Some jurisdictions apply a "means and manner" test - did the franchisor control the means and manner of the franchised business operation? Increasingly, the standard is moving to the "instrumentality" test - whether the franchisor controlled the instrumentality that caused the harm to the plaintiff. The last part of this section highlights cases involving employment claims that illustrate the courts' attempt to balance the policies behind vicarious liability with the realities of the franchise relationship. The result of this is the narrowing of the analysis to focus on control over the instrumentality of the harm. The courts' trend to narrow the focus is the opposite of the NLRB General Counsel's efforts to expand the application of joint employer status to franchisors. That underscores the importance of the NLRB's proceedings involving McDonald's and the inevitable judicial review that will follow.

A. Means and Manner Test; Survey of Cases

Following are abbreviated summaries of findings in vicarious liability cases in jurisdictions that applied a standard based on an agency analysis of whether the franchisor controlled the means and manner of the operation of the franchisee's business:
1. **Billops v. Magness Const. Co.**\(^{39}\)

The Supreme Court of Delaware reversed the grant of summary judgment in favor of the franchisor in this case which involved allegations of wrongful extortion of funds by the banquet director of a franchised Hilton Hotel. Rather than analyzing control over the actions that caused the alleged harm, the court focused instead on an agency analysis. An agency relationship exists if control of daily operations is exercised. The franchise agreement had a detailed operation manual that regulated every substantial operational aspect of daily business, and detailed records were required to be kept to ensure compliance with such. The franchisor also had the right to enter the premises to inspect for compliance. The court found that agency focuses on apparent authority, and not the actual relationship between a putative principal and agent, and concluded that this was a question of fact that was for a jury to determine.

2. **Greil v. Travelodge Int’l, Inc.**\(^{40}\)

The Illinois Appellate Court for the First District (2\(^{nd}\) Division) revised the grant of summary judgment for Travelodge in this case that involved safety issues. Plaintiff hotel guest jumped from his second story room to the sidewalk below when a robber entered his room. There was a disputed question of fact as to whether the franchisor, franchisee, or both failed to provide plaintiff with "clean, safe and orderly" accommodations and failed to maintain the "highest standards of hospitality." The license agreement and the operations manual, which was incorporated by reference, sufficiently involved the franchisor in day-to-day operations of the motel to raise a question of fact as to whether an actual agency relationship existed between the franchisor and the franchisee. Some of the facts that influenced the appellate court were that the franchisee was required to send its managers to the franchisor’s training program, that violation of the Travelodge standards could result in the cancellation of the license and that the franchisee was required to indemnify the franchisor and to maintain insurance for the benefit of the franchisor as well as the franchisee. The appellate court also noted that the franchisor inspected the franchisee's operations regularly and found deficiencies such as lighting in the parking lot, locks and window latches. Finally, the court noted that there was no evidence that third parties were informed that the hotel was independently owned and operated.

3. **Parker v. Domino’s Pizza, Inc. et al.**\(^{41}\)

The Florida Court of Appeal reversed the trial court’s summary judgment in favor of the franchisor in an action by plaintiffs who were injured in the aftermath of an automobile accident allegedly caused by a delivery driver employed by one of Domino’s franchisees. The franchise agreement and an operating manual evidenced a sufficient level of control by the franchisor to impose liability, including such mandates as sales quotas, site requirements, specific rules for food preparation, specific signage requirements, mandatory training, company inspections and royalty fees. The court referred to the operating manual as “a veritable bible” for overseeing a Domino’s franchise, “containing prescriptions for every conceivable facet of the business.”

\(^{39}\) 391 A.2d 196 (1978).

\(^{40}\) 541 N.E.2d 1288 (1st Dist. 1989).

\(^{41}\) 629 So. 2d 1026 (Fla. Dist. Ct. App. 1993).
B. **Instrumentality Test; Survey of Cases**

Following are summaries of findings in vicarious liability cases in jurisdictions that apply the standard of whether the franchisor controlled the instrumentality that caused the harm to the plaintiff:

1. **Hong Wu v. Dunkin' Donuts, Inc.**

   The U.S. District Court for the Eastern District of New York granted summary judgment for Dunkin' Donuts in this case which involved an assault on an employee of a franchisee. According to the court, the standard for franchisor vicarious liability in New York was whether the franchisor controlled the day-to-day operations of the franchisee and, in particular, whether the franchisor exercised a considerable degree of control over the instrumentality that caused the harm. The court applied the test to determine whether the franchisor retained sufficient control over the security measures of the franchisee to give rise to a legal duty to the plaintiff employee for the assault at the restaurant. It found that the franchisor did not control the instrumentality that caused the harm because the franchisor did not mandate specific security measures or otherwise control the franchisee's response to increased security risks presented by maintaining a business that was open 24 hours a day. Although the franchisor made security equipment available for purchase, it did not require the franchisee to install an alarm system or take other security measures. The franchisee made its own decisions regarding hiring a security consultant, installing security equipment, and modifying the site security plan. Finally, the franchisor did not inspect for security or require the franchisee to report security breaches to the franchisor.

2. **Reese v. Dunkin' Brands, Inc.**

   In Reese, an employee of a franchisee brought an action under Title VII of the Civil Rights Act alleging sexual harassment, discrimination, and wrongful discharge against the franchisor. The franchisee filed a motion for summary judgment asserting that it was not the plaintiff's employer and that it was not liable for employment-related acts. In granting the motion for summary judgment, the court cited a four-part test for determining when a parent company is considered the employer of a subsidiary's employees: (1) the interrelation of operations, (2) common management, (3) centralized control over labor relations, and (4) common ownership. The most important question under the test is which party made the final decisions regarding employment matters related to the person claiming discrimination. The plaintiff presented no evidence that the franchisor participated in the hiring, promotion, retention, discipline, or discharge decisions of franchisee employers. As such, the franchisor did not retain sufficient control over the employment matters at issue to warrant liability as an employer.

3. **Courtland v. GCEP-Surprise, LLC**

   The District Court in Arizona granted summary judgment to the franchisor in this case which involved employment discrimination claims under Title VII by the plaintiff who was a

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former bartender and server at a franchised Buffalo Wild Wings location. The franchisor did not have vicarious liability for employment discrimination because it had no daily control over the hiring, firing and supervision of the franchisee's employees. The court also determined that the franchisor was not the joint employer of the plaintiff.

Snell & Wilmer, L.L.P., the firm with which Ms. Grueneberg is affiliated, represented Domino's in its appeal to the California Supreme Court.

Ochoa, et al. v. McDonald's Corp., et al., United States District Court for the Northern District of California, no. 14-cv-02098-JD.

The franchisee, Sui Juris, LLC, had filed for bankruptcy.

C. Specific Recent Vicarious Liability Cases Involving Employment Claims

Some recent cases merit special attention in illustrating developments in how the courts are addressing the vicarious liability of franchisors for acts of their franchisees and franchisees' employees.

1. **Patterson v. Domino's**/ **Ochoa v. McDonald's**

The impact of the California Supreme Court decision in *Patterson v. Domino's* resonates beyond the standard it set for vicarious liability for franchisors in California. It analyzed vicarious liability in the unique context of franchising and noted that the "imposition and enforcement of a uniform marketing and operational plan cannot automatically saddle the franchisor with responsibility for employees of the franchisee who injure each other on the job." Recently, the reach of the *Patterson* decision has become central to a California wage and hour claim, namely whether *Patterson* is limited to discrimination cases under a California fair housing statute, or whether it sets forth vicarious liability and joint employer concepts that can be applied in other franchise contexts, specifically wage and hour disputes.

In *Patterson*, an employee of a Domino's franchisee alleged that she had been sexually harassed by a manager employed by the franchisee. The trial court granted Domino's summary judgment motion. The trial court based its decision on the conclusion that Domino's did not control the day-to-day operations of the franchisee's business or its employment practices to the extent that the franchisee became an agent of Domino's. It rejected the plaintiff's argument that the actions of Domino's field representative represented excessive control.

The court of appeals, on the other hand, applied the same principles as the trial court, but reached the opposite conclusion and reversed the trial court. In particular, the court noted that Domino's operational controls went beyond food preparation and included requirements for uniforms, detailed clothing and accessory guidelines, grooming and hygiene standards, neatness and sanitation. It also found excessive involvement by Domino's in the franchisee's employment practices.

Rejecting a traditional agency analysis, the California Supreme Court reversed the appeal court's decision. The court noted that California courts of appeal had been applying a
test focused on the degree to which a particular franchisor exercised control over the means and manner of the franchisee's operations. However, the Supreme Court noted that acknowledging the growth and importance of the franchise method of product and service distribution means acknowledging that a franchisor's uniform marketing plan and enforcement of brand standards alone should not subject a franchisor to vicarious liability.

Domino's standards and methods that the franchisee was required to follow focused on pizza-making and delivery, general store operations and brand image. Domino's did not control the hiring and firing of the franchisee's employees. One argument for imposing liability on Domino's raised by the plaintiff was that the Domino's field representative told the franchisee to fire the offending manager. At that point, however, the franchisee had already suspended the manager and reported him to the police who arrested him. The manager never returned to work.

The franchise agreement provided that Domino's had no right to direct the franchisee's employees in store operations, and that the franchisee was solely responsible for managing its employees. While the contract provisions alone do not resolve the issue, the court noted that the franchisee had sole control over the employees in its store and that Domino's was not included in the process of hiring, supervising or firing employees.

Although there seemed to be some uncertainty about whether the owner of the franchisee received sexual harassment training from Domino's, it was clear that the franchisee had developed its own sexual harassment training and policy for its employees, and communicated it to them. Moreover, the franchisee encouraged employees to report any incidents directly to the franchisee's owner, and Domino's had no mechanism for monitoring sexual harassment complaints from its franchisee's employees. Finally, the disciplinary action suspending the franchisee's manager was unilaterally undertaken by the franchisee.

The court concluded that a franchisor will be liable if it does retain control over the day-to-day operations of the franchisee and it cannot escape that liability by declining to establish a policy with respect to the specific conduct that is at issue. Nonetheless, the decision and its analysis indicated a move away from the traditional agency standard of the "means and manner" test toward a standard of whether the franchisor controlled the instrumentality that caused the harm.

