

# Drawing Lines in Franchisor Support— Is It Necessary and Where Are the Lines to Draw in Today’s Joint- Employment Environment?

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## I. Introduction

Few question why a company would want to become a franchisor. Entering into franchisor-franchisee relationships provides franchisors with the opportunity to expand their systems more rapidly and without the capital investment or leverage that would otherwise be required to develop and operate company-operated units and without exposing itself to the risks of various external challenges, such as rising labor costs. A more frequently asked question is why the counterparty in the franchise relationship, the franchisee, is motivated to enter into a franchise relationship. What is the value proposition that franchisors offer to franchisees that franchisees find so attractive?

Franchising as a business model has historically provided a set of benefits and advantages not present in the independent business model. First and foremost is the franchisee's ability to capitalize on the power of a well-recognized brand.<sup>1</sup> A well-known brand name provides instant credibility to the franchisee's business by representing the promise of a certain level of quality related to the franchised business to the public, which the franchisee is then able to monetize.

To ensure a healthy and successful franchise system, responsible franchisors have traditionally supported franchisees by providing training and other services that enable the franchisees to effectively operate under the franchisor's business model. Areas of support that some franchisors may provide, and which some franchisees might expect, include recruiting and/or interviewing employees, online applicant tracking systems, scheduling software, payroll support, franchisee employee training, public relations support, crisis management, safety and security services, revenue management, and data security. This support is frequently expressed as "being in business for yourself, but not by yourself."<sup>2</sup>

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1. The centrality of the brand to the franchise relationship is illustrated in part by the obligation of the franchisor to disclose in its Franchise Disclosure Document (FDD) a variety of information regarding each trademark to be licensed to the franchisee. These required disclosures include whether or not each such trademark is registered with the United States Patent and Trademark Office, as well as information regarding pending infringements, oppositions, cancellation proceedings, or litigation regarding the trademarks. 16 C.F.R. § 436.5(m). And because the trademark is an essential element of the value proposition, some courts have held that if the franchisor loses its trademark, the franchisee may rescind the franchise agreement and seek restitution. In *A to Z Rental, Inc. v. Wilson*, 413 F.2d 899 (10th Cir. 1969), the court opined that the loss of the franchisor's exclusive right to use a trademark or trade name, together with other breaches of the agreement, constituted a material breach of the franchise agreement. See also *State Transmissions v. Cooney*, Civil Action No. 89-4865 (E.D. Mich. Jan. 11, 1990); *In re Convenient Food Mart, Inc.*, 1990 WL 51228 (N.D. Ill. Apr. 9, 1990).

2. Extensive disclosures regarding the training and support to be provided by the franchisor are also required to be included within the FDD. Item 11 of the FDD must disclose whether the franchisor provides pre-opening, as well as continuing assistance with hiring and training employees, developing products and services, improving and developing the franchise business, establishing prices, establishing and using administrative, bookkeeping, accounting, and inventory control procedures, and resolving problems encountered by the franchisee. The FDD must also describe in detail the franchisor's training program, including a table detailing the subject

Reputable and successful franchisors strive to add value to the franchised business by providing the franchisees with the benefit of the franchisor's experience, operational expertise, and scale. Providing this assistance helps build and sustain the goodwill behind the brand, which benefits both franchisors and franchisees alike. Unfortunately, the change in the joint employer standard announced by the National Labor Relations Board (NLRB) in the *Browning-Ferris* decision, coupled with the NLRB's pursuit of the franchisor of McDonald's as a joint employer, sent a message to the franchise community that it is far safer to eliminate assistance to the franchisees, rather than risk the specter of joint employer liability. The ever-shifting legal landscape, beginning with the release of the *Browning-Ferris* decision in 2015, its reversal by the NLRB in the *Hy-Brand* case in December 2017, and the NLRB's subsequent vacation of *Hy-Brand* a few months later, has only reinforced the message that assisting franchisees, which should be the core mission of franchisors, is fraught with peril.

This message has been internalized by many franchisors, negatively impacting the way franchisors interact with their franchisees and the support franchisors provide (or do not provide) to franchisees. Many franchisors are eliminating or reducing the full menu of support services they once offered to their franchisees. Eliminating many, if not all, of these services potentially reduces much of franchising's value proposition and increases the risk of brand harm through loss of controls and consistency.<sup>3</sup>

Reduction in services and support, particularly training, also creates litigation risk to franchisors. Some courts have held that a failure to provide initial and continuing training, especially when the franchisee has no prior experience in the business or industry in which the franchise system operates, can lead to claims for breach of contract and the implied covenant of good faith and fair dealing.<sup>4</sup>

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matters, hours of classroom training, hours of on-the-job training, and location of the training. 16 C.F.R. § 436.5(k).

3. Although franchisees, and their representatives, in the forms of advisory councils and independent associations, are certainly concerned about the reduction in services provided by franchisors, there have also been concerns about what they perceive to have been a steady escalation over the years by some brands in the amount of control and discretion reserved by franchisors to themselves in their franchise agreements. They see the development of the law in the area of joint employment as a direct consequence of that phenomenon, and the resulting legal risk to franchisors as a self-inflicted injury for which franchisees should not be penalized.

4. See *Aberle v. N. Dakota B&B Permanent & Temp. Pers. Sys., Inc.*, 186 N.W.2d 446, 449 (N.D. 1971) ("[T]he defendant must have foreseen that with the plaintiff's educational background and experience and his intellectual and emotional endowments that he could not succeed without a thorough training program and constant advice and counsel, particularly in the initial stages of this admittedly complex enterprise."); *Ford Motor Co. v. Lyons*, 405 N.W.2d 354, 384 (Wis. Ct. App. 1987) ("Ford breached its obligation by failing to provide adequate counseling to the dealership. . . ."); *Oakleaf of Ill. v. Oakleaf & Assocs.*, 527 N.E. 2d 926 (Ill. App. Ct. 1988) (holding that the plaintiff produced adequate evidence that sales activities were hampered by the failure to promptly provide machines, spare parts, and technical help); *In re DeRosa*, 98 B.R. 644, 646 (Bankr. D. R.I. 1989) ("[T]he DeRosas requested assistance and advice from the defendant on numerous occasions but no meaningful help was given."); *Fox v. Dynamark Sec. Ctrs., Inc.*, 885 F. 2d 864 (4th Cir. 1989) (although the agreement provided

These harms and risks from the decision by many franchisors to reduce or eliminate previously provided services came at a cost. There is no panacea to avoid the risks and added costs resulting from the *Browning-Ferris* standard and the uncertainty around its future in various contexts. If it persists, franchise systems, franchisors, and franchisees, will be harmed. The question remains whether, in this environment, there are viable solutions beyond resisting joint employment and vicarious liability claims in the courts, pursuing legislative solutions, and reducing services and support.

This article explores the potential risk to the franchise industry of the application of the joint-employer doctrine and ways franchisees may continue to receive certain services to optimize their value proposition, even if such services involve some increase in cost. The authors include an examination of the current state of the law and recent developments, describe results from a recent survey and interviews pertaining to reductions or elimination of services due to joint employer concerns, and describe concepts and methods of addressing services notwithstanding the joint employer concerns, that is, some “best practices” given the challenges presented by joint employer concerns.

## II. Joint Employment: A Shifting and Inconsistent Standard

### A. NLRB

#### 1. *Browning-Ferris Industries of California, Inc.*

In August 2015, the National Labor Relations Board (NLRB or Board) upended over thirty years of precedent to “restate” the joint-employer standard under the National Labor Relations Act (NLRA),<sup>5</sup> the federal law that encourages collective bargaining and regulates certain labor practices. Under the NLRA, two or more separate business entities are joint employers of a single workforce if “they share or co-determine those matters governing the essential terms and conditions of employment.”<sup>6</sup> The central issue is control. Since a pair of decisions in 1984, the NLRB had focused on whether a putative joint employer actually exercised “direct and immediate control” over the essential terms and conditions of the relevant worker’s employment, such as hiring, firing, discipline, supervision, and direction.<sup>7</sup> Although a fact-specific inquiry, this standard was widely seen as creating a fairly predictable legal regime for most businesses, including those in the franchise industry. Absent extraordinary circumstances, the franchisor would rarely be found

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for training such periods at such locations as may be designated by the franchisor, a jury could determine whether or not the training provided was so inadequate as to constitute a breach because of bad faith performance and unfair dealing).

