UNCERTAINTY ABOUNDS

The Joint Employer Doctrine and the Franchise Business Model

By David L. Steinberg, Derek D. McLeod, and Emily M. Mayer

Among the billion-dollar questions that can be asked is whether recent efforts to redefine the joint employer doctrine will be detrimental to the franchise industry. The National Labor Relations Board (NLRB) and the U.S. Department of Labor have recently taken positions to expand liability for putative employers such as franchisors.[1] Such efforts have provoked a strong and largely negative reaction from the franchise community. Some believe the goal of expanding joint employer liability is to facilitate the unionization of small, franchise-owned businesses by categorizing them as joint employers with larger corporate franchisors. Nowhere is this issue more pervasive than in the restaurant and retail food chain sector, where McDonald's has become the poster child for franchisor joint employer liability.

Reports released by the U.S. Chamber of Commerce and the International Franchise Association examining the doctrine's redefinition and the threat it may pose to small businesses argue that such "politically based" changes could be the death knell for the franchise industry.[2] The concern for business in general, and franchisors in particular, is that what began as an obscure labor law issue with respect to employment terms established by McDonald's for its franchisees has manifested itself into a fight for the future of the franchise business model.

The joint employer doctrine: A brief history

Broadly defined, an employee may be deemed to have "joint employers" when, in addition to a primary employer, a secondary employer exerts sufficient control

over the terms of the same individual's employment.[3] Whether two entities—one the actual employer and the other a putative one—are deemed joint employers is critical to determining potential liability for violations of the National Labor Relations Act,[4] the Fair Labor Standards Act,[5] and other statutory schemes, including Michigan's Elliott Larsen Civil Rights Act.[6]

For decades, the NLRB declined to find franchisors jointly liable for their franchisees' unfair labor practices.[7] Since at least 1984, the joint employer doctrine would apply only when there was a "showing that the employer meaningfully affect[ed] matters relating to the employment relationship such as hiring, firing, discipline, supervision, and direction."[8] In shorthand, and as understood and applied, the inquiry was "whether a putative joint employer's control over employment matters [was] direct and immediate."[9]

In August 2015, however, in *Browning-Ferris Industries of California, Inc (BFI)*,[10] the NLRB rejected the actual exercise of control limitation imposed on the joint employer doctrine and, in many respects, changed the landscape of labor law in the process. In particular, in *BFI*—which did not deal with any franchise law issues—the NLRB decided that an entity is a joint employer if it possesses "[r]eserved authority to control terms and conditions of employment, even if not exercised…."[11] The board further explained that it will no longer require that "a statutory employer's control… be exercised directly and immediately." Instead, "[i]f otherwise sufficient, control exercised indirectly—such as through an intermediary—may establish joint-employer status."[12] In so holding, the board explained that the cases imposing joint employer liability only when the putative employer actually exercised control were "increasingly out of step with changing economic circumstances, particularly the recent dramatic growth in contingent employment relationships."[13]

Unsurprisingly, the NLRB's "refinement" or "expansion" of the joint employer doctrine has been viewed by many as posing a significant threat to franchisors, who typically retain control over certain aspects of their franchisees' businesses such as employee training, operational techniques and standards, and discipline procedures. The full effect of the board's decision in *BFI* has yet to be completely understood but may soon play out in, among other places, NLRB proceedings against McDonald's USA LLC, where franchisor-required employee policies and procedures are under scrutiny.[14] Notably, McDonald's Corporation recently settled one of its franchisee-worker class-action lawsuits.[15]

FAST FACTS

The joint employer landscape in the franchise and other contexts is in flux.

In 2016, the Michigan Franchise Investment Law was amended to make clear that franchisors and franchisees are not considered joint employers under state law.

The 2016 presidential election may affect recent decisions of the National Labor Relations Board.

The changing landscape of the joint employer doctrine and its potential effect on the franchise business model

In the typical franchise scenario, the franchisor creates a product or service, markets the brand through advertising, and sets standards, specifications, and policies for franchisees. The independent franchisee manages its own operations, establishes wage rates and employment benefits, and decides other employment policies regarding hiring, discipline, and termination. But under the "refined" standard articulated in *BFI*, the franchisor may be deemed a joint employer if the facts indicate that the franchisor exercised indirect control regarding essential terms of employment. The franchisor can therefore be liable for any applicable state or federal statutory violations. Moreover, the franchisor could be jointly responsible with its franchisee for engaging in the collective bargaining process concerning employment terms and conditions.