In the Ochoa case, a group of McDonald's employees are seeking overtime and other unpaid wages from the local franchisee as well as McDonald's corporate. In a Motion for Summary Judgment, McDonald's corporate has argued that under the Patterson standard it is not a common law employer or joint employer of the franchisee's employees. The employees oppose the Motion for Summary Judgment, arguing that the Patterson standard is not appropriate for wage and hour cases, but instead the court should apply a employer definition found in a California Labor Code and Wage Order. Notably, the Wage Order has a definition quite similar to the Browning-Ferris joint employer standard. Specifically, the Wage Order finds an employer if the entity "directly or indirectly, or through an agent or any other person ... exercised control over wages, hours, or working conditions of any person." At the time of publication, the Motion for Summary Judgment in Ochoa has not been decided.

\[49\] California Wage Order No. 2001-5 §2(H).
2. **Kerl v. Rasmussen.**

Earlier, in 2004, the Wisconsin Supreme Court undertook an extensive analysis of the standard for imposing vicarious liability on franchisors in *Kerl v. Rasmussen.*

In a case of first impression, the Supreme Court held that a franchisor may only be vicariously liable for the tortious conduct of its franchisee if the franchisor controls or has the right to control, the daily operation of the specific aspect of the franchisee's business that is alleged to have caused the harm.

The case involved an employee of an Arby's restaurant who was a work-release inmate who ambushed and shot his ex-girlfriend and her boyfriend and then committed suicide in a nearby parking lot. The employee had left work without permission. The Circuit Court granted Arby's motion for summary judgment on the issue of vicarious liability. The Court of Appeals noted that the issue had not previously been addressed in Wisconsin and affirmed the lower court's decision after surveying case law from other jurisdictions and concluding that the prevailing standard for a franchisor's liability was whether the franchisor controlled the specific instrumentality which allegedly caused the harm or whether the franchisor had a right of control over the alleged negligent activity.

The Wisconsin Supreme Court undertook a detailed analysis of the doctrine of respondeat superior doctrine ("let the master answer") and its 250-year history. It noted that the prerequisite for vicarious liability under respondent superior is the existence of a master/servant relationship. For there to be liability, the harm must be committed within the scope of the servant's employment - stepping away from the master's business may preclude liability.

The Wisconsin Supreme Court also noted that in modern times, the policy behind imposing vicarious liability has also involved spreading risk and encouraging safety and the exercise of due care. Despite the expansion of the doctrine, the court noted that imposing vicarious liability where the requisite degree of control is lacking would not serve either the original or the modern policies behind the doctrine.

Turning to franchising, the court described franchising as follows: "A franchise relationship is a marriage of convenience. It enables franchisors to spread the capital cost of enlarging the market for their goods and services by transferring most of those costs to local franchisees. The franchise relationship enables the franchisors to reach new, far-flung markets without having to directly manage a vast network of individual outlets. For the franchisee, the arrangement mitigates the risks of starting a new business by enabling it to capitalize on the goodwill and established market associated with the franchisor's trademark or trade name. The burdens of starting and operating a business are eased considerably by the franchisors, which provide quality and operational methods and standards, and may offer management training programs to the franchisee."

Since the application of the doctrine to franchising was a case of first impression in Wisconsin, the court looked to decisions in other jurisdictions. The court concluded that the usual justifications for vicarious liability lose force in the context of franchising. The franchisor

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50 2004 WI 86, 273 Wis. 2d 106, 682 N.W.2d 328.

typically imposes detailed quality and operational standards and inspection rights in order to protect the ownership of its mark. This type of control is based on the integrity of the franchisor's trademark, and not routine, daily supervision of the management of the franchisee's business. Because the franchisee is an independent entrepreneur, the modern policy behind vicarious liability similarly is less effective as there is a lack of incentive to enhance safety in the absence of daily supervision and management by the franchisor.

The Wisconsin Supreme Court also noted that other jurisdictions had concluded that quality and inspection rights contained in a franchise agreement do not establish the control necessary for a successful claim of vicarious liability. Rather, in the case of franchising, the traditional control or right to control standards must be narrowed to a test of whether the franchisor controlled or had the right to control the instrumentality or aspect of the franchisee's business alleged to have caused the harm.

Hence, the Wisconsin Supreme Court established a standard that the franchisor may be liable for the tortious conduct of its franchisee only if the franchisor has control or a right of control over the operation of the specific aspect of the franchisee's business that is alleged to have caused the harm. The standard provisions commonly included in franchise agreements involving uniform quality, marketing and operational requirements and a right of inspection are not enough. Applying that standard to the facts in the case, the court concluded that the requirements in Arby's license agreement were broad and general and insufficient to impose vicarious liability in this case. In particular, the court emphasized that the franchisee had sole control over the hiring and supervision of its employees.

The specific provisions that the court found to be too broad to meet the standard were as follows:

- **Operating Standards and Guidelines** - requiring operation of the business in strict compliance with Arby's manual, compliance with all laws and regulations, maintenance of business records in a manner satisfactory to Arby's, mandatory specifications for building and equipment, requirement to obtain supplies from approved suppliers, and specific standards regarding containers, uniforms, paper goods and other packaging supplies.

- **Insurance Requirements** - the franchisee must maintain at least $1 million of liability insurance and name Arby's as an additional insured

- **Right to Inspect and Test** - Arby's could inspect premises and test products.

- **Termination** - Arby's ability to terminate the franchise relationship if the franchisee defaults and does not cure within 30 days after notice.

3. **Vann v. Massage Envy Franchising LLC**

The Federal District Court for the Southern District of California granted Massage Envy's motion for summary judgment in *Vann v. Massage Envy*, holding that the franchisor was not the joint employer of an employee of its franchisee who claimed wage and hour violations.

The court relied heavily on the California Supreme Court's decision in *Patterson* which it found helpful even though that case involved an analysis of vicarious liability rather than joint employment.

In *Vann*, the Massage Envy Franchise Agreement provided that any personnel policies and procedures set forth in the Operations Manual were optional. The court noted that the plaintiff's evidence on uniform pay policy for franchisees' employees actually showed a lack of uniformity, suggesting that the franchisor did not control franchisee employee wages and hours.

An argument that the franchisor exercised control over hiring and firing of franchisees' employees was based on a script contained in the Operations Manual for conversations between employees and clients and on the fact that the franchisor required that all massage therapists must pass background checks. However, the Franchise Agreement provided that the franchisee had the exclusive right to control the hiring and firing of its employees, and the evidence supported that conclusion.

The use of regional directors (who solicit prospective franchisees and perform some or all of the franchisor's required services with respect to franchisees in a given area) did not rise to the level of control over the franchisee's daily operations. The court found no evidence of that and noted that in *Patterson*, franchisor representatives had visited franchisees four times per year and the Supreme Court found that did not amount to control over daily operations.

Finally, franchisor policies on the types of massages offered, the types of products used during the massages and the conversations that the therapists had with clients were part of the standard policies and procedures that are typical in franchise systems, and a necessary concern, not evidence of control.

4. **Orozco v. Plackis**

*Orozco v. Plackis* involved a determination of whether the owner of the franchisor was the employer of a franchisee's employees for purposes of liability under the Fair Labor Standards Act ("FLSA"). The Fifth Circuit Court of Appeals reversed the magistrate judge's denial of the owner's motion for judgment as a matter of law after a jury trial determined that the owner was an employer.

The claims centered on a reduction of the employee's salary by the franchisee over a period of time from $1,200 every two weeks to $1,050 every two weeks to $10 per hour.

The court examined each of four elements of the economic reality test used in determining employer status under the FLSA.

The first element is the power to hire and fire the employee. In this case, the franchisee hired the employee from the franchisor's company-owned restaurant because no additional training would be necessary. The court indicated this was insufficient to establish the ability of the franchisor's owners' right to hire or fire the franchisee's employee, even if the franchisee's decision followed a meeting with the owner of the franchisor.

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53 *Orozco v. Plackis*, 757 F.3d 445 (5th Cir. 2014).
Likewise, the court determined that the franchisor's owner did not supervise or control the employee's work schedule, the second element of the analysis. The owner reviewed the employee's work schedule and trained both the franchisee and the employee. The employee was required to remain at work until after the arrival of another employee who also worked at a franchisor-owned outlet. This schedule requirement was imposed following one of the owner's visits to the franchisee's location and his meeting with the franchisee. According to the court, neither the advice the owner may have given to the franchisee nor the mere review of work schedules was sufficient to establish control over those schedules.

The third element under the economic reality test is whether the putative employer determined the employee's rate and method of payment. Both the employee and the franchisee testified that the owner did not control his rate of pay. The plaintiff failed to provide any evidence of the fourth element — whether there was control over the employee's employment records.

The court also addressed two provisions of the Franchise Agreement. Section 8a provided: "Franchisee shall at all times comply with all lawful and reasonable policies, regulations and procedures promulgated or prescribed from time to time by Franchisor in connection with Franchisee's shop or business." This established a certain degree of control, according to the court, but not enough to support the jury's verdict. Indeed, the court pointed to another part of Section 8a that provided: "Franchisee shall, irrespective of any delegation of responsibility reserve and exercise ultimate authority and responsibility, with respect to the management and operation of Franchisee's shop."

The other provision of the Franchise Agreement that caught the court's attention was a requirement that the franchisee follow "policies and procedures promulgated by the franchisor for 'selection, supervision or training' of personnel." The court referred to this as an innocuous statement that did not establish any of the elements of the economic reality test.

The court noted that the FLSA is a remedial statute and that satisfaction of all of the four elements is not necessary to find that someone is an employer under the economic reality test. A franchisor could be an employer of its franchisee's employees. Nonetheless it concluded in this case that under the totality of circumstances the franchisor's owner was not the employer of its franchisee's employee.

5. Domino's Pizza, LLC v. Reddy

A Texas Court of Appeal addressed the issue of Domino's vicarious liability for death and injuries to others caused by one of its franchisee's delivery drivers in Domino's v. Reddy. The driver was cited by police for failing to control his speed and for having a defective tire, causing his vehicle to hydroplane into the victims' vehicle.

At trial, a jury verdict held the driver 10% negligent, the franchisee 30% negligent and Domino's 60% negligent. The jury's findings included the following:

- Domino's controlled or had the right to control the acts or omissions that caused the injury.

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Domino's failed to exercise ordinary care in the control or right to control these details.

Domino's failure was the proximate cause of the injury.

The delivery driver was driving his vehicle for the benefit of Domino's and subject to Domino's control.

The appellate court reversed and dismissed the plaintiff's claims. The court described the standard under Texas law for determining a franchisor's vicarious liability for the conduct of a franchisee — whether the franchisor had the right to control the franchisee with respect to the details of the specific conduct in question. The right to control can be demonstrated by an agreement that explicitly grants the franchisor the right or by the franchisor's actual exercise of control.

The court examined a number of provisions of the Domino's franchise agreement and Manager's Reference Guide to make this determination.