5. National Labor Relations Act of 1935, 29 U.S.C. §§ 151–169.

6. NLRB v. *Browning-Ferris Indus. of Pa., Inc.*, 691 F.2d 1117, 1123 (3d Cir. 1982).

7. *TLI, Inc.*, 271 NLRB 798 (1984), *overruled by* *Browning-Ferris Indus. of Cal., Inc.*, 362 NLRB No. 186 (Aug. 27, 2015); *Laerco Transp.*, 269 NLRB 324 (1984), *overruled by* *Browning-Ferris Indus. of Cal.*, 362 NLRB No. 186 (Aug. 27, 2015).

to be a joint employer with its franchisees under the pre-*Browning-Ferris* standard.

All that changed with *Browning-Ferris Industries of California, Inc.*<sup>8</sup> In a three to two decision issued in August 2015, the Board concluded that Browning-Ferris, Inc. was a joint employer of workers provided by staffing agency Leadpoint Business Services Inc. at a Browning-Ferris recycling plant, and therefore had an obligation to participate in collective bargaining over a contract for those workers. In reaching this conclusion, the Board overturned a regional director's 2013 finding that Leadpoint was the sole employer of the workers that it supplied to Browning-Ferris. The Board "restated" the joint employer standard and concluded that the two companies were joint employers. Overturning earlier decisions requiring "direct and immediate control," the Board held that indirect control through an intermediary or the reserved right to control, even if unexercised, may be sufficient to find a joint-employer relationship.

According to the majority, "[r]eserved authority to control terms and conditions of employment, even if not exercised, is clearly relevant to the joint-employment inquiry."<sup>9</sup> Thus, the hypothetical or contractually reserved right to control, even if never exercised, would now be sufficient to find a joint-employer relationship. Further, following this decision, the NLRB no longer requires control to be exercised directly and immediately. "If otherwise sufficient, control exercised indirectly—such as through an intermediary—may establish joint-employer status."<sup>10</sup> Moreover, although the "essential terms and conditions of employment" have long been considered to be "hiring, firing, discipline, supervision, and direction," the majority declared that the non-exhaustive list also includes things like "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."<sup>11</sup> This expansive standard lowered the bar for imposing joint-employer liability. Suddenly, a company could be drawn into a labor dispute involving employees over whom it lacked any direct and immediate control.

An impassioned dissent chastised the majority for rewriting and expanding "the decades-old test" for determining whether two separate and independent entities are "joint employers" of certain workers.<sup>12</sup> The dissent warned that "[t]his change will subject countless entities to unprecedented new joint-bargaining obligations that most do not even know they have, to potential joint liability for unfair labor practices and breaches of collective-bargaining agreements, and to economic protest activity, including what have heretofore been unlawful secondary strikes, boycotts, and picketing."<sup>13</sup>

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8. 362 NLRB No. 186.

9. *Id.*

10. *Id.* at 1.

11. *Id.* at 19.

12. *Id.* at 25.

13. *Id.*

*Browning-Ferris* was appealed to the D.C. Circuit, which heard oral arguments on March 9, 2017.<sup>14</sup> However, on December 14, 2017, although the appeal was pending, the Board itself overturned *Browning-Ferris* in a three to two decision in *Hy-Brand Industrial Contractors, Ltd.* (as discussed later). Following the NLRB's *Hy-Brand* decision, the D.C. Circuit remanded the original *Browning-Ferris* appeal. The NLRB subsequently vacated *Hy-Brand* in February 2018 and, in a reversal of the reversal of the reversal, reinstated *Browning-Ferris*. Thereafter the D.C. Circuit took the rare step of rescinding its remand order, re-accepting the appeal, and holding a second round of oral arguments on July 3, 2018.

On December 28, 2018, the D.C. Circuit affirmed the Board's determination that both the reserved right to control and indirect control can be relevant factors in the joint-employer analysis but reversed the Board's articulation of the indirect-control element because the Board "failed to distinguish between indirect control that the common law of agency considers intrinsic to ordinary third-party contracting relationships, and indirect control over the essential terms and conditions of employment."<sup>15</sup> Finding the Board "provided no blueprint for what counts as 'indirect' control,"<sup>16</sup> the D.C. Circuit remanded the case back to the Board for further proceedings.

## 2. *Hy-Brand Industrial Contractors, Ltd.*

On December 14, 2017, the Board overruled *Browning-Ferris* in the case of *Hy-Brand Industrial Contractors, Ltd.*<sup>17</sup> A new three to two majority explicitly repudiated the *Browning-Ferris* expansion of the joint-employer standard and restored the NLRB's traditional standard for determining whether two separate and independent businesses are joint employers of the same employees. Relying heavily on the *Browning-Ferris* dissent, the majority argued that the standard announced in *Browning-Ferris* was an "analytical grab bag" that was too "vague and ill-defined" to provide meaningful guidance to employers and employees.<sup>18</sup> The Board then announced its return to the prior test, which "provided certainty and predictability."<sup>19</sup> Following *Hy-Brand*, "a finding of joint-employer status requires proofs that the alleged joint-employer entities have actually exercised joint control over essential employment terms (rather than merely having 'reserved' the right to exercise control), the control must be 'direct and immediate' (rather than indirect), and joint-employer status will not result from control that is 'limited and routine.'"<sup>20</sup>

Applying the traditional test, the Board held that *Hy-Brand Industrial Contractors Ltd.* and *Brandt Construction Co.*, which are construction companies owned by the same individuals, were joint employers and both liable

14. *Browning-Ferris Indus. of Cal. Inc. v. NLRB*, Nos. 16-1028, 16-1063, 16-1064 (D.C. Cir. 2017).

15. *Browning-Ferris Indus. of Cal., Inc. v. NLRB*, 911 F.3d 1195, 1222-23 (D.C. Cir. 2018).

16. *Id.* at 1220.

17. 365 NLRB No. 156 (Dec. 14, 2017).

18. *Id.* at 4, 10.

19. *Id.* at 4.

20. *Id.* at 51.

for illegally firing seven employees who had gone on strike to protest their wages and working conditions.

Although neither *Browning-Ferris* nor *Hy-Brand* was a franchise case, the *Hy-Brand* majority analyzed the effect of the *Browning-Ferris* standard on the franchising industry. Observing that *Browning-Ferris* was “almost certainly momentous and hugely disruptive” to franchise relationships, the *Hy-Brand* majority found that expansion of the joint-employer standard necessarily placed franchisors in a dilemma: franchisors could either police their trademarks and brand standards (as they are legally required to do in order to safeguard their trademarks) and risk joint-employer liability for such “indirect” or “reserved” control, or they could avoid such standards enforcement and risk losing their trademark rights altogether.<sup>21</sup>

The return to the traditional standard was short-lived. On February 26, 2018, the Board vacated *Hy-Brand* after concluding (based on a report of the Inspector General of the NLRB and recommendation of the Board’s Designated Agency Ethics Official) that board member Bill Emanuel (who was a member of the three to two majority) should have recused himself from the case due to a potential conflict of interest; namely, his former firm had represented one of the parties in *Browning-Ferris* before the Board, and *Hy-Brand* was essentially a continuation of deliberations that took place in *Browning-Ferris*.<sup>22</sup> As a result, “the overruling of the *Browning-Ferris* decision is of no force or effect.”<sup>23</sup>

### 3. *McDonald’s USA, LLC*

In late 2014 and early 2015, the then-General Counsel of the NLRB, Richard Griffin, initiated several actions against McDonald’s USA, LLC—the franchisor of the McDonald’s system—and its franchisees, seeking to hold McDonald’s USA liable as a “joint employer” for alleged labor violations by its franchisees.<sup>24</sup> The charges alleged that workers’ rights were violated when they were disciplined for participating in minimum wage protests. The decision to authorize the complaints against McDonald’s USA demonstrated a dramatic change in how the NLRB viewed franchising.