Although we would argue that the McDonald's franchise system—to the extent it demonstrates control of employee working conditions by the franchisor—is not necessarily typical of smaller, more prevalent franchise systems, the NLRB has chosen the McDonald's system as "illustrative" of practices by the general franchise industry. In 2014, the NLRB's general counsel filed 13 complaints against McDonald's USA LLC and certain franchisees alleging violations of the rights of employees working at various McDonald's restaurants. While the allegations included typical employment-related matters such as penalizing employees for protesting and taking other actions to improve their wages and working conditions,[16] other issues involving daily operations were also alleged as unfair practices:

- Offering franchisees optional interview questions for prospective hiring;
- Providing franchisees with software tools to help them schedule shifts and perform other operational functions tied to employee performance and profitability; and
- Issuing rules regarding time limits for order-taking and food delivery, and even identifying when bathrooms should be cleaned.[17]

On the other hand, in an advice memorandum issued by a regional office just months before *BFI*, the NLRB's Chicago

office concluded that franchisor *Nutritionality, Inc d/b/a Freshii* (*Freshii*) was not liable for the employment practices of its franchisee, and that the franchisor and franchisee were *not* joint employers.[18] The NLRB's general counsel affirmed the Chicago office's determination after *BFI* and further stated that the franchisor merely established operational, quality control, and brand identity requirements, and that its guidelines concerning human resources and employment matters such as sample interview questions and guidance regarding calculation of labor costs did not constitute participation in matters of labor and employment.[19] The general counsel also determined that although the franchisor in *Freshii* provided franchisees with access to scheduling software (as did McDonald's), franchisees were not required to use it.[20]

Although certainly cause for concern, labeling McDonald's as the death knell for the franchise industry seems, at this point, hyperbolic—especially given the results of the 2016 presidential election.[21] The potential controls established by McDonald's for monitoring employee pay rates, hours, scheduling, and other employment policies are not considered typical of most franchise business models. For example, although many franchise systems use point-of-sale software to assist franchisees with, among other things, designating hours worked and employee wages, most franchisors take a hands-off approach to the terms and conditions of employment offered by their franchisees. Franchisors instead focus on employee conduct and behavior that affects brand image and product quality.

Until this recent scrutiny by the NLRB, few franchisors (if any) suspected that such guidance to franchisees could potentially implicate the franchisor as a joint employer. In reality, many franchisees *intentionally* purchase franchises to receive the franchisor's guidance while simultaneously retaining the ability to own and run their businesses. Certainly, without the benefit of these guidance tools, other than receiving brand identification, many business owners would otherwise choose not to join a franchise system. No franchise system can survive a relationship in which the franchisor begins to distance itself from the needs of its franchisees for fear of potential liability arising from assistance provided to its franchisees.

Given this reality, where is the actual wrong that must be righted by the NLRB? In the United States alone, nearly 800,000 independently owned franchise businesses provide more than nine million jobs.[22] If franchisors are to be held legally responsible as joint employers, will it not then be necessary for franchisors to exert *more* day-to-day control over the business operations of franchisees, thereby increasing administrative costs and making franchise businesses less profitable for their owners? This is likely if franchisors are required to participate in labor negotiations with unions. Direct and indirect control imposed by the franchisor over employment matters is not what either party desires and is contrary to the entire franchise business model of establishing businesses owned and operated by independent entities.

It is not an overreaction to say that the general public will be the loser if some franchises are regulated out of business. The franchise sector generates more than $2 trillion in economic revenue[23] and provides access to innumerable products and services such as food, gasoline, child care, cleaning services, elder care, haircutting, and car repair services from myriad industries that provide established brands, marketing, and tested business methods. It also is worth noting that minority-owned franchise businesses succeed at a rate 46 percent higher than minority-owned nonfranchise businesses.[24]

Legislative responses to joint employer uncertainty

In reaction to these potential joint employer issues, nine states have passed laws specifically providing that, in the franchise context, franchisors do not employ their franchisees' employees. Michigan is one of these states. In 2015, the Michigan Franchise Investment Law[25] was amended, effective March 22, 2016, to add a section which states:

> To the extent allocation of employer responsibilities between the franchisor and franchisee is permitted by law, the franchisee shall be considered the sole employer of workers for whom it provides a benefit plan or pays wages except as otherwise specifically provided in the franchise agreement.[26]

Such legislative responses, of course, are a defensive measure taken by some states to protect the franchise business model. It is possible that the Trump administration will oppose further attempts to expand the

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joint employer standard. Nevertheless, franchisors must remain vigilant by guarding against the establishment of standards that may be determined by courts or agencies to constitute control over the essential terms of employment of franchisee employees. ■