- **Inspections** — the Guide required that vehicles used by delivery drivers must be inspected, but did not specify how the inspections should be performed. Domino's did not conduct these inspections and did not receive the results of inspectors.\(^{55}\)

- **Delivery Area** — Domino's established the limitations on the franchisee's delivery area. The goal was to deliver pizzas within thirty minutes. Domino's operational reviews of the franchisee every three months focused on speed of delivery. The franchisee established a competition for its delivery drivers that was neither required, suggested nor promoted by Domino's.

- **Hiring and Training** — Domino's forwarded an application form for the franchisee to use in hiring employees, but the franchisee handled the details of hiring employees. Domino's also provided training materials to the franchisee, but did not train the franchisee's employees. Moreover, the franchisee conducted its own Management Team Member Safety Awareness presentation.

The franchise agreement provided that the franchisee was an independent contractor, that the franchisee's staff members were not employed by Domino's, that Domino's had no right to direct those staff members, that the franchisee was solely responsible for hiring, recruiting, training, scheduling, supervising and paying its employees, that the franchisee was solely responsible for operating its store and that Domino's did not assume responsibility by providing operating assistance. The fact that Domino's imposed minimum operating standards did not alter the franchisee's status as an independent contractor.

This case, juxtaposed with the decision in the *Parker* case,\(^{56}\) illustrates the difference between the "means and manner" test and the "instrumentality" test in analyzing vicarious liability issues.

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\(^{55}\) In fact, the franchisee did not conduct inspections, but relied instead on state inspection stickers.

\(^{56}\) 629 So. 2d 1026, *supra* at note 27.
IV. IMPACT ON FRANCHISORS IF JOINT EMPLOYER STANDARD IS CHANGED

A. Increase in Non-Traditional and Traditional Union Campaigns

There can be little debate that union campaigns are increasing in number and that the cause of that increase is a result of pro-union representatives in certain key positions in the United States government executive branch and agencies such as the NLRB. However, the twenty-first century union campaign does not necessarily take the form of attempting to unionize a particular workforce via a traditional organizational effort. Recently, unions are lending their hand and expertise in organization and public relations to non-unionized workforces to lead public relations and social media campaigns to increase awareness of inadequate wages, benefits and safety at non-unionized workplaces.

In fact, in its Fact Sheet related to the filing of complaints against McDonald's, the NLRB noted that "beginning in late November 2012, a nationwide fast food workers campaign commenced involving employees employed by McDonald's USA, LLC and numerous McDonald's franchises." The campaign did not seek unionization, instead it sought the perceived fruits of unions, such as a "living" wage and benefits. This campaign led to the filing of 291 unfair labor practice charges against McDonald's, including allegations of discriminatory discipline, reduction in hours, discharges or other coercive conduct directed at employees in response to union and protected concerted activities.

For the last several years, the NLRB has been expanding its reach through its enforcement powers and has targeted non-union employers for violations of the NLRA and its concerted activities protections. For example, the NLRB has asserted that the employee handbook of a non-union shop violated the NLRA, because it prohibited employees of the company from discussing what they earned with other employees, a concerted activity. The NLRB's General Counsel issued a memorandum on this issue in March of 2015. The NLRB has attacked arbitration provisions found in employment contracts and employee handbooks.

The McDonald's cases illustrate that employees in non-union workplaces may be able to rely on the investigative and enforcement authority of the NLRB to obtain more favorable working conditions. The NLRB's willingness to project its authority into the non-union workplace, especially in the franchise area, is due in part to the expanded joint employer doctrine and the jurisdiction it provides.

Moreover, post-Browning-Ferris, there is a high possibility that unions will attempt to utilize the Browning-Ferris decision to seek unionization of franchise systems. Since Browning-Ferris did not specifically mention franchise models, it is unclear how far the NLRB will go, but there is no doubt that unions will attempt to find out.

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57 McDonald's Fact Sheet, National Labor Relations Board (www.nlrb.gov/news-outreach/fact-sheets/mcdonalds-fact-sheet).


59 24 Hour Fitness, USA, Inc. and Alton J. Sanders, NLRB Case No. 20-CA-035419.
B. Franchisor Liability under the National Labor Relations Act (NLRA)

Franchisor liability under the NLRA is potentially twofold. First, there is the question of franchisor liability under the NLRA for the employees of a franchisee and the second question is franchisor liability under the NLRA for its own employees. Both questions are important to consider for a franchisor, while only the first requires examination of the joint employer doctrine. The process for considering a charge that there has been a violation of the NLRA is illustrated on the procedural chart attached to this paper as Appendix A. The ultimate arbiter of whether franchisors are found to be joint employers will be the courts after the various phases of investigation, complaints, hearings and remedial orders are pursued.

1. Franchisor Liability Regarding a Franchisee’s Employees

As described above in Section II, this area has been evolving rapidly in the last year and the evolution has unfortunately not been linear. Prior to mid-2014, the NLRB had consistently taken the position that the franchisor-franchisee relationship did not give rise to joint employer liability. That all changed with an amicus brief submitted by the NLRB Office of General Counsel in a case, interestingly enough, that did not involve a franchise, *Browning-Ferris.* The General Counsel’s support for a new joint employer standard for franchise systems, specifically that “the ‘traditional standard’ cases finding that franchisors were not joint employers preceded the advent of new technology that has enabled some franchisors to exercise indirect control over employee working conditions beyond what is arguably necessary to protect the quality of the product/brand.” However, the General Counsel advised that the NLRB would “continue to exempt franchisors from joint-employer status to the extent that their indirect control over employee working conditions is related to their legitimate interest in protecting the quality of their product or brand.”

However, the “indirect control” suggested by the General Counsel was not adopted by the NLRB in a September 2014 decision. In *CNN America Inc. and Team Video Services LLC,* 361 NLRB 47 (2014), the NLRB applied, more-or-less, its traditional standard as to when two entities will be determined to be joint employers. Specifically, joint employer exists when the entities “share or codetermine those matters governing the essential terms and conditions of employment [which] meaningfully affect the matters relating to the employment relationship ‘such as hiring, firing, discipline, supervision and direction.” The NLRB declined to require that the joint employer’s control be “direct and immediate.”

Then, on December 14, 2014, the General Counsel approved the filing of complaints in 86 cases, with 13 of those cases involving allegations of joint employer against McDonald’s USA, LLC. In support of the application of the joint employer doctrine, the NLRB made simple and legally conclusory averments, specifically that (a) there was a franchise agreement, (b) McDonald’s corporate possessed and/or exercised control over labor relations policies of the franchisee and (c) had been a joint employer. At the time of publication of this paper, the

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60 This position was then restated by the General Counsel in a November 4, 2014 letter to two members of the House of Representatives, cautioning that “indirect control” would not include conduct “merely related to the franchisors’ legitimate interest in protecting the quality of their brand or product.”


62 *Lewis Foods of 42nd Street, LLC,* et al., NLRB Case No. 02-CA-093893, Consolidated Complaint.

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consolidated NLRB proceeding was still in the discovery phase and the hearing is scheduled for early October of 2015. The clear thrust of the NLRB’s joint employer argument is the control the franchisor has over employment relations in the McDonald’s franchise system.

On April 28, 2015, the General Counsel issued an Advice Memorandum with respect to the Freshii franchise system, a fast food franchise. The General Counsel advised that the Freshii franchise system did not create a joint employer relationship between the franchisor and franchisee under either the CNN America standard or the standard proposed by the General Counsel in the Browning-Ferris amicus brief. 83

To reach these conclusions, the Advice Memorandum examines the franchise agreement and the actual monitoring of the franchisee’s operations by the franchisor in the Freshii system. What the General Counsel considers important is instructive of what franchisors should or should not do in attempting to avoid joint employer liability.

The genesis of the Advice Memorandum was an action brought by the NLRB against a Freshii franchisee for allegedly terminating one employee and disciplining another for attempting to unionize the franchisee’s workforce. The Region 13 Director sought the opinion of the General Counsel’s office as to whether the Freshii franchisor should be charged as a joint employer.

The General Counsel’s office did reference the boilerplate language of most franchise agreements that the franchisee is being granted a “business system, business formats, methods, procedures, designs, layouts, trade dress, standards, specifications and marks...” And, the General Counsel’s office noted that an operations manual is provided to the franchisee and that if the franchise agreement or operations manual is violated the franchisee can be terminated. These facts alone would seem to provide a franchisor with significant control, if only indirect, over a franchisee’s employees. However, the General Counsel’s office concluded that those facts alone were insufficient to find joint employer. Instead, the General Counsel’s office looked at the actual control exercised by the franchisor over human resource functions (i.e., direct control), instead of the potential to control.

Important to the General Counsel’s office in Freshii was the following: (1) it was explicitly provided that the Freshii system standards did not include any personnel policies or procedures; (2) the franchise agreement provides that Freshii “neither dictates nor controls labor or employment matters for franchisees and their employees...”; (3) although the operations manual provides guidance on human resource matters, the franchisee is not required to use the guidance; (4) although the franchisor provides a sample employee handbook the franchisee is not required to use the handbook; (5) franchisees are solely responsible for hiring, discipline and termination of their employees; and (6) franchisees are soley responsible for setting employee salary and benefits.

With these facts in mind, the General Counsel’s office concluded that there was no evidence to establish that “Freshii meaningfully affects any matters pertaining to the employment relationship between [the franchisee] and its employees,” and therefore there is no joint employment relationship using the traditional CNN America standard. The General Counsel’s Office further concluded that “Freshii does not significantly influence the working

conditions of [the franchisee's] employees," and therefore there is no joint employment relationship using the *Browning-Ferris* "economic realities" standard.\(^{64}\)

Clearly, by the *Freshii* Memorandum, the NLRB was attempting to calm the concern that was developing that all franchises would be classified as joint employers. *Freshii* did not create a black or white rule, however, but instead noted case-by-case factors to be considered.

### 2. Franchisor Liability Regarding its Own Employees

It is important to at least touch on this issue. There is no doubt that the NLRB is looking to hook the "big fish" so to speak. Thus, for those franchisors that have corporate locations and/or which have corporate staff it is important to understand what concerted activity means to the NLRB. Concerted activity exists when two or more employees take action for their mutual aid or protection regarding terms and conditions of employment. A single employee may also engage in protected concerted activity if he or she is acting on the authority of other employees, bringing group complaints to the employer's attention, trying to induce group action, or seeking to prepare for group action.\(^{65}\) For example, protected concerted activities include employees addressing their employer about improving pay or discussing other work-related issues, such as safety concerns, with each other, or an employee speaking to an employer on behalf of one or more co-workers about improving workplace conditions.

As a result, the franchisor must be careful not to reprimand or punish any of its own employees, whether in the home office or at a corporate location, for voicing dissatisfaction with wages, working conditions or safety. In such a circumstance, the NLRB would not need the joint employer doctrine to pursue the franchisor for a labor violation. For instance, in the *McDonald's* cases, many of the locations at issue are corporate-owned and therefore NLRA liability is "direct" and does not require a finding of joint employer.