The NLRB’s complaints provided little detail about the basis for asserting joint employer liability against McDonald’s USA, simply noting that McDonald’s USA had a franchise agreement with each franchisee and declaring, without elaboration, that McDonald’s possessed or exercised

21. *Id.* at 41-42. Indeed, many franchisors have experienced the dilemma noted by the *Hy-Brand* majority in various respects. At the same time, in the opinion of one of the authors from the franchisee perspective, franchisors often have another choice: examine which standards and controls are actually necessary to protect the goodwill behind the system’s trademarks, and then venture no further. Section IV attempts to propose practical solutions for navigating this tension.

22. *Hy-Brand Indus. Contractors, Ltd.*, 366 NLRB No. 26, (Feb. 26, 2018).

23. *Id.* at 1.

24. Press Release, Office of Public Affairs, NLRB Office of the General Counsel Issues Consolidated Complaints Against McDonald’s Franchisees and Their Franchisor McDonald’s, USA, LLC as Joint Employers (Dec. 19, 2014), <https://www.nlr.gov/news-outreach/news-story/nlr-office-general-counsel-issues-consolidated-complaints-against>.

control over each franchisee's labor policies. Essentially, the NLRB contended that McDonald's USA controls the conditions of employment of the franchisee's employees through the imposition of its franchise model. In a separate "McDonald's Fact Sheet" posted on the NLRB's website when the complaints were filed, the NLRB's General Counsel hinted it was McDonald's USA's use of technology, allowing it to make real-time staffing recommendations to individual franchisees based on real-time restaurant revenue, that captured the NLRB's attention.<sup>25</sup>

The General Counsel's actions against McDonald's USA and its franchisees were consolidated into a single case before an administrative law judge in the NLRB's New York region. On March 19, 2018, shortly before the close of testimony, McDonald's USA announced a settlement with the NLRB's new General Counsel, Peter Robb. Under the proposed settlement, McDonald's franchisees would give full back pay to certain workers and potential monetary payments in lieu of reinstatement for individuals who were discharged. McDonald's USA would establish a settlement fund with \$250,000 provided by the franchisees. Any unused funds would be distributed back to the franchisees at the end of a specified period. McDonald's franchisees also would post notices to collectively address all allegations in the charges. McDonald's USA admitted no wrongdoing. The settlement documents contain language that McDonald's USA and its franchisees are not joint employers.

The charging parties objected to the settlement, claiming it let McDonald's USA off the hook. Following a hearing, the ALJ agreed with the charging parties' objections and rejected the proposed settlement on July 17, 2018, largely because it did not label McDonald's USA a joint employer.<sup>26</sup> The ALJ found the deal was too easy on McDonald's USA, saying the company's minimal role in fulfilling the settlement "does not begin to approximate" the consequences of joint-employer liability.<sup>27</sup> The ALJ stated that "McDonald's obligations under the Settlement Agreement are therefore not comparable in any way, shape, or form to joint and several liability."<sup>28</sup>

The ALJ also concluded the settlement lacks "certain fundamental elements," adding that it is "virtually guarantee[d]" that the settlement would not end the case and that the deal's narrow scope does not match up with the stakes presented by the multiyear suit.<sup>29</sup> According to the ALJ, "[NLRB] General Counsel [Peter Robb's] proffered justifications for the proposed

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25. The McDonald's Fact Sheet is no longer available on the NLRB's website, but has been preserved elsewhere. See McDonald's Fact Sheet, NLRB, [http://mcdzee.org/wp-content/uploads/2016/09/McDonald%27s%20Fact%20Sheet%20\\_%20NLRB.pdf](http://mcdzee.org/wp-content/uploads/2016/09/McDonald%27s%20Fact%20Sheet%20_%20NLRB.pdf) ("Our investigation found that McDonald's USA, LLC, through its franchise relationships and its use of tools, resources and technology, engages in sufficient control over its franchisees' operations, beyond protection of the brand, to make it a putative joint employer with its franchisees.")

26. Order Denying Motions to Approve Settlement Agreements, McDonald's USA, LLC v. Fast Food Workers Committee, et al., Case No. 02-CA-093893 (NLRB July 17, 2018).

27. *Id.* at 20.

28. *Id.* at 22.

29. *Id.* at 2.

informal settlements' significant shortcomings are inadequate and inconsistent with Board policy and practice."<sup>30</sup>

McDonald's USA and the NLRB's General Counsel have appealed the ALJ's settlement rejection to the full Board. A decision is pending as this article is going to print.

#### 4. Pending NLRB Rulemaking

The NLRB may change policy either by deciding administrative cases or through formal notice-and-comment rulemaking. Having been stymied in its recent effort to return to the pre-*Browning-Ferris* standard in *Hy-Brand*, the NLRB announced a proposed rule in September 2018 that, if implemented, would clarify the standard for determining joint-employer status under the NLRA. The NLRB published a Notice of Proposed Rulemaking on September 14, 2018. Comments to the proposed rule were due by January 14, 2019.<sup>31</sup>

Under the NLRB's proposed rule, for purposes of the NLRA, an employer "may be considered a joint employer of a separate employer's employees only if the two employers share or codetermine the employees' essential terms and conditions of employment, such as hiring, firing, discipline, supervision, and direction. A putative joint employer must possess and actually exercise substantial direct and immediate control over the employees' essential terms and conditions of employment in a manner that is not limited and routine."<sup>32</sup>

The proposed rule would overturn the test established by *Browning-Ferris*. Indirect control or the reserved but unexercised right to control would once again no longer be sufficient to establish a joint-employer relationship. Indeed, the proposed rule could be even stricter than the pre-*Browning-Ferris* standard because it adds the word "substantial" to the words "direct and immediate" in stating the standard.

The NLRB's proposed rule includes multiple illustrative examples, including two examples involving franchising. The first example explains that a franchisor that sets mandatory hours of operations for franchised units, but that does not participate in individual scheduling assignments, would not be a joint employer as the franchisor has not exercised direct and immediate control over essential terms and conditions of employment for the franchisee's employees.<sup>33</sup> However, under the proposed rule, a franchisor that requires its franchisees to offer its workers certain benefits, such as a particular health insurance plan and 401(k) plan, has exercised direct and immediate

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30. *Id.*

31. The Standard for Determining Joint-Employer Status, 83 Fed. Reg. 46,681, 46,696–97 (Sept. 14, 2018) (to be codified at 29 C.F.R. §103.40); The Standard for Determining Joint-Employer Status, 83 Fed. Reg. 55,329 (Nov. 5, 2018) (extending comment deadline). The Standard for Determining Joint-Employer Status; Extension of Comment Period, 83 Fed. Reg. 64,053 (Dec. 10, 2018) (extending comment deadline).

32. 83 Fed. Reg. at 46,696–97.

33. *Id.* at 46,697 (example 5).

control over the terms and conditions of employment and thus would be a joint employer of the franchisee's employees.<sup>34</sup>

Even if implemented, the NLRB's proposed rule would only affect joint-employment determinations under the NLRA. It would have no direct impact on determinations under other federal laws, including the Fair Labor Standards Act.

### B. *Fair Labor Standards Act*

Although the drama at the NLRB is headline-grabbing (and may undermine public confidence in the Board), the reality is that most franchisors do not face a significant threat of system-wide unionization or administrative action by the NLRB. By contrast, franchisors frequently face wage-and-hour claims under the Fair Labor Standards Act (FLSA)<sup>35</sup> based on arguments that it is the employer of its franchisees or the joint employer of its franchisees' employees.