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ENDNOTES

1. See, e.g., *McDonald's USA LLC*, 362 NLRB 168 (2015); David Weil, US Dep't of Labor Blog, *Are You a Joint Employer?* <http://bullardlaw.com/assets/news_pdfs/Are%20You%20a%20Joint%20Employer%20%20DOL%20Blog%20Post%20posted%201-20-16%20(00771669x9C8DD).PDF> (posted January 20, 2016). All websites cited in this article were accessed March 21, 2017.
2. US Chamber of Commerce, *U.S. Chamber and IFA Study: Expansive View of Joint Employment Becoming Greater Threat to Small Business* (June 21, 2016) <https://www.uschamber.com/press-release/us-chamber-ifa-study-expansive-view-joint-employment-becoming-greater-threat-small>.
3. See, e.g., *NLRB v Browning-Ferris Indus of Pa, Inc*, 691 F2d 1117, 1123 (CA 3, 1982).
4. 29 USC 151 *et seq.*
5. 29 USC 201 *et seq.*
6. MCL 37.2202 *et seq.*
7. See, e.g., *Tilden, SG, Inc*, 172 NLRB 752, 753 (1968) (the board found that Tilden (franchisor) did not have joint employer liability when the control exercised over the franchisees was no greater than necessary "to keep the quality and good will of the Tilden name from being eroded").
8. *TLI, Inc*, 271 NLRB 798 (1984).
9. *Airborne Express*, 338 NLRB 597 n 1 (2002).
10. *Browning-Ferris Indus of California, Inc*, 362 NLRB 186, slip op 2 (2015).
11. *Id.* "Essential terms of employment indisputably include wages and hours" and also include control over mandatory terms and conditions of employment, controlling scheduling, overtime, and assignment work and determining the manner and method of work performance. *Id.* at slip op 19.
12. *Id.* at slip op 2.
13. *Id.*
14. National Labor Relations Board, *NLRB Office of the General Counsel Authorizes Complaints Against McDonald's Franchisees and Determines McDonald's, USA, LLC is a Joint Employer* (July 28, 2014) <https://www.nlrb.gov/news-outreach/news-story/nlrb-office-general-counsel-authorizes-complaints-against-mcdonalds>; see also *McDonald's*, 362 NLRB 168 (affirming the administrative law judge's decision denying the franchisor's motion for particulars, which would have required the NLRB's general counsel to set forth the legal and factual contours of the joint employer standard).
15. See, e.g., Graham, *McDonald's Settles Franchisee-Worker Class Action As Legal Protections Erode*, Investor's Business Daily (October 31, 2016) <http://www.investors.com/news/mcdonalds-settles-franchisee-worker-class-action-as-legal-protections-erode/> ("McDonald's is the prime target in the [NLRB's] attack on the franchise industry as it aims to label the fast-food empire a 'joint employer' of franchisee workers, upending the legal protections that have fueled the growth of franchising").
16. National Labor Relations Board, NLRB Office of the General Counsel Issues Consolidated Complaints Against McDonald's Franchisees and their Franchisor McDonald's, USA, LLC as Joint Employers (December 19, 2014) <https://www.nlrb.gov/news-outreach/news-story/nlrb-office-general-counsel-issues-consolidated-complaints-against>.
17. Spandorf, *DOL's Joint Employer Guidance: What it Means for Franchising*, 19 Franchise Lawyer 3 (Spring 2016).
18. *Nutritionality, Inc d/b/a Freshii*, NLRB Advice Memorandum (Case No. 13-CA-134294), issued May 14, 2015.
19. *Nutritionality, Inc d/b/a Freshii*, NLRB Denial Letter (Case No. 13-CA-134294), issued September 14, 2015.
20. *Nutritionality, Inc d/b/a Freshii*, NLRB Advice Memorandum (Case No. 13-CA-134294), issued May 14, 2015.
21. The EmpLAWyerologist, *Could the President-Elect Trump Recent NLRB Rulings?* <http://theemplawyerologist.com/2016/11/10/president-elect-trump-r/> ("Mr. Trump will have the ability to impact several key government entities, such as the Department of Labor, the EEOC, the U.S. Supreme Court….").
22. International Franchise Association, *FAQS About Franchising* <http://www.franchise.org/faqs-about-franchising>.
23. Pam Villarreal, *Keeping the American Dream Alive: The Challenge to Create Jobs Under the NLRB's New Joint Employer Standard*, Statement for the Record before the United States Senate Committee on Small Business & Entrepreneurship (June 16, 2016) <http://www.ncpa.org/pdfs/16-0616%20NCPA%20Testimony-%20Villarreal-%20NLRB%20Joint%20Employer%20Rule_pv%20edit.pdf>.
24. Hogan, *The NLRB Joint-Employer Cases: An Attack on American Business* (June 1, 2015).
25. MCL 445.1501 *et seq.*
26. MCL 445.1504b.