### C. Franchisor Required to Participate in Collective Bargaining

Given the NLRB's expansion of authority in the last five or so years, including the review of employee handbooks of non-union employers and the joint employer doctrine, it is inevitable that the NLRB will seek to require a franchisor to sit at the bargaining table for franchisees' employees. As stated above, in the *Browning Ferris* amicus brief, the General Counsel argued several times that a new joint employer standard was required to get more franchisors to the bargaining table. In fairness, however, the NLRB, as described above, is providing franchisors with notice and a choice – continue to be involved in day-to-day human resource decisions, e.g., hiring, pay, discipline, termination, and be subject to joint employer and collective bargaining, or get out of the day-to-day monitoring and avoid the minefield.

\(^{64}\) In the Advice Memorandum this standard is defined similarly to how it was defined in the *Browning-Ferris* brief. Specifically, "the Board finds joint employer status where, under the totality of the circumstances, including the way the separate entities have structured their commercial relationship, the putative employer wields sufficient influence over the working conditions of the other entity's employees such that meaningful bargaining could not occur in its absence. This approach makes no distinction between direct, indirect and potential control over working conditions and results in a joint employer finding where 'industrial realities' make an entity essential for meaningful bargaining." Advice Memorandum, NLRB, Office of General Counsel, *Nutritionality d/b/a Freshii*, supra.

\(^{65}\) Rights We Protect, National Labor Relations Board (http://www.nlrb.gov/rights-we-protect/employee-rights).
Should the franchisor decide to remain involved in employment functions/decisions, it will likely be deemed a joint employer by the NLRB and as a result, the franchisor will likely be required to participate in bargaining. This will cause significant complications for the franchisor. For instance, given the NLRB’s willingness to allow microunits of employees to unionize, this could result in a franchise hotel having four or more unions under one roof, i.e., separate unions for housekeeping, maintenance, cooks and servers. Such a scenario would be difficult to manage for any franchise system.

D. Minimum Wage Legislation

Until the dynamics of Washington politics change, federal minimum wage legislation will not be passed by Congress anytime soon and the passage of minimum wage legislation will fall to the individual states and in some cases cities and municipalities, e.g., the City of Los Angeles. This will create a patchwork of minimum wage rules and regulations for nationwide franchisors. The change of the joint employer standard will have no effect in the minimum wage area. However, given that local municipalities may be enacting their own minimum wages, both franchisors and franchisees must be careful to ensure that the local minimum wage is being paid.

E. Appropriations Committee Legislation

The Appropriations Committees in the U.S. House of Representatives and in the U.S. Senate recently advanced spending bills that include a provision prohibiting the NLRB from implementing a new joint employer definition. As of the date of publication of this paper, there has been no vote on this legislation. Franchisors and franchisees alike should continue to monitor any attempt by Congress to limit the DOL’s utilization of the joint employer doctrine through the appropriations process.

V. POTENTIAL ISSUES UNDER OTHER EMPLOYMENT STATUTES

In addition to concerns that franchisors and franchisees should have regarding the impact of joint employer classification in the traditional labor law context, they should also be concerned about the impact of the concept of joint employer in the employment law context. The threat in this instance is twofold; first, the Federal government, primarily through the Equal Employment Opportunities Commission (“EEOC”), and second, enterprising plaintiffs’ lawyers that will undoubtedly seek the deeper pocket of the franchisor to resolve discrimination claims, and the like.

It does not require much imagination to conclude that the EEOC will follow in the footsteps of the NLRB. In fact, in Dr. Weil’s paper written for the Wage and Hour Division, Improving Workplace Conditions Through Strategic Enforcement, Dr. Weil advocates building “stronger linkages to other key DOL agencies.”

The EEOC Compliance Manual already addresses the concept of joint employer, although the EEOC Manual utilizes different terminology. In analyzing jurisdiction in situations

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63 Weil Report, supra, note 2, at p. 4.

where an employee is conceivably employed by more than one entity the EEOC Manual provides for two classifications: integrated enterprises and joint employers.\textsuperscript{68}

The EEOC Manual defines integrated enterprises by a list of factors that are very similar to the NLRB joint employer definition – including the degree of interrelation between the entities' operations and management, centralized control of labor relations and the degree of common ownership or financial control. In the case of an integrated enterprise, the number of employees of the multiple employers within the integrated enterprise is aggregated for purposes of jurisdiction and the employers will be considered one enterprise for purposes of coverage and liability.\textsuperscript{69} If the integrated enterprise approach is applied to the franchise relationship, a franchisor would be open to significant exposure from the acts of its franchisee.

The EEOC Manual definition of joint employer is a little different than the NLRB definition. Specifically, an EEOC joint employer “refers to two or more employers that are unrelated or that are not sufficiently related to qualify as an integrated enterprise, but that each exercise sufficient control of an individual to qualify as the employer.” In the case of an EEOC joint employer, “to determine whether an [employer] is covered, count the number of individuals employed by the [employer] alone and the employees jointly employed by the respondent and other entities.” The EEOC’s joint employer doctrine is applied primarily to staffing agencies.\textsuperscript{70}

Enterprising plaintiffs’ attorneys are already hard at work trying to use the joint employer theory to access the deep pockets of franchisors in discrimination cases. Many Federal Circuit Courts of Appeal have already applied the joint employer doctrine to Title VII actions\textsuperscript{71}, but with the added publicity and possible expansion of the joint employer doctrine, plaintiffs’ attorneys will no doubt begin adding the franchisor as a defendant in any discrimination/harassment case involving a franchise system.

Given the shifting landscape, an analysis of the potential liability and the degree of risk under these federal statutes must be considered by a franchisor in determining whether to “pull back” from franchisee human resource training, or whether to take more control of the franchisees’ employee relations. The ultimate decision, as examined in this paper, will depend upon factors such as the size of the franchise, the number of employees in the franchisee workforce, the necessity of “control” over the workforce, and whether the risk can be insured against, i.e., Employment Practices Liability (EPL) coverage.

\textsuperscript{68} In a case involving a Subway franchise and joint employer liability the Middle District of Florida analyzed the differences between an integrated enterprise and a joint employer under Title VII. \textit{EEOC v. Papin Enterprises, Inc.}, 2009 WL 961108 (M.D.FL April 7, 2009).


\textsuperscript{70} \textit{Id.}

\textsuperscript{71} 160 A.L.R.Fed. 441 at sections 7(a), 7(b), 8(a) and 8(b) (2000).
A. Title VII of the Civil Rights Act of 1964, the Family and Medical Leave Act, and the Fair Labor Standards Act

Federal employment law is a patchwork of different statutes, written in different decades, with different regulations and varying interpretive jurisprudence. For example, the Family and Medical Leave Act specifically addresses joint employer liability, but Title VII and the Fair Labor Standards Act depend upon the court's interpretation of joint employer liability and the extent to which it applies in any given factual scenario. What is more, the jurisprudence on joint employer is not only different among the employment law statutes, but it is at times different amongst the Circuits interpreting the same statute. This lack of a bright line rule opens the door for significant litigation with respect to franchisors and joint employer liability given the factually intensive, case-by-case analysis required.

1. Title VII

The United States Courts of Appeal have applied joint employer liability in a number of contexts in the employment law area. In 2013, the Sixth Circuit held that Skanska, a construction manager involved in the construction of a hospital in Memphis, Tennessee, exerted sufficient control over the actions of its subcontractor's employees that it was a joint employer and could potentially be liable for racial discrimination under Title VII.72 Per the Sixth Circuit, to determine joint employer liability the court should look at the entity's ability to hire, fire or discipline employees, affect their compensation and benefits, and direct and supervise their performance. In the Skanska case, the general contractor recommended pay rates and was involved in the decision to terminate.

The Eleventh and Third Circuits have applied joint employer liability in sexual harassment cases under Title VII.73 Each circuit applied a test similar to the Sixth Circuit's in Skanska. However, the Eleventh Circuit did note:

the basis of the [joint employer] finding is simply that one employer while contracting in good faith with an otherwise independent company, has retained for itself sufficient control of the terms and conditions of employment of the employees who are employed by the other employer. Thus the joint employer concept recognizes that the business entities involved are in fact separate but that they share or co-determine those matters governing the essential terms and conditions of employment.74

Over the last decade there have been a handful of cases where the plaintiff in a discrimination case has sought to attach joint employer liability to the franchisor, with mixed results.75 The mixed results are a product of the case-by-case analysis necessary under the


73 Graves v. Lowery, 117 F.3d 723 (3rd Cir. 1997); Virgo v. Riviera Beach Associates, Ltd., 30 F.3d 1350 (11th Cir. 1994).

74 Virgo, 30 F.3d at 1360.

75 For no joint employer liability, see e.g., Bricker v. R&A Pizza, Inc., 804 F.Supp. 2d 615 (S.D. Ohio 2011) (Domino's Pizza LLC prevailed on a motion to dismiss that is was not liable to employee of franchisee for sexual harassment); Hatcher v. Augustus, 956 F.Supp. 387, 392 (E.D.N.Y.1997) (the court found that a franchisor was not a joint
joint employer doctrine and the varying involvement of franchisors in human resource issues. There is simply no bright line test.

However, franchisors can expect the case law on the issue to expand exponentially over the next several years, which hopefully might lead to more definitive guidance. The first of likely many cases was filed in Virginia earlier this year. In Betts, et al. v. McDonald’s Corporation, 15-CV-0002 (W.D. Va.), a group of 10 former employees of McDonald’s, nine African-American and one Hispanic, that worked at three McDonald’s restaurants in Virginia, sued McDonald’s Corporation, McDonald’s USA, LLC and the local franchisee entities for race discrimination and harassment under Title VII and Section 1981. The allegations of discrimination and harassment in the Amended Complaint are quite troubling. However, for purposes of this paper, the remarkable aspect of the Amended Complaint is that nearly 70 paragraphs are devoted to establishing McDonald’s corporate’s control over the human resource responsibilities of the franchisees. In asserting joint employer liability, the plaintiffs’ attorneys focus on the following:

- Franchise Agreement requirements that the franchisee comply with standards of quality and cleanliness and all business policies, practices and procedures imposed by McDonald’s;
- Payment of royalties;
- Corporate oversight, including business advisors and mystery shoppers;
- Training and the requirement that all managerial employees graduate from a franchisor training course;
- Provision of comprehensive training manuals that include hiring, management, supervision of employees;
- Provision of an additional manual specific to training, discipline, diversity, nondiscrimination and sexual harassment;
- Provision of workforce management software;
- Surveying of employees; and
- Corporate assessment of all job applicants prior to hiring.