#### 1. FLSA's Definition of Employment

The FLSA defines "employer" as including "any person acting directly or indirectly in the interest of an employer in relation to an employee,"<sup>36</sup> and "employee" as "any individual employed by an employer."<sup>37</sup> Meanwhile, "employ" means "to suffer or permit to work."<sup>38</sup> The U.S. Supreme Court has described the FLSA's concept of employment as "the broadest definition that has ever been included in any one act."<sup>39</sup>

Given these vague definitions, it should be no surprise that the standard for determining employment (including joint employment) under the FLSA varies greatly from court to court. In evaluating employment under the FLSA, most courts apply the "economic realities test" under which "employees are those who as a matter of economic reality are dependent upon the business to which they render service."<sup>40</sup>

However, the formulation of the economic realities test can differ significantly by court. For example, the Second Circuit focuses on the relationship between the worker in question and the putative joint employer; that is, "whether the alleged employer (1) had the power to hire and fire the employees; (2) supervised and controlled employee work schedules or conditions of employment; (3) determined the rate and method of payment; and (4) maintained employment records."<sup>41</sup>

34. *Id.* (example 6).

35. 29 U.S.C. § 201, *et seq.* The FLSA requires that most employees in the United States be paid at least the federal minimum wage for all hours worked and overtime pay at time and one-half the regular rate of pay for all hours worked over forty hours in a workweek. The FLSA exempts certain employees who exercise managerial functions and meet other requirements.

36. 29 U.S.C. § 203(d).

37. *Id.* § 203(e)(1).

38. *Id.* § 203(g).

39. *U.S. v. Rosenwasser*, 323 U.S. 360, 363 n.3 (1945).

40. *Secretary of Labor v Lauritzen*, 835 F.2d 1529 (7th Cir. 1988).

41. *Herman v. RSR Sec. Servs. Ltd.*, 172 F.3d 132, 139 (2d Cir. 1999) (quoting *Bonnette v. Cal. Health & Welfare Agency*, 704 F.2d 1465, 1470 (9th Cir. 1983)).

By contrast, the Fourth Circuit focuses instead on the relationship between the two putative joint employers. In *Salinas v. Commercial Interiors Inc.*,<sup>42</sup> that court adopted a new six-factor test for finding joint employment:

(1) whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate the power to direct, control, or supervise the worker, whether by direct or indirect means; (2) whether, formally or as a matter of practice, the putative joint employer jointly determine, share, or allocate the power to, directly or indirectly, hire the worker or modify the terms or conditions of the worker's employer; (3) the degree of permanency and duration of the relationship between the putative joint employers; (4) whether, through shared management or a direct or indirect ownership interest, one putative joint employer controls, is controlled by, or is under common control with the other putative joint employer; (5) whether the work is performed on a premises owned or controlled by one or more of the putative joint employers, independently or in connection with one another; and (6) whether, formally or as a matter of practice, the putative joint employers jointly determine, share, or allocate responsibility over functions ordinarily carried out by an employer, such as handling payroll, providing workers' compensation insurance, paying payroll taxes, or providing the facilities, equipment, tools, or materials necessary to complete the work.<sup>43</sup>

According to the court, any "one factor alone can serve as the basis for finding [joint employment]."<sup>44</sup> Indeed, the court will find joint employment exists unless the putative employers are "completely disassociated' with respect to Plaintiffs' employment."<sup>45</sup>

A survey of how the various circuit courts determine employment under the FLSA is beyond the scope of this article. Other articles have analyzed at length how various courts have analyzed employment (including joint employment) under the FLSA.<sup>46</sup> What is particularly of note, however, is how various courts have viewed the nature of franchising (including the types of support that many franchisors typically provide to, and the actual control they exercise over, their franchisees) in the context of a FLSA employment analysis. Two recent cases—*Parrott v. Marriott International, Inc.*<sup>47</sup> and *Haitayan v. 7-Eleven, Inc.*<sup>48</sup>—are illuminating (and, to many, distressing) regarding how differently various courts view the nature of franchising in evaluating FLSA claims.

## 2. *Parrott v. Marriott International, Inc.*

*Parrott v. Marriott International Inc.* is a FLSA collective action case. The plaintiffs were previously employed as food and beverage managers at two different franchised "Courtyard by Marriott" hotels in Michigan and Virginia.<sup>49</sup> They alleged that they and other food and beverage managers were misclassified as "exempt" managers under the FLSA, and thereby improperly

42. 848 F.3d 125 (4th Cir. 2017).

43. *Id.* at 141-42.

44. *Id.* at 142.

45. *Id.* at 147.

46. See, e.g., David J. Kaufmann, Felicia N. Soler, Breton H. Permesly & Dale A. Cohen, *A Franchisor Is Not the Employer of Its Franchisees or Their Employees*, 34 FRANCHISE L.J. 439 (2015).

47. 2017 WL 3891805 (E.D. Mich. Sept. 6, 2017).

48. 2018 WL 1626248 (C.D. Cal. Mar. 14, 2018).

49. *Parrott*, 2017 WL 3891805, at \*1.

deprived of overtime pay.<sup>50</sup> Instead of suing the franchisees they worked for, the plaintiffs sued the franchisor, Marriott International, claiming Marriott was liable as a “joint employer” for the misclassification and resulting FLSA underpayment violation.<sup>51</sup> Although acknowledging that they were employed by the franchisees—not Marriott—the plaintiffs claimed that Marriott’s control over its franchise system is so vast that Marriott effectively determines labor conditions.<sup>52</sup>

Marriott moved to dismiss the complaint, arguing that the plaintiffs had not pleaded facts that established Marriott’s control over their terms and conditions of employment, including not pleading that Marriott (1) had the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records.<sup>53</sup> Unable to show a lack of control over the conditions of employment, Marriott argued that the plaintiffs were attacking the franchise model itself by focusing on Marriott’s efforts to protect brand standards—efforts that are unrelated to the terms and conditions of employees’ employment. Marriott emphasized that the franchise agreements explicitly state that the franchisees, not Marriott, have exclusive control over the hiring of employees and the terms and conditions of employment at the hotels.<sup>54</sup>

In denying Marriott’s motion to dismiss, the U.S. District Court for the Eastern District of Michigan made no distinction between Marriott’s control incident to system-wide brand standards versus its alleged control over the franchisees’ employment and personnel matters.<sup>55</sup> Although the complaint did contain various factual allegations regarding Marriott’s purported control over the plaintiffs’ condition of employment,<sup>56</sup> several of the examples of Marriott’s “control” identified by the plaintiffs and cited by the court have nothing to do with the conditions of employment but rather involve system-wide brand standards, including hotel appearance and uniform methods of operations, such as:

- Marriott’s determinations regarding consistent décor and trade dress;
- Marriott’s determination of the location of Marriott hotels;

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50. *Id.*

51. *Id.*

52. *Id.* at \*2.

53. *Id.*

54. These arguments are found in the motion to dismiss filed in the case, which is available as Docket Number 15 in *Parrott v. Marriott International, Inc.*, Case No. 2:17-cv-10359-VAR-RSW (E.D. Mich.).

55. *Parrott*, 2017 WL 3891805, at \*1.

56. For example, the plaintiffs alleged that Marriott (1) treated food managers like Marriott employees by giving all food managers discount room rates at Marriott hotels worldwide; (2) supervised and controlled work schedules for food managers by auditing financial records and meeting with hotel personnel about controlling labor costs; (3) maintained employment records; and (4) imposed standardized procedures for hiring food managers. *Id.* at \*2. The plaintiffs further claimed they received direct training, instruction, and workplace directives from Marriott employees, were “faulted” by Marriott corporate auditors for failure to follow those directives, and were told they worked “first and foremost” for Marriott. *Id.* at \*3.

- Marriott's selection of vendors;
- Marriott's development of menus; and
- Marriott's frequent inspections for compliance with Marriott standards.<sup>57</sup>

The court made no distinction at the motion to dismiss stage between the franchisor's control incident to system-wide brand standards and control over the franchisees' employment and personnel decisions and matters.<sup>58</sup> Further, the court appeared receptive to the plaintiffs' argument that Marriott's ability to terminate a franchise agreement amounted to the ability to terminate the food managers' employment.<sup>59</sup>

### 3. *Haitayan v. 7-Eleven, Inc.*

In *Haitayan v. 7-Eleven, Inc.*, multiple 7-Eleven franchisees filed a putative class action under the FLSA and California law, claiming that they were misclassified by the franchisor as independent contractors.<sup>60</sup> The plaintiffs sought hundreds of thousands of dollars in overtime pay and business expenses for each similarly situated franchisee.<sup>61</sup> The U.S. District Court for the Central District of California dismissed the misclassification claims on the pleadings, finding the franchisees did not and could not plead facts sufficient to show that they were employees of 7-Eleven.<sup>62</sup> Although not a joint employer case, the court's evaluation of control by the franchisor to enforce brand standards is helpful.

The plaintiffs argued that the franchise agreement created an employment relationship because 7-Eleven exerted control over many details of store operations, such as temperature, operating hours, types and sources of products sold in the stores, and the requirement to make daily deposits of all cash receipts into a designated bank account.<sup>63</sup> The plaintiffs also alleged that 7-Eleven required the franchisees to complete unpaid initial training.<sup>64</sup> The

57. A copy of the amended complaint is available at Docket Number 13 in *Parrott v. Marriott International Inc.*, Case No. 2:17-cv-10359-VAR-RSW (E.D. Mich.).

58. *Parrott*, 2017 WL 3891805, at \*4; see also *Wickliff v. La Quinta Worldwide, LLC*, 2017 WL 4423407, at \*4 (D. Or. Oct. 4, 2017) (relying on the mere nature of franchising, including the fact that the franchise agreement required the franchisee to "adhere to certain systems, business methods, and training and hiring procedures" and operate its hotel "under the specifications" set by La Quinta, in denying in part the franchisor's motion to dismiss claims that La Quinta was liable under Title VII of the Civil Rights Act and Oregon law for an alleged sexual assault by the franchisee's employee against another employee at the franchisee's hotel).

59. *Parrott*, 2017 WL 3891805, at \*2. Other courts have repeatedly rejected the argument that the franchisor's ability to terminate a franchise agreement constitutes the ability to terminate a franchisee's employees. See, e.g., *Brunner v. Liautaud*, 2015 WL 1598106, at \*4 (N.D. Ill. Apr. 8, 2015) (the franchisor's "ability to exercise a contractual right in terminating a franchise, provided in the Jimmy John's Franchise Agreement, does not amount to Liautaud having the power to terminate a franchisee's employees"); cf. *In re Motor Fuel Temperature Sales Practices Litig.*, 2012 WL 153616, at \*5 (D. Kan. April 30, 2012) (the franchisor's "right to terminate the agreement for failure to meet standards . . . does not amount to sufficient control" for purposes of imposing liability against the franchisor).

60. *Haitayan v. 7 Eleven, Inc.*, 2018 WL 1626248, at \*1 (C.D. Cal. Mar. 14, 2018).

61. *Id.*

62. *Id.* at \*6-7.

63. *Id.* at \*3.

64. *Id.* at \*4.

court disagreed, finding “the type or degree of control alleged by Plaintiffs is wholly insufficient to make them employees.”<sup>65</sup> Notably, the court indicated that plaintiffs’ allegations did not show that 7-Eleven exercised control over employees’ wages, hours, hiring practices, or other working conditions.<sup>66</sup>

The court noted that the business format franchising relationship permits the franchisor to exercise the control necessary to protect its trademarks, brand, and goodwill. According to the court, requiring the 7-Eleven franchisees to complete training, and setting standards for how they operate their franchised stores, were necessary to ensure uniformity among all 7-Eleven stores.<sup>67</sup> The system-wide “controls” alleged “do not exceed what is necessary to protect 7-Eleven’s trademark, trade name, and good will.”<sup>68</sup> The court found that plaintiffs’ allegations regarding improper control all related to the franchisor’s right to protect and control its brand, service standards, merchandise selection, and hours of operation.<sup>69</sup> The court further found such uniformity ultimately benefits the franchisees because of the increased goodwill it brought to the brand.<sup>70</sup>

Consistent with the reasoning of the district court in *Haitayan*, other courts have held that the franchisor cannot be deemed a joint employer with the franchisee under the FLSA simply because it makes recommendations to the franchisees or enforces brand standards.<sup>71</sup> However, as noted earlier regarding *Parrott*, not all courts recognize the distinction between the franchisor’s control and support regarding brand standards and the franchisor’s control over the essential terms and conditions of employment.

#### 4. Shifting Department of Labor Guidance

Adding to franchisors’ confusion regarding whether the mere nature of franchising may render the franchisor the employer of its franchisees or

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65. *Id.* at \*5.

66. *Id.* at \*3.

67. *Id.* at \*4.

68. *Id.* at \*5.

69. *Id.* at \*6.

70. *Id.* at \*4. On February 27, 2019, the Ninth Circuit reversed the district court’s dismissal order and remanded the case for further proceedings, finding the district court (1) improperly considered the persuasiveness of the plaintiffs’ factual allegations rather than the plausibility of their legal claims, and (2) focused on the terms of the franchise agreement but did not consider the plaintiffs’ factual allegations regarding 7-Eleven’s actual control. *Haitayan v. 7-Eleven, Inc.*, 2019 WL 968927, at \*1 (9th Cir. Feb. 27, 2019).

71. *See, e.g., Pope v. Espeseth, Inc.*, 228 F. Supp. 3d 884, 890 (W.D. Wis. 2017) (granting the franchisor summary judgment based in part on the fact that the franchisees were expressly informed that the franchisor’s operations manual (which contained various recommendations regarding employee scheduling and compensation) and “all personnel-related documents and recommendations” were “optional and should be modified and customized as the franchisee deems appropriate . . . to suit their own business needs.” This express disclaimer, as well as the franchisee’s actual practice of modifying the manual as he wished, precluded a finding that the franchisor was a joint employer under the FLSA or Wisconsin state law.); *Gessele v. Jack in the Box, Inc.*, 2016 WL 7223324 (D. Or. Dec. 13, 2016) (granting summary judgment to the franchisor on the plaintiff’s FLSA claim, holding the franchisor was not the joint employer of the franchisees’ employees; the fact that the franchisor required its franchisees to use its payroll system and provided non-mandatory materials on human resources did not establish control over working conditions sufficient to treat it as a joint employer).

the joint employer of its franchisees' employees under the FLSA is shifting guidance from the Department of Labor (DOL), which enforces federal minimum wage and overtime laws.

On January 20, 2016, the DOL's Wage and Hour Division issued informal guidance (Administrator's Interpretation No. 2016-1) regarding joint employment under the FLSA. Authored by the Division's then-Administrator David Weil, the guidance advocated a broad "economic realities" standard for finding joint employment that covers "a multitude of circumstances where the alleged employer exercised little or no control or supervision over the putative employees."<sup>72</sup> Administrator Interpretations generally contain broadly applicable guidance that is intended to provide clarity regarding a particular statutory or regulatory issue. Unlike a law or formal regulation, such informal guidance does not carry the weight of law or necessarily receive deference in courts, which are free to disregard it.

Although the DOL's 2016 guidance did not mention franchise relationships, an accompanying Question and Answer document expressly noted that a franchisor and its franchisee could be deemed the joint employer of a franchisee's workers depending on the situation.<sup>73</sup> Under the 2016 guidance's expansive view of joint employment, a franchisor could be liable for any minimum wage or overtime violations by its franchisees.