If these allegations are true, McDonald’s may have significantly more oversight over its franchisees than the typical franchise system, which provides much more traction for a plaintiff’s attorney to pursue joint employer liability.

employer for the purpose of Title VII liability, noting that the franchisor did not operate the store and the franchisee “exclusively possessed the rights and responsibilities regarding all employment matters and the day-to-day operations in his store, and his relationship with the plaintiff as his employee.”); for joint employer liability, see e.g., Myers v. Garfield & Johnson Enterprises, Inc., 679 F.Supp.2d 598 (E.D.Pa. 2010) (employee of Jackson Hewitt franchisee survived a motion to dismiss, with court holding that franchisor could be held liable under joint employer theory in Title VII claim).
Unfortunately, as joint employer liability is a factual case-by-case analysis, franchisors may find themselves in discrimination lawsuits at least through summary judgment, as federal judges may be hesitant to dismiss franchisors on a motion to dismiss, since facts to determine joint employer status will need to be developed during discovery.

2. **Family and Medical Leave Act**

The Family and Medical Leave Act, 29 U.S.C. §2601, et seq. ("FMLA") provides up to 12 weeks of unpaid leave per year to qualifying employees and prevents discrimination and retaliation of employees that request or have taken family and medical leave. In order to be subject to the FMLA, the employer must have 50 or more employees. As it is one of the more recent Federal statutes involving employment rights, the FMLA regulations actually address joint employer liability.

Federal regulations provide that:

Where two or more businesses exercise some control over the work or working conditions of the employee, the businesses may be joint employers under FMLA. Joint employers may be separate and distinct entities with separate owners, managers, and facilities. When the employee performs work which simultaneously benefits two or more employers, or works for two or more employers at different times during the workweek, a joint employment relationship generally will be considered to exist in situations such as: ... (2) where one employer acts directly or indirectly in the interest of the other employer in relations to the employee; or (3) where the employers are not completely disassociated with respect to the employee's employment and may be deemed to share control of the employee, directly or indirectly, because one employer controls, is controlled by, or is under common control with the other employer.\(^76\)

Importantly, only the primary employer is responsible for giving the required notices to employees, providing FMLA leave and maintenance of health benefits.\(^77\) The primary employer is determined by the entity that has the authority to hire and fire, assign and place the employee, make payroll and provide benefits.\(^78\) In most franchise systems, this will make the franchisee the primary employer.

There are numerous cases involving the FMLA where the joint employer regulation is applied with respect to non-franchise businesses to establish the jurisdictional threshold of 50 employees, often where an employee of a small subsidiary of a larger parent company seeks

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\(^{76}\) 29 C.F.R. 825.106(a).

\(^{77}\) 29 C.F.R. 825.106(c).

\(^{78}\) 29 C.F.R. 825.106(c).
FMLA protection. However, cases examining whether a franchisor can be held liable as a joint employer, not involving jurisdiction, are very limited and the results are mixed.

In July of 2013, the District of Arizona ruled that a franchisor, Buffalo Wild Wings could not be held liable as a joint employer with its franchisee under the FLSA/FMLA joint employer test. The court concluded that the franchisor did not have day-to-day control over the franchisee’s employees, such as right to hire, supervise or fire employees, payroll responsibility and recordkeeping. The Courtland case held that a franchise contract itself is not sufficient to establish that the franchisor is a joint employer.

In March of 2013, the Northern District of Indiana ruled that a plaintiff alleged sufficient facts in a complaint to survive a motion to dismiss on the issue of joint employer, against a number of parties including a franchisor. The Newman court held that allegations of direct supervisory authority, payment of some employees, and being subject to personnel policies and standards were sufficient to establish joint employer liability on a motion to dismiss. The court held that based on the allegations asserted by the plaintiff it was plausible that the plaintiff was employed by multiple entities including a franchisor.

3. Fair Labor Standards Act Claims

The FLSA defines employer as “any person acting directly or indirectly in the interest of an employer in relation to the employee.” 29 U.S.C. § 203(d). The definition may seem simple at first blush, but when Congress uses “employer” to define “employer” complications will arise. Moreover, whenever the term “indirectly” is used, it is never simple. The term “indirectly” likely gives rise to the application of the joint employer doctrine to FLSA claims. In Fact Sheet #79E, the DOL examined joint employer liability under the FLSA in general and specific to employment in domestic service jobs. Fact Sheet #79E provides:

A single individual may be simultaneously considered an employee of more than one employer under the FLSA. In such cases, the employee’s work for the joint employers is considered as one employment for purposes of the Act, and the joint employers are individually and jointly responsible for FLSA compliance, including paying not less than the minimum wage for all hours worked during the workweek and, if applicable, overtime compensation for all hours worked over 40 in the workweek. 29 C.F.R. 791.2(a).

The FLSA and all Federal Courts analyze FLSA claims utilizing the “economic realities” test to determine whether joint employment exists. The “economic reality” test centers on who controls the conduct and payment of the employee. Factors that will be considered by the FLSA

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79 See e.g., Cuff v. Trans States Holdings, Inc., 768 F.3d 605 (7th Cir. 2013).

80 Courtland, supra note 31.


82 Fact Sheet #79E: Joint Employment in Domestic Service Employment Under the Fair Labor Standards Act (FLSA), United States Department of Labor, Wage and Hour Division (Revised June 2014).
include whether a possible employer has the power to: (1) direct, control or supervise the worker; (2) hire or fire, modify the employment conditions or determine pay rates or the methods of wage payment; (3) the degree of permanency and duration of the relationship; (4) where the work is performed; (5) undertake responsibilities in relation to the worker which are commonly performed by employers; and (6) perform payroll or similar functions. No one factor is dispositive. All Federal Circuit Courts apply the economic realities test to FLSA joint employer cases, although the factors may be combined or slightly altered.\textsuperscript{83}

The Fifth Circuit recently addressed the application of the joint employer test in a case involving a franchisor and the FLSA.\textsuperscript{84} After a jury found the franchisor liable for multiple violations of the FLSA, the Fifth Circuit reversed after examining the economic realities test. Although the franchisor ultimately prevailed in Orozco, the result must be viewed with caution. First, the case went to a jury and the franchisor was held liable. Second, the Fifth Circuit recognized that the economic realities test must be applied on a case-by-case basis. And third, the Fifth Circuit provided that “we do not suggest that franchisors can never qualify as the FLSA employer for a franchisee’s employees; rather, we hold that Orozco failed to produce legally sufficient evidence to satisfy the economic reality test.”\textsuperscript{85} As a result, although the franchisor might ultimately prevail, there will likely be litigation costs to get there.

Notably, the Fifth Circuit did emphasize that a provision in the franchise agreement relating to franchisee compliance with the policies and procedures of the franchisor is not sufficient in and of itself to establish joint employer liability, which is very similar to the NLRB General Counsel’s position.

Unlike the EEOC integrated enterprise analysis, which takes a broader look at the relationship between the businesses, the economic realities test focuses on the day-to-day interaction and control of the employee.

**B. Occupational Safety and Health Act Claims and Worker’s Compensation**

1. **OSHA Claims**

In mid-March of 2015, 28 complaints were filed with OSHA by McDonald’s workers alleging various workplace hazards, including a high risk of burns resulting from inadequate safety equipment. The complaints, which have not been made public, reportedly do not allege joint employer in establishing jurisdiction over McDonald’s, but McDonald’s corporate is involved as nine of the complaints occurred at corporate locations. However, the question of whether

\textsuperscript{83} For example, the Third Circuit’s economic realities factors are – (a) the alleged joint employer’s authority to hire and fire the relevant employees; (b) the alleged joint employer’s authority to promulgate work rules and assignments, and to set the employee’s conditions of employment, including compensation, benefits and hours; (c) the alleged joint employer’s involvement in day-to-day supervision of the employees, including discipline; and (d) the alleged joint employer’s actual control of the employee’s records, which include payroll, taxes and insurance. In Re: Enterprise Rent-A-Car Wage & Hour Practices Litigation, 683 F.3d 462 (3d Cir. 2012).

\textsuperscript{84} Orozco, supra note 37.

\textsuperscript{85} Id., p. 452.
OSHA would apply joint employer in the franchise model remains. A July 2014 policy memorandum may shed light on the possible answer to this question.86

By way of background, in April of 2013, OSHA launched the Temporary Worker Initiative ("TWI") in order to help prevent work-related injuries and illnesses among temporary workers.87 More specifically, OSHA was concerned that the safety of temporary workers would fall-through-the-cracks amongst the staffing agency and the host employer. As a result, "OSHA will consider the staffing agency and the host employer to be 'joint employers' of the worker." OSHA continues by stating that:

> Joint employment is a legal concept recognizing that, in some situations, the key attributes of the traditional employer-employee relationship are shared by two or more employers in such a manner that they each bear responsibility for compliance with statutory and regulatory requirements.88

This is a broad proclamation of the joint employer concept by OSHA and franchisors should be mindful of its application to the franchise model. To date, however, OSHA has not made any overt moves to apply the joint employer doctrine to franchises. But, a closer look at the TWI Memorandum is warranted.

An initial reaction might be to conclude that in the staffing agency, host employer relationship, the host employer will be responsible for all safety issues, especially given that the host employer knows the work to be performed and the materials or equipment to be utilized that might be hazardous. However, the TWI Memorandum requires the staffing agency to identify any hazards present, to ensure that the workers will receive any required training, protective equipment and that those protections are in place. The TWI Memorandum goes so far as to permit the staffing agency to inspect the worksite to ensure safe working conditions.

Is it far-fetched that OSHA might require a similar safety regimen in the franchise arena? By way of example, assume there is a fast food franchise chain that mandates the equipment to be used in restaurant, including hot-oil fryers, grills and potent cleaning agents. The broad language used by OSHA to define a joint employer and the affirmative steps the TWI Memorandum requires of staffing agencies, would seem to indicate that at some point OSHA would consider making the franchisor responsible for the day-to-day safety missteps of a franchisee.

2. Worker’s Compensation Claims

As with OSHA, in worker’s compensation cases whether an employee is jointly employed will most often come up in the temporary staffing or contract worker situations. In those situations, it is crucial to address joint employer issues in the contract between the staffing company and the host employer, e.g., who is responsible for payroll, supervision, human

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86 Policy Background on the Temporary Worker Initiative (Memorandum), Occupational Safety and Health Administration, United States Department of Labor (July 15, 2014).
87 Id.
88 Id.
resources and insurance (including worker's compensation). Even in situations where one party, typically the staffing agency, is responsible for worker's compensation via contract, the host employer must be careful to not assume many of the functions of the traditional employer-employee relationship, or it will risk being a joint employer for worker's compensation purposes with no insurance.

There is no evidence yet that injured individuals or insurance companies are making a concerted effort to make franchisors responsible for workplace injuries sustained on the franchisee's premises. However, given the apparent expansion of joint employer liability beyond its previous bounds (or some might say going back to the original intent of joint employer), it is probably worth having a discussion with your insurer to determine if there is add-on coverage that will protect against this risk.

C. Affordable Care Act

In ruling on the constitutionality of the Affordable Care Act ("ACA") in June of 2012, Chief Justice John Roberts declared, in his majority opinion, that Congress did not pass the ACA under its Commerce Clause powers but it did so under its taxing powers, as the rules regarding the ACA are found in the IRS regulations.

The ACA's employer mandate is tied to the "common law employer" of an employee. The ACA Final Rule defines the term "employee" as an individual who is an employee under the common law control standard under Treas. Reg. § 31.3401(c)-1(b). The Treasury Regulations further provide that the employer-employee relationship generally exists when:

the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer not only as to what shall be done but how it shall be done ... the right to discharge is also an important factor indicating that the person possessing that right is an employer.\(^89\)

Although this definition might be open to a joint employer interpretation, the IRS has indicated informally that joint employment does not exist for purposes of the ACA employer mandate, and that an employee may have only one employer for this purpose. The IRS' stated position is that neither the Code, regulations, other formal guidance, [nor] any binding court precedent recognize co-employment or joint-employment for federal employment tax purposes, except in limited circumstances.\(^90\) Moreover, since the IRS has a different mission statement than the DOL, it is unlikely that the IRS will wade into the joint employer issue.

D. State Laws Seek to Clarify Franchisor-Franchisee Relationship.

In response to the NLRB's recent actions with respect to McDonald's and the expansion of the joint employer doctrine three states have passed laws defining the franchisor-franchisee

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89 Treas. Reg. § 31.3401(c)-1(b).

90 Memorandum, Office of the Assistant Chief Counsel, Department of the Treasury, No. 200017041 (March 3, 2000).
relationship for purposes of those states’ discrimination and wage and hour statutes, limiting any potential joint employer liability.

In April of 2015, Tennessee enacted a statute that provided that franchisees’ employees, as well as the franchisees themselves will not be “deemed to be an employee of the franchisor for any purpose.”

In July of 2015, Texas enacted a statute that provides that a franchisor is not considered an employer for claims related to employment discrimination, wage payment, minimum wage and worker’s compensation, unless a Texas court concludes that the franchisor “exercises a type or degree of control over the franchisee or the franchisee’s employees not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademarks and brand.”

Also in July of 2015, Louisiana enacted a statute that provides that “an employee of a franchisee may be deemed to be an employee of the franchisor only where the two entities share or co-determine those matters governing the essential terms and conditions of employment and directly and immediately control matters relating to the employment relationship such as hiring, firing, discipline, supervision, and direction.”

At the time of publishing this paper, similar legislation was also working its way through the Wisconsin and Michigan legislatures. Importantly, these state statutes do not affect or prevent the expansion of the joint employer doctrine at the Federal level, which is the level of greatest concern.

VI. CONSEQUENCES ON FRANCHISING IF JOINT EMPLOYER STANDARD IS ADOPTED

The NLRB General Counsel’s recommendation that franchisors can be held as joint employers with franchisees by merely possessing the “unexercised potential” to control working conditions could have devastating and far-reaching effects on franchising as a business model and the economy as a whole. This is not just a concern for franchisors but for franchisees as well. The franchise model has helped millions of entrepreneurs own their own businesses and acquire the right to operate those businesses using a proven franchise system. By giving them the resources they need to begin operating a successful business, franchisees are put in a far better position than other small businesses.

If franchisors are held to be joint employers, and thereby made liable for individual franchisees’ employment practices, there will be a domino effect that ripples through the entire franchising infrastructure. The increased liabilities and cost of doing business for franchisors could reach a tipping point where it no longer makes financial sense for them to stay in business – or it may require them to dramatically cut back on the amount of franchising (or, in the alternative, increase franchise fees to cover the rising costs to the financial detriment of franchisees). This will erode the number of opportunities for hopeful entrepreneurs seeking to own their own franchise business. For those franchisees who remain in business, they will likely

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lose much of their autonomy, which will dissuade them and others from opening new franchised locations.

Franchisees are used to running their own businesses. They hire and fire their own employees, establish wages and benefits, set work schedules, pay their own taxes, hire their own accountants and lawyers, apply for business licenses, have their own Employer Identification Numbers, and make day-to-day decisions about their business – all without the knowledge or consent of the franchisor. This puts them in control of their profitability. Finding a franchisor to be a joint employer would take away this control to the detriment of the franchisee.

At a hearing before the U.S. House of Representatives Committee on Education and the Workforce, Clint Ehlers, an owner of two FASTSIGNS® franchises in Pennsylvania, put it succinctly:

My concern is not that I will be charged with any labor violations, but that my franchisor, in response to the NLRB’s changing long-standing joint employer standards, will take measures to protect itself that will end up reducing my autonomy as a franchise owner…. I will have less independence and less control over the business that I worked so hard to build. And since I would no longer be an independent owner, my business would be worth less.94

There are two different scenarios that would likely play out if the NLRB established franchisors as joint employers. The first is over-involvement by franchisors: franchisors will be forced to increase operational control over franchisees’ employment practices; franchisees will have less control over who they hire and fire and how they discipline and reward employees; franchisees will be less empowered to make day-to-day decisions that impact the operation of their business; profitability will decrease; economic realities will no longer support the franchising business model; franchisees will be less incentivized to continue franchising (or purchase additional locations) and those looking to open a franchised business will seek alternative business opportunities; thousands of employees will be out of work; and the U.S. economy, which depends so heavily on franchising, will be irreparably weakened.

The second scenario is under-involvement by franchisors: in an effort to limit liability for their franchisees’ employment practices, franchisors will pull back on their operational controls, training, and standards enforcement; brand quality and uniformity – the hallmark of franchising – will plummet; franchise businesses will suffer; reduced profitability will undermine the franchise model and have the same economic impact described in the paragraph above.

The harm that a new joint liability standard would have on franchisees and their employees cannot be overstated. Jagruti Panwala is a businesswoman who owns four hotels and is in the process of building a fifth – all of them are franchised. She employs over 200 people. She chose the franchise business model because, while the brand affiliation would help generate revenues, it allowed her to be in business by herself and ultimately be responsible for

the success or failure and profitability of her businesses. She is concerned about what the proposed joint employer standard would mean for her independence:

At its very core, any decision imputing liability for franchisees’ employment decisions onto the franchisor, may cause franchisors to impose control over the daily operations of each business in an effort to mitigate against any claims. Essentially, I would no longer be in business for myself.95

In her closing remarks to Chairman Roe of the House Committee on Education and the Workforce, Ms. Panwala expressed her indignation over the NLRB General Counsel's characterization of franchisees as expressed in its brief in Browning-Ferris:

It essentially claimed that franchisors were the true employers who inserted "intermediaries" between themselves and employees in order to avoid collective bargaining over working conditions. Mr. Chairman, I am no intermediary. I am a business owner and a job creator.96

Another doomsday scenario is one where franchisors decide to exit the business of franchising altogether. Not only would hopeful prospective franchisees no longer have the opportunity to own their own business, or existing franchisees have the chance to acquire additional franchised units, but existing franchisees could lose their businesses entirely. In a recent Franchise Law Journal article,97 the authors suggest that franchisors could potentially rely on the "frustration of purpose" legal doctrine to terminate their existing franchise agreements. The argument would be that the change in the joint employer standard was an unforeseeable event based on the well-established legal precedent in this area, and a fundamental tenet of franchising is that a franchisee is an independent contractor of the franchisor, not an employee or joint employer. Therefore, all existing franchise agreements would be subject to termination due to an unforeseeable event occurring after the contract was entered into that renders the contract unworkable and ineffectual.98

According to the Restatement (Second) of Contracts, frustration of purpose is described as:

Where, after a contract is made, a party's performance is made impracticable without his fault by the occurrence of an event the non-occurrence of which was a basic assumption on which the contract was made, his duty to render that performance is...
discharged, unless the language or the circumstances indicate to the contrary.\(^99\)

Under the joint employer scenario, a franchisor could argue that the change in the law (or the interpretation of that law) "so upsets the fundamental economic nature of franchisor-franchisee relationship and was so unforeseeable as to justify widespread termination."\(^{100}\)

VII. PRACTICAL APPROACHES TO MINIMIZING FRANCHISOR RISKS

The risks and consequences of vicarious liability are well established, but the recent attacks on the franchising model vis-à-vis changes to the joint employer standard place new emphasis on taking steps to avoid such liabilities. Whether a franchisor has 10, 100, or 1000 franchised locations, there are certain steps it can take now to try to limit its risks. Of course, nothing will eliminate risk, and there is no guaranty that the approaches discussed in this section will reduce or eliminate liability, but the authors believe the suggestions in this section are some of the more important steps that every franchisor should consider.

How far a franchisor decides to go in changing its contracts, policies, and procedures will depend on each franchisor's risk tolerance and finding the right balance between maintaining brand standards and uniformity and the risk of being a joint employer or vicariously liable. Franchisors must try to "walk the line," which has become exceedingly difficult as the line continues to move (or is perceived to move). Understandably, many franchisors may choose to refrain from making any substantial changes to its contracts, policies and procedures until the line becomes more clearly defined. Either way, it will be important for franchisors to keep a close eye on how this area of the law develops over the next 12 months or so as important decisions come down in the NLRB cases discussed in this paper, new state legislation is introduced, and additional cases are decided.

A. Review the Franchise Agreement

Franchisors should take a fresh look at their franchise agreement through the lens of the current legal environment. The following are specific provisions that are commonly found in franchise agreements and are worth reviewing.

1. Definition of "Operations Manual"

When is the last time most franchisors looked at their definition of an operations manual? In many cases, franchisors will define the operations manual very broadly to ensure that they are capturing all related information. But doing so can have the disadvantage of making the operations manual over-inclusive and inadvertently include employment-related requirements or recommendations that are not intended. For example, the definition of operations manual commonly includes language such as, "The Manual includes any and all manuals, guidelines, handbooks, policies, and other writings which the Franchisor furnishes or may furnish to Franchisee from time to time concerning the System and Franchisor's standards, methods, and procedures."

\(^{99}\) Restatement (Second) of Contracts § 261 (1981).