After a change in the DOL's leadership following the 2016 presidential election, new U.S. Secretary of Labor Alexander Acosta withdrew Administrator's Interpretation No. 2016-1 on June 7, 2017.<sup>74</sup> In announcing the withdrawal of the 2016 guidance, the DOL emphasized that the removal "does not change the legal responsibilities of employers," adding that the DOL will continue to fully and fairly enforce the FLSA.<sup>75</sup> This statement suggests the DOL will enforce the FLSA under the traditional, pre-Weil joint employment standard, which focuses on whether a putative employer has actual control over the relevant workers.

On April 9, 2019, the DOL published a Notice of Proposed Rulemaking that seeks to clarify the standard for finding joint-employment under the FLSA.<sup>76</sup> The DOL's proposed rule proposes a four-factor balancing test that would assess whether the putative joint employer:

- Hires or fires the employee;

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72. David Weil, U.S. Dep't of Labor, Wage & Hour Div., Administrator's Interpretation No. 2016-1, at 2 (Jan. 20, 2016), [http://www.smithmoorelaw.com/webfiles/DOL\\_Joint\\_Employment\\_2016.pdf](http://www.smithmoorelaw.com/webfiles/DOL_Joint_Employment_2016.pdf).

73. U.S. Dep't of Labor, Wage & Hour Div., Joint Employment AI: Questions and Answers, at Ans. 5 (Jan. 20, 2016).

74. Press Release, U.S. Dept. of Labor, US Secretary of Labor Withdraws Joint Employment, Independent Contractor Informal Guidance (June 6, 2017), <https://www.dol.gov/newsroom/releases/opa/opa20170607>.

75. *Id.*

76. Joint Employer Status Under the Fair Labor Standards Act, 84 Fed. Reg. 14,043 (Apr. 9, 2019) (to be codified at 29 C.F.R. pt. 791). Comments to the proposed rule are due by June 10, 2019.

- Supervises and controls the employee's work schedules or conditions of employment;
- Determines the employee's rate and method of payment; and
- Maintains the employee's employment records.<sup>77</sup>

### C. Federal and State Joint-Employment Legislation

#### 1. The Save Local Business Act

Introduced in the U.S. House of Representatives on July 27, 2017, H.R. 3441—the Save Local Business Act—seeks to clarify who may be deemed a joint employer under the NLRA and the FLSA. Under the proposed legislation, to be a joint employer, a business must “directly, actually, and immediately, and not in a limited and routine manner, exercise[] significant control over the essential terms and conditions of employment, such as hiring employees, discharging employees, determining individual employee rates of pay and benefits, day-to-day supervision of employees, assigning individual work schedules, positions, and tasks, or administering employee discipline.”<sup>78</sup>

According to a congressional report, the proposed bill “restores the long-held standard for determining joint employer status under the NLRA that was overturned by a decision of the National Labor Relations Board . . . [and] provides a uniform joint employer standard under the FLSA.”<sup>79</sup> The congressional report also states:

The *Save Local Business Act* reaffirms that two or more employers must have “direct, actual and immediate” control over employees to be considered joint employers. H.R. 3441 provides needed clarity to the job creators, entrepreneurs, and workers who are being adversely impacted by expanding joint employer standards.

In particular, the bill rolls back vague and convoluted joint employer schemes as created by the NLRB in *Browning-Ferris*, by the U.S. Court of Appeals for the Fourth Circuit with respect to the FLSA in *Salinas v. Commercial Interiors, Inc.* (*Salinas*), and by regulators and other courts. H.R. 3441 restores a commonsense definition of employer and protects workers and local employers from future overreach by unelected bureaucrats and activist judges.<sup>80</sup>

The U.S. House of Representatives passed the Save Local Business Act on November 7, 2017. However, the U.S. Senate took no action on the bill before the term of the 115th Congress ended. The prospects for this bill in the current Congress are not encouraging, especially given the change in the composition of the U.S. House of Representatives following the mid-term 2018 elections.

#### 2. The Trademark Licensing Protection Act

With the Save Local Business Act stalled, other bills to address the joint-employment standard have been proposed. On August 31, 2018, H.R. 6695,

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77. *Id.* at 14,048.

78. Save Local Business Act, H.R. 3441, 115th Cong. § 2 (2017).

79. H.R. Rep. No. 115-379, at 2, 18 (2017).

80. *Id.* at 5-6.

the Trademark Licensing Protection Act of 2018, was introduced in the U.S. House of Representatives.<sup>81</sup> The proposed act would have clarified that the mere licensing of a trademark does not create an employment or agency relationship:

The licensing of a mark for use by a related company, and any control or exercise of control over thereof for the purpose of preserving the goodwill, reputation, uniformity, or expectation of the public of the nature and quality of goods or services associated with the mark, may not be construed as establishing an employment [including joint employment] or principal-agent relationship between the owner of the mark and the related company.<sup>82</sup>

Neither house of Congress passed the Trademark Licensing Protection Act before the end of the term of the 115th Congress. Once again, the prospects for this bill in the current Congress are not promising.

### 3. State Joint-Employment Legislation

Separate from the two pending federal bills, nineteen states have enacted legislation in the wake of *Browning-Ferris* aimed at clarifying and limiting joint-employer liability. As the following list shows, some states have revised their employment laws to clarify when joint employment exists under state law, although others more directly provide that a franchisor is not the employer of its franchisees or its franchisees' employees:

- **Alabama.** Enacted in 2017, Alabama's Franchise Business Protection Act provides that a franchisee, an employee of a franchisee, or an independent contractor working for a franchisee "may not be deemed or construed to be employees of a franchisor."<sup>83</sup>
- **Arizona.** As of 2017, Arizona has amended its employment relationship statutes to provide that "[a] franchisor is not an employer or co-employer of either a franchisee or an employee of the franchisee, unless the franchisor agrees, in writing, to assume the role of employer or co-employer of the franchisee or the employee of the franchisee."<sup>84</sup>
- **Arkansas.** On April 4, 2017, the Arkansas governor signed a bill clarifying that, "[n]otwithstanding a voluntary agreement entered into between the United States Department of Labor and a franchisee, neither a franchisee nor a franchisee's employee shall be deemed to be an employee of the franchisor or sub-franchisor."<sup>85</sup>
- **Georgia.** In 2016, Georgia enacted a law—which became effective in January of 2017—that provides as follows: "Notwithstanding any order issued by the federal government or any agreement entered into with the federal government by a franchisor or a franchisee, neither

81. Trademark Licensing Protection Act of 2018, H.R. 6695, 115th Cong. (2018).

82. *Id.* at § 2.

83. ALA. CODE § 25-6-5.

84. ARIZ. REV. STAT. ANN. § 23-1604.

85. ARK. CODE ANN. § 11-2-125.

a franchisee nor a franchisee's employee shall be deemed to be an employee of the franchisor for any purpose."<sup>86</sup>

- **Idaho.** Effective July 2018, Idaho added a provision to the Idaho Code stating that neither a franchisee nor a franchisee's employee will be considered an employee of the franchisor for any purpose, unless (1) the franchise agreement specifically describes the franchisee or the franchisee's employee as the franchisor's employee, or (2) a court or another tribunal finds the franchisor exercised a type of degree of control over the franchisee or the franchisee's employee that is not customarily exercised by a franchisor.<sup>87</sup>
- **Indiana.** Under an addition to Indiana law that went into effect in 2016, a franchisor is not an employer or co-employer of a franchisee or a franchisee's employee "unless the franchisor agrees, in writing, to assume the role of an employer or co-employer of the franchisee or the employee of a franchisee."<sup>88</sup>
- **Kentucky.** In 2017 Kentucky passed legislation amending various employment provisions related to joint employment. For example, Kentucky's wages and hours chapter now provides that "[n]otwithstanding any voluntary agreement entered into between the United States Department of Labor and a franchisee, neither a franchisee nor a franchisee's employee shall be deemed to be an employee of the franchisor for any purpose under this chapter."<sup>89</sup>
- **Louisiana.** Louisiana enacted relevant legislation in August 2015. Subject to a narrow exception, the law clarifies that "neither a franchisee . . . nor an employee of the franchisee shall be deemed to be an employee of the franchisor for any purpose."<sup>90</sup> For purposes of Louisiana's workers' compensation and unemployment compensation laws, a franchisee's employee may be deemed an employee of the franchisor only if the franchisor and franchisee "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."<sup>91</sup>
- **Michigan.** Like Kentucky, Michigan has enacted a range of legislation that clarifies the relationship between a franchisor and the employees of its franchisees. For example, in May of 2016, Michigan amended its Employment Security Act to state: "Except as specifically provided in the franchise agreement, as between a franchisee and franchisor, the

86. GA. CODE ANN. § 34-1-9.

87. IDAHO CODE § 44-905.

88. IND. CODE ANN. § 23-2-2.5-0.5.

89. KY. REV. STAT. ANN. § 337.010.

90. LA. REV. STAT. § 23:921(F)(2).

91. *Id.* § 23:921(F)(3).

franchisee is considered the sole employer of workers for whom the franchisee provides a benefit plan or pays wages.”<sup>92</sup>

- **New Hampshire.** As of July 2017, New Hampshire’s labor relations law provides in pertinent part that “[a] franchisor is only an employer if the franchisor agrees in writing to assume the role of employer or co-employer of the franchisee or the employee of the franchisee.”<sup>93</sup>
- **North Carolina.** North Carolina’s Wage and Hour Act, effective in May of 2017, provides in pertinent part that “[n]either a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purposes.”<sup>94</sup>
- **North Dakota.** Effective August 2017, North Dakota’s law broadly provides as follows: “Notwithstanding any other provision of law or any voluntary agreement between the United States Department of Labor and a franchisee, a franchisee or an employee of a franchisee is not considered an employee of the franchisor.”<sup>95</sup>
- **Ohio.** In 2019, Ohio amended its unpaid wages, workers’ compensation, and unemployment compensation laws to provide that a franchisor is not the “employer” of a franchisee or a franchisee’s employee, unless “the franchisor agrees to assume that role in writing” or a court “determines that the franchisor exercises a type or degree of control over the franchisee or the franchisee’s employees that is not customarily exercised by a franchisor for the purpose of protecting the franchisor’s trademark, brand, or both.”<sup>96</sup>
- **Oklahoma.** Passed in 2016, Oklahoma’s broad statute provides in pertinent part that “[a] franchisor shall not be considered the employer of a franchisee or a franchisee’s employees.”<sup>97</sup>
- **South Dakota.** As of 2017, South Dakota law broadly provides: “Notwithstanding any other provisions of law or any voluntary agreement between the United States Department of Labor and a franchisor, a franchisee or an employee of a franchisee is not considered an employee of the franchisor.”<sup>98</sup>
- **Tennessee.** In 2015, Tennessee enacted legislation clarifying that “[n]otwithstanding any voluntary agreement entered into between the United States Department of Labor and a franchisee, neither a franchisee nor a franchisee’s employee shall be deemed to be an employee of the franchisor for any purpose.”<sup>99</sup>

92. MICH. COMP. LAWS ANN. § 421.41.

93. N.H. REV. STAT. ANN. § 275:4.

94. N.C. GEN. STAT. ANN. § 95-25.24A.

95. N.D. CENT. CODE ANN. § 51-19-18.

96. *See, e.g.*, OHIO REV. CODE ANN. § 4111.03(D)(2).

97. OKLA. STAT. ANN. tit. 59, § 6005.

98. S.D. CODIFIED LAWS § 60-1-6.

99. TENN. CODE ANN. § 50-1-208(A).

- **Texas.** In 2015, Texas enacted S.B. 652, which amended several provisions of the Texas Labor Code to specify that a franchisor is not considered an employer of a franchisee or a franchisee's employee for purposes of claims relating to employment discrimination, payment of wages, the Texas Minimum Wage Act, or the Texas Workers' Compensation Act, unless the franchisor "has been found by a court of competent jurisdiction in this state to have exercised 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."<sup>100</sup> Subject to the same exception, the act further specifies that a franchisor is not deemed to be in a co-employment relationship with a franchisee or a franchisee's employees for purposes of Texas law governing professional employer organizations and that the general definition of "employer" in the Texas Unemployment Compensation Act does not apply to a franchisor with respect to a franchisee or a franchisee's employees.
- **Utah.** Effective May 2016, Utah's employment relations and collective bargaining law was amended to clarify that "a franchisor is not considered to be an employer of (i) a franchisee; or (ii) a franchisee's employee," unless the franchisor "exercises a type or degree of control over the franchisee or the franchisee's employee not customarily exercised by a franchisor for the purpose of protecting the franchisor's trademarks and brand."<sup>101</sup>
- **Wisconsin.** In 2016, Wisconsin amended various statutory provisions to clarify that a franchisor is not the employer of a franchisee or a franchisee's employees, unless the franchisor has agreed in writing to assume that role or it is administratively determined that the franchisor "exercised a type or degree of control over the franchisee or the franchisee's employees that is not customarily exercised by a franchisor for the purpose of protecting the franchisor's trademarks and brand."<sup>102</sup>
- **Wyoming.** Wyoming's labor and employment statutes were amended in 2017 to provide in pertinent part that "[n]either a franchisee nor a franchisee's employee shall be deemed to be an employee of the franchisor for any purpose under this title, unless otherwise agreed to in writing by the franchisor and the franchisee."<sup>103</sup>

Similar bills have been proposed in other states but have not yet been enacted.<sup>104</sup>

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100. TEX. LAB. CODE ANN. § 401.014.

101. UTAH CODE ANN. § 34-20-14(2).

102. WIS. STAT. ANN. § 111.3205.

103. WYO. STAT. ANN. § 27-1-116.

104. For example, in March 2017, the Virginia legislature passed HB 1394, which would have clarified that neither a franchisee nor a franchisee's employee may be deemed to be an employee of the franchisor unless a court of competent jurisdiction has found the franchisor exercised a type or degree of control over the franchisee or the franchisee's employees that is

These state laws do not supersede federal law, including the FLSA and the NLRA, and thus do not undercut the importance of clarity at the federal level. Nevertheless, franchisors welcome such state laws, which provide clarity, ensure that state agencies do not adopt *Browning-Ferris's* more expansive view of joint employment, and may curtail state law claims against franchisors with franchise systems operating in those states.

### III. Impact of Joint Employment Concerns on the Franchise Community

That franchisors have made changes to the way they interact and support franchisees as a result of joint employer concerns is well-known. But the authors have not seen data, statistics, or writings chronicling the nature and degree of reduced services. In an effort to obtain more precise and reliable statistical data, reportable experiences, and anecdotal information, the authors, through and with the International Franchise Association (IFA), conducted a survey and reviewed interviews with franchisees and franchisors of brands of varying sizes, age, and industries.

The results confirm that the substantial majority of brands, although not all, report reducing or eliminating certain services. Further, many brands reported increasing certain other requirements of the system, for example, increasing insurance (both for the franchisor and what is required of the franchisees) and crisis management planning and related expenditures.

The survey requested background data of the respondent and asked specifically whether the brand had eliminated, increased, or decreased services to the franchisees as a result of joint-employer concerns. It further asked respondents to identify specific services reduced, eliminated, or increased.

The survey was sent to over 5,500 recipients. Thirty-two recipients responded to the survey, not enough to provide the survey with statistical reliability, but enough for the authors to provide certain observations. The respondents ranged in age of system from mature brands that have been franchising for over twenty years (over seventeen reported they had been franchising for over twenty years) to less than five years (eight respondents). There was also a healthy cross section of system sizes, with seven respondents reporting over 500 units; thirteen reporting 100 units or fewer; six reporting 101–249 units; and six reporting 250–499 units. Five franchisees were included in the respondents (including one respondent who indicated it was both a franchisor and a franchisee). Further, the nature of the brands represented was diverse, with everything from health and wellness, to food and beverage/restaurants, to various service brands.