\(^{100}\) Kaufmann, supra note 80 at 501.
Instead of being all-encompassing, a franchisor should consider defining the operations manual narrowly to include just a single document, whether it is paper or electronic. This will make it easier for the franchisor to maintain control over the manual's content (see discussion in Section VII.B. below). In addition, it is important to define the manual to specifically exclude any employment related information (for example, it should not incorporate employee handbooks or forms). Another option is to rename the operations manual altogether – for example, "Brand Standards Manual" – to make it clear that the purpose of the manual is to maintain consistency in the brand, and not to dictate the franchisee's day-to-day operations.

Finally, franchisors should reconsider the wisdom of any franchise agreement provision that incorporates the operations manual by reference into the franchise agreement. Since the operations manual includes more specific standards and system requirements, which more closely impact the franchisee's day-to-day operations, it is generally advisable to keep those terms separate from the franchisee's other contractual obligations. In addition, franchisors typically want to maintain the operations manual as a malleable document that can be unilaterally updated and modified by the franchisor from time to time. By incorporating the operations manual directly into the franchise agreement, any change to the manual could arguably be deemed a contractual amendment, requiring a written document signed by both the franchisor and franchisee.

2. Franchisor's Obligations

The section of the franchise agreement dealing with the franchisor's obligations should not make reference to the franchisor's right or obligation to train, advise, consult or approve the franchisee's employees. The notable exception to this is management training, which is typically necessary to ensure compliance with brand standards. However, franchisors should be careful not to overstep their bounds and consider eliminating certain services and only providing other services to franchisees' management-level employees. These services should never include employment-related advice involving hiring, firing, wages, or discipline. Franchisors should also consider eliminating any obligations to furnish its franchisees with employment forms, handbooks, or manuals; limiting or eliminating grooming and appearance standards (uniforms are generally acceptable as a brand standard); and limiting or eliminating franchisor background checks and minimum employment standards.

Freshii provides guidance on what a franchisor can provide without being found to be a joint employer. The franchisor provided a sample advertisement for employees, interview questions, a sample employee manual and staff scheduling calculators: It did not require the franchisee to use them. The following specific provisions of the Franchise Agreement were cited by the General Counsel and franchisors may want to consider using them:

- "[T]he System Standards do not include 'any personnel policies or procedures'".102
- "[T]he franchisee alone will 'determine to what extent, if any, these policies and procedures might apply' to its restaurant operations."103

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102 Freshii, supra at 3.

103 Id.
• “Freshii 'neither dictates nor controls labor or employment matters for franchisees and their employees...”

Notwithstanding Freshii and the general goal of limiting the franchisor's involvement in operational training and advice, there are some franchise concepts that carry unique risks and concerns that may necessitate a different approach. For example, businesses involving children, the elderly, or the disabled – such as child care, tutoring, retirement services, and home health care businesses – may require a franchisor to mandate employee background checks, provide substance abuse policies, and provide anti-harassment training for the protection of its franchisees' customers. The risk of not doing these things may very well outweigh the risks of vicarious liability or joint employment.

3. **Franchisee's Obligations**

Consistent with the above recommendations for "franchisor's obligations," the franchisee's obligations section of the franchise agreement should clearly state that the franchisee is obligated (and has sole authority) to make all employment related decisions, including hiring, firing, discipline, wages, hours, benefits, and so on. The franchisee should also specifically be required to train all of its non-management employees and to inform all new employees that the franchisee is their employer, not the franchisor. It is even advisable to require the franchisee to obtain signed acknowledgment forms from all employees whereby they affirm their understanding that they are employees of the franchisee.

4. **Franchisor/Franchisee Relationship**

It may not be enough anymore to simply state that the franchisor and franchisee are "independent contractors" and that there is no fiduciary relationship between them. It is now advisable to include explicit language stating that the franchisor is not an employer of the franchisee or an employer (or joint employer) of the franchisee's employees. Furthermore, it should be expressly stated that the franchisor does not have direct or indirect control over employment decisions; the franchisor is not responsible for, and does not have authority over, the franchisee's employment decisions; and the parties do not have authority to bind one another. The franchisee should also be prohibited from using the franchisor's trademarks in their corporate name. All of this language will help dispel any doubts or confusion over the relationship of the franchisor and franchisee.

5. **Obey All Laws**

Most "obey all laws" clauses consist of a general requirement that the franchisee comply with "all federal, state, and local laws, rules and regulations." Franchisors should consider revising this language to specifically obligate the franchisee to comply with all state and federal labor and employment laws, including, but not limited to, the Fair Labor Standards Act (FLSA), Family and Medical Leave Act (FMLA), Occupational Safety and Health Act (OSHA), Employee Retirement Income Security Act (ERISA), Title VII, the Age Discrimination in Employment Act, and the Affordable Care Act.

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104 *Id.*
6. **Indemnification**

Indemnification provisions are usually broadly written and generally enforceable, but franchisors should consider adding specific language that the franchisee must indemnify the franchisor for any liability arising from labor or employment law violations. It should also be clear that the indemnification includes acts and omissions of both the franchisee and the franchisee's employees. As always, the obligation to indemnify should survive expiration or termination of the franchise agreement in case an employment-related claim is brought down the road.

7. **Insurance**

As with the indemnification provision, the insurance requirements are another opportunity for franchisors to limit their employment liability risks. To ensure that franchisees are sufficiently covered for employment-related claims, some franchisors have begun to require Employer Practices Liability Insurance (EPLI). This insures the franchisee against claims by employees that their legal rights as employees have been violated, including such claims as sexual harassment, discrimination, wrongful termination, and breach of the employment contract. If a franchisee is sufficiently covered, there will be less of a motive for an employee to pursue a joint employer claim against the franchisor. Also, when it comes to insurance, it will only help if it is valid and binding, carries sufficient limits, and includes the franchisor as an additional insured. To ensure that a franchisee is complying with all of its requirements under the franchise agreement, it is recommended that the franchisor collect endorsements, not just certificates of insurance, and periodically check to make sure policies are kept current.

Franchisors should also consider requiring that franchisees notify them of any modification or termination of an existing policy and requiring supplemental (or "tail") coverage that will extend coverage for a period of time after expiration of the policy for acts that occurred while the original policy was still in effect.

**B. Review the Operations Manual**

In addition to revising the franchise agreement, it is recommend that franchisors conduct a full-scale audit of their operations manual with the goal of answering two questions with respect to each provision in the manual: (1) Is the provision critical to maintain system standards?; and (2) Should the provision be mandatory or optional? By answering these questions, franchisors can take a giant step towards mitigating their risks.

The first question a franchisor should ask itself is whether each provision in the manual is directly related to system standards. If it is not, they should consider taking it out. This can include provisions that tend to "micromanage" the day to day operations of the franchisee or items that are outdated and no longer enforced by the franchisor. For example, the Freshii Operations Manual specifically provided that system standards did not include employee policies or procedures. Also, any provisions that, directly or indirectly, control the franchisee's employees should be removed, including any employment handbooks, manuals, or forms. Examples of provisions that tend to relate to system standards are those involving cleanliness, quality of products/services, physical appearance of the premises, display of trademarks, including signage, and other provisions that directly impact the "customer experience."

To answer the second question – mandatory vs. optional – it may help to ask one more question: "Does this requirement directly impact the guest experience?" If not, the franchisor
should consider removing it altogether or at least making it optional. Any requirement that does not directly or indirectly implicate brand standards – what the customer sees, smells, tastes, or hears – may not need to be in the operations manual to begin with. Making these items optional, even if they are “suggested” or “recommended,” will strengthen the franchisor’s position against a claim of vicarious or joint employer liability. These items can even be removed from the manual and placed in a separate “guidelines” document. Employment practices should rarely, if ever, be included as mandatory operating procedures.

There are a few other things that can be done to reduce a franchisor’s liability when it comes to the operations manual. For example, it may be advisable to include a disclaimer on every page of the operations manual as a reminder that the franchisor is not an employer of the franchisee or the franchisee’s employees and does not control the day-to-day decisions of the franchisee. This is especially important for those sections where the franchisor is offering “suggested” or “recommended” practices. If they do not already, all franchisors should provide an online version of the manual so that it can easily be modified from time to time. This also makes it easier to inform franchisees of any changes and rebut any argument that they did not have access to the most recent version of the manual. Finally, franchisors should not forget to review other practices, policies, and directives that may not be specifically covered by the operations manual but could still expose the franchisor to claims of joint employment.

C. Review Training Programs

Reviewing and revising the franchise agreement and operations manual are important steps in protecting a franchisor from employment related liability, but not only do franchisors need to “talk the talk,” but they also need to “walk the walk.” In other words, avoiding employment liability depends not just on the language contained in written documents but the words and actions of the franchisor’s representatives who interact with franchisees on a daily basis.

The first step is to educate. Field personnel are often the last people to know what’s going on in the legal world. So while attorneys are discussing and debating the NLRB and court decisions discussed in this paper, it is imperative that the foot soldiers are attuned to these changes so that they can conduct themselves appropriately. Field personnel should, therefore, be trained so that they have an understanding of what a “joint employer” is and what “vicarious liability” means. Ultimately, it is their words and acts that will typically provide the basis for one of these claims.

Field personnel should also be educated on what to say and not to say to franchisees and franchisees’ employees to reduce the risk to the franchisor. For example, field personnel should primarily interact with the owner or general manager of a franchised business, and not directly communicate about the business with non-management employees. Any advice or consultation provided by the field personnel should “trickledown” from the franchisee’s senior management to other employees. Field personnel should also understand that they do not play a role in hiring, firing, wages, or disciplinary decisions. Franchisee owners or general managers may ask for advice on these issues, but the field personnel should not get involved.

105 “Field personnel” is a general term used here that refers to any employees or representatives of a franchisor who are field-based and regularly interact with franchisees on a face-to-face basis. Depending on the franchise system, these employees may be referred to as business consultants, sales consultants, area consultants, field specialists, and other names.
One of the central issues in Patterson v. Domino's was the role of Domino's field personnel (referred to as area leaders in the Domino's system). The opinion noted that the area leader provided guidance to the franchisee in opening his restaurant but did nothing to help him train his employees. On the other hand, when the franchisee informed the area leader about the complaint by his employee that her manager was sexually harassing her, the area leader allegedly told the franchisee that he had to get rid of the manager. According to the franchisee's testimony, he never said "no" directly to the area leader for fear of losing his business. In Patterson, this was ultimately irrelevant since the manager in question had already been suspended by the franchisee and failed to return to work. The lesson for franchisors is that the actions of field personnel can make the difference in the determination of whether the franchisor is liable for the actions of the franchisee's employee. While Patterson involved the issue of vicarious liability, courts deciding joint employer issues have relied on the analysis.\(^{106}\)

Another important consideration with respect to field personnel is whether, and to what extent, they should be involved in the inspection of franchised businesses. Generally, franchisors use inspections to help enforce brand standards and ensure compliance, and such inspections are typically considered an essential element of the franchise system. However, they can also create liability for the franchisor if problems are discovered, reported to the franchisee and then go uncorrected. While most franchisors would not choose to forego inspections altogether, it is important to educate and train field personnel on how to conduct inspections, how to communicate issues to the franchisee, how to document their findings, and how to properly follow up to ensure corrective action has been taken. Franchisors should also consider outsourcing inspections to a third party to limit their involvement and maintain a more systematic inspection process.

When it comes to formal training programs provided to the franchisee, franchisors should typically take the approach of "training the trainers." In other words, a franchisee's senior management personnel should be trained not only on how to operate the franchised business, but also what they need to know to train lower level employees. This allows the franchisor to avoid directly training these employees. Franchisors should avoid having a direct role in recruiting, training, supervision, or directing non-management personnel.

Freshii provides an illustration of a good approach to training. The local development agent provided initial training to the franchisee that included staff training for three days before opening, and five days after opening. After that, the franchisee was responsible for all personnel training.

Like franchisee training, training of the franchisor's field personnel should be ongoing, not a one-time event. Especially as the joint employer and vicarious liability areas of the law continue to evolve, it will be important to keep field personnel abreast of these developments. It is crucial that these issues are kept at the forefront of their minds.

D. **Other Practical Considerations**

In addition to revising legal documents and training the franchisor's personnel, there are other practical steps a franchisor can take to try to minimize its employment-related liability. The following are some of the more important steps:

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\(^{106}\) Vann, *supra*.
• Do not mandate software that controls employment practices, such as wages, hours, labor costs, and scheduling. If the Freshii case taught us anything, it is the weight the NLRB appears to place on scheduling software such as that used by the franchisees in the McDonald’s cases. As discussed in Section IV.B.1 above, the NLRB’s Advice Memorandum in Freshii concluded that Freshii and its franchisee were not joint employers under either the NLRB’s current standard or the new standard proposed by the NLRB General Counsel. The NLRB went out of its way to emphasize the fact that Freshii was not involved in the franchisee’s scheduling and setting work hours of its employees, either directly or through scheduling software. Nor did Freshii have any input into scheduling algorithms or methods used in any scheduling software. This is a major point of distinction with the McDonald’s franchisees who were notably required to use labor scheduling software provided by McDonald’s (the franchisor) to measure their labor costs in real time. This software allegedly caused franchisees to take workers off the clock when labor costs approached certain levels (even when the employees were at the restaurants at the franchisees’ request).

• Avoid assigning (or permitting) franchisees and their employees from using e-mail addresses that may lead guests or vendors to assume they are an employee of the franchisor. An e-mail from the corporate franchisor should be easily distinguishable from an e-mail from the general manager of a franchised location. Also consider prohibiting franchisees from using the franchisor’s trademarks in their e-mail signature and even require that they identify themselves in their signature as an independent franchise owner. Ensure that the franchisor has clear and concise policies on franchisee use of e-mail.

• Require franchisees to include employer disclaimer language in all manuals, handbooks, training materials, forms, etc., which are provided to their employees. This will help distinguish the franchisee as the employer and an independently owned and operated business. Also prohibit franchisees from using the franchisor’s trademark in any employment handbooks or on franchisee’s paychecks to employees. Require signage informing the public, the franchisee, and the franchisee’s employees that each franchise is independently owned and operated.

• Taking it a step further, consider requiring the franchisee to have its employees sign a certification form acknowledging that the franchisee is their employer and that the franchisor (including field personnel, in particular) has no right to hire, fire, or discipline them.

• Ensure that all franchisee advertising, signs, posters, business cards, stationery, etc., clearly indicate to third parties that the franchisee is an independently owned and operated business.

• Consider conducting a system audit (or hire a consultant to do so) and eliminate unnecessary controls from franchise programs.

• Consider outsourcing the franchisee training function to a third party, or even delegating the responsibility to an independent franchise association.

• Consider recommending to franchisees that they outsource their employee functions, for example by using a Professional Employer Organization (PEO) or other HR consultant.
• Do not coach franchisees in how to address union organizing efforts. In *Freshii*, the General Counsel emphasized that neither the franchisor nor its development agent responded when the franchisee notified the development agent that the franchisee had been presented with a letter from its employees asking the franchisee to recognize the union.

• Avoid sending default or termination notices to franchisees after inspections that result in relatively minor deficiencies. Instead, send less formal letters identifying areas for improvement.

**VIII. CONCLUSION**

Is the future of franchising more R.E.M. or Johnny Cash? Is it "The End of the [Franchising] World As We Know It"?, or do franchisors merely have to reassess the way they do business in order to "Walk the Line" between doing too much to help their franchisees and doing too little? Will franchisors overreact to the NLRB's decision to pursue a joint employment theory in *McDonald's* by withdrawing from its support of franchisees? Will this lead to a deterioration of brand standards and product/service uniformity? What does the Browning-Ferris decision and the *Freshii* advice memorandum mean? Are they inapposite, or can they be read together? Does the NLRB have a clear position on the joint employer standard and franchising? Will the courts come to the rescue? How should franchisors manage this ambiguity?

These are all excellent and thought provoking questions, and ones that will take time to answer. Franchisors and franchisees need to stay attuned to the actions and decisions of the NLRB, the Department of Labor, and various courts around the country to understand the direction that the law is going, while making sure not to overreact to the detriment of their franchisees and their franchise systems. Hopefully, this paper has provided a fruitful background and analysis of the employment related risks facing franchisors and the franchise industry today, along with practical steps that franchisors can take now to help reduce these risks.
APPENDIX A

The NLRB Process for Unfair Labor Disputes

CHARGE
Filed with Regional Director; alleges unfair labor practice by employer or labor organization.

INJUNCTION
Regional Director must ask district court for temporary restraining order in unlawful boycott and certain picketing cases.

INVESTIGATION
Regional Director determines whether formal action should be taken.

INJUNCTION
Regional Director may, with Board approval, ask district court for temporary restraining order after complaint is issued in certain serious unfair labor practice cases.

COMPLAINT AND ANSWER
Regional Director issues complaint and notice of hearing. Respondent files answer in 10 days.

HEARING AND DECISION
Administrative Law Judge presides over a trial and files a decision recommending either (1) order to cease and desist from unfair labor practice and affirmative relief or (2) dismissal of complaint. If no timely exceptions are filed to the Administrative Law Judge’s decision, the findings of the Administrative Law Judge automatically becomes the decision and order of the Board.

DISMISSAL
Board finds respondent did not commit unfair labor practice and dismisses complaint.

REMEDIAL ORDER
Board finds respondent committed unfair labor practice and orders respondent to cease and desist and to remedy such unfair labor practice.

COURT ENFORCEMENT AND REVIEW
Court of appeals can enforce, set aside or remand all or part of the case. U.S. Supreme Court reviews appeals from courts of appeals.

WITHDRAWAL – REFUSAL TO ISSUE COMPLAINT - SETTLEMENT
Charge may, with Agency approval, be withdrawn before or after complaint is issued. Regional Director may refuse to issue a complaint; refusal (dismissal of charge) may be appealed to General Counsel. Settlement of case may occur before or after issuance of complaint (informal settlement agreement subject to approval of Regional Director; formal settlement agreement executed simultaneously with or after issuance of complaint, subject to approval of Board). A formal settlement agreement will provide for entry of the Board’s order and may provide for a judgment from the court of appeals enforcing the Board’s order.

OTHER DISPOSITION
Board remands case to Administrative Law Judge for further action.

107 www.nlrb.gov.
Biographies

Susan Grueneberg, Esq.

Ms. Grueneberg is a Partner at the law firm of Snell & Wilmer L.L.P. in Los Angeles, California and is a certified specialist in franchise and distribution law. Ms. Grueneberg serves as Chair of the Industry Advisory Committee to the North American Securities Administrators Association (NASAA) Franchise Project Group and is a Past Chair of the American Bar Association Forum on Franchising. She is also a member of the International Franchise Association's Legal/Legislative Committee. She is also a past Chair of the California State Bar Franchise and Distribution Law Commission, the commission that oversees the certification of legal specialists in franchise and distribution law in California. Ms. Grueneberg also formerly served on the California State Bar Business Law Section Executive Committee, as Chair of the California State Bar Franchise Law Committee and as a member of the Board of Governors of the Century City Bar Association. A graduate of UCLA Law School, Ms. Grueneberg also taught at the Chinese University of Hong Kong as a U.S. State Department Fellow, and received a National Academy of Sciences Fellowship for post-graduate study in economics at the University of Beijing. She is co-editor of the ABA publication "The FTC Franchise Rule".

James B. Shrimp, Esq.

Mr. Shrimp is a partner in High Swartz, LLP in Norristown, Pennsylvania, just outside Philadelphia. Mr. Shrimp is the principal partner of High Swartz's employment and franchise litigation departments. Mr. Shrimp’s practice includes the representation of employers in discrimination cases brought in federal court and state court, and at the administrative level. His practice also includes representing both franchisors and franchisees in litigation involving the franchise, commercial disputes and employment matters. Mr. Shrimp also represents businesses in wage and hour disputes and restrictive covenant disputes; commercial contract disputes; and trademark infringement matters and TTAB proceedings. Mr. Shrimp is a member of the ABA Forum on Franchising. Mr. Shrimp earned a bachelor of arts in History, cum laude, from Misericordia University in 1996. Mr. Shrimp earned his J.D. from the Villanova University School of Law in 1999. Mr. Shrimp is admitted to practice in Pennsylvania, New Jersey and their attendant Federal Courts.

Christopher J. Wallace, Esq.

Chris Wallace is Vice President and Assistant General Counsel, Franchising, at Choice Hotels International, Inc. in Rockville, Maryland. Mr. Wallace manages Choice’s Franchise and Contracts Administration Division and is responsible for overseeing Choice’s franchise compliance function and advising the Company on franchising legal issues. He oversees the preparation of all Franchise Disclosure Documents, franchise agreements, renewals and relicensings, and all franchise defaults and terminations. Previously, Mr. Wallace was Counsel in the Franchising & Distribution group of the law firm of Nixon Peabody LLP in Washington, DC from 2004 to 2012. Prior to that, he was a litigation attorney in both Washington, DC and New York City. Mr. Wallace is a Certified Franchise Executive™ (CFE) who has been practicing franchise law for over 14 years and is an active member of the ABA Forum on Franchising and International Franchise Association. He is a graduate of Colgate University and Pace University School of Law.