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not customarily exercised by a franchisor for the purpose of protecting the franchisor's trademarks and brand. H.B. 1394, 2017 Session, <https://lis.virginia.gov/cgi-bin/legp604.exe?171+ful+HB1394ER+pdf>. (Va. 2017). Governor Terry McAuliffe vetoed the bill. Governor's Veto of HB1394, <https://lis.virginia.gov/cgi-bin/legp604.exe?171+amd+HB1394AG>.

Of those responding, twenty-four reported decreasing or eliminating services,<sup>105</sup> although three others reported that the brand had not decreased services to the franchisees but rather had increased certain services. Five reported that the brand had made no changes.

The most consistent areas of services that have been eliminated or reduced include advice and counseling regarding employment issues and human resources support. Twenty-one reported decreasing or eliminating such support (nineteen reported reducing or eliminating HR support and eighteen reported reducing or eliminating advice or counseling on employment issues).

The second largest category of reduced or eliminated support was training. It was further divided by training to management level employees of the franchisees versus training to staff or other employees of the franchisees. Eleven reported decreasing or eliminating training for staff or other franchisee employees, and nine reported decreasing or eliminating management-level franchisee employee training.<sup>106</sup> Yet some respondents indicated the brand had increased training. Twelve reported increasing training for staff and other employees of the franchisees, and ten reported increasing training for management level employees of the franchisees.<sup>107</sup> Many brands reported reducing or eliminating providing advice and counseling on legal matters (fifteen respondents).

Many brands also reported increasing providing revenue management tools. Only one respondent reported decreasing revenue management tools. Many brands also reported increasing data security (fourteen), data privacy (twelve), and PCI compliance (eleven) requirements.<sup>108</sup> Twelve reported increasing insurance requirements.

In addition, five reported reducing or eliminating providing financial advice, although twelve reported increasing that service.

In addition to the surveys, the IFA conducted a number of in-person interviews, which were more robust and provided significant insight and further information. The interviews confirmed that franchisors appear to have significantly reduced or eliminated previously provided services. IFA staff conducted thirty interviews, fifteen with representatives of franchisors and fifteen with representatives of franchisees. The respondents varied in size (from

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105. Six respondents answered “no” to the question of whether they had reduced services as a result of joint employer concerns, but then indicated “yes” to reducing specific services for one or more of the follow-on categories. The authors are considering those responses to be a “yes.”

106. Specifically, seven reported decreasing or eliminating initial training for franchisee management employees; eight reported decreasing or eliminating initial training for franchisee staff or other employees; nine reported decreasing or eliminating ongoing training for franchisee management employees; and nine reported decreasing or eliminating ongoing training for franchisee staff or other employees.

107. Specifically, nine reported increasing initial training for franchisee management employees; nine reported increasing initial training for franchisee staff or other employees; seven reported decreasing or eliminating ongoing training for franchisee management employees; and six reported decreasing or eliminating ongoing training for franchisee staff or other employees.

108. Some of the responses regarding increasing services like privacy data and security and PCI compliance were not directly related to joint employer concerns, but rather the substantial risks to the brand reputation and customer perception from data breaches.

systems with forty units to 6,000 units and from 600 to 200,000 franchisee employees). The systems represented various industries, including medical care, hospitality, beauty, quick service restaurants, fitness, and home services.

Every interviewee indicated that joint employer liability is a major concern, and that it became a major concern in the wake of the *Browning-Ferris* decision, and further reported that the brand has changed how and the degree to which it provides assistance to, and interacts with, franchisees.<sup>109</sup> For example:

- Eighty-six percent of the franchisors and fifty-three percent of the franchisees indicated that training provided to franchisee employees had been reduced or eliminated.
- Sixty-six percent of the franchisors and sixty-seven percent of the franchisees indicated that the franchisor had reduced or eliminated providing operations and performance standard recommendations.
- Eighty percent of the franchisors and fifty-three percent of the franchisees indicated that franchisor-supplied advice/guidance regarding staffing and scheduling had been reduced or eliminated.
- Forty-six percent of the franchisors and fifty percent of the franchisees indicated that franchisor-supplied advice/guidance regarding personnel manuals and human resources had been reduced or eliminated.<sup>110</sup>
- Seventy-three percent of the franchisors and sixty-seven percent of the franchisees indicated that franchisor-supplied advice/guidance regarding compensation to employees had been reduced or eliminated.
- Thirty-three percent of the franchisors and sixty percent of the franchisees indicated that franchisor-supplied advice/guidance regarding employee benefit programs had been reduced or eliminated.
- Fifty-three percent of the franchisors and forty-three percent of the franchisees indicated that franchisor-supplied advice/guidance regarding employee standards/performance or assessments had been reduced or eliminated.

Although not definitively conclusive, the takeaway from these interviews is that the adoption of the *Browning-Farris* standard and the ongoing uncertainty surrounding joint-employer issues has likely resulted in an industry-wide reduction in services delivered by franchisors to franchisees.

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109. Further, respondents indicated other changes as a result of joint employer concerns. For example, seventy-three percent of respondents indicated that they have changed the franchise agreement as a result of joint employer concerns. Ninety-three percent of respondents indicated that the system had changed the operations manual as a result of joint employer concerns.

110. Examples include multiple franchisors who no longer provide assistance or resources to franchisees to find and evaluate employee candidates through, for example, portals that collect applications, assist with interviews employee candidates, and provide an online tracking systems for applicants. And many franchisors who previously provided some employment-related advice or counseling to franchisees with employment issues reported no longer doing so.

#### IV. Best Practices—Where to Draw the Line

The joint employer “Catch-22” for franchisors can be summarized as follows: franchisors need to exercise brand controls, both as a matter of sound business strategy and out of legal necessity (to retain meaningful control over trademarks, to enforce system standards, etc.), but by exercising such controls, franchisors simultaneously invite more scrutiny and risk with respect to joint-employer claims. Further, franchisors want to provide support and training on various areas of the business to ensure brand consistency and to assist the franchisees, both operationally and financially.

But the line between brand controls and “other” controls is not always clear, and the resulting “bleed over” (both real and perceived) between these two spheres has led some franchisors to pull back in both spheres. And franchisees sometimes view the control reserved and exercised as exceeding that which is necessary to protect the brand. The changed standard and uncertainty surrounding the new standard, as noted earlier, creates a dichotomy that has disrupted the traditional benefits to the franchisees. The result has been a loss of services to the franchisees, each of which goes to the heart of the franchise relationship.<sup>111</sup> Examples of such services include human resources support, such as recruiting and/or interviewing employees; online applicant tracking systems; scheduling software; payroll support; franchisee employee training; public relations support; crisis management; safety and security services; and revenue management support.

At its most extreme, the franchisor discontinues providing helpful services. In addition, the franchisor may become “frozen” in time as it vacillates in its decision to offer or not offer certain services and can otherwise become ensnared in formalistic legal precautions and procedures that negate the value to the franchisee of the services at issue. This paralysis not only adds costs, but it can also result in a net reduction in the quality and quantity of services offered, with a corresponding negative impact on the entire franchise system.<sup>112</sup>

This indecisiveness is understandable in light of the unknowns and uncertainties about the joint employer standard that will apply in the future in various contexts. That uncertainty, coupled with the current political climate and aggressive lobbying on both sides of the debate, has made guidance on whether and, if so, how, a brand should continue to provide services very difficult (including whether it should change, reduce, or cease providing services it previously provided). As noted earlier, many brands have significantly reduced or eliminated many beneficial services or have outsourced services at added cost and

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111. See *supra* Section III.

112. For example, some commentators have suggested that franchisees have a higher rate of wage and hour violations because these franchisees lack basic training, experience, and resources on the subject (which is partially attributable to franchisor’s “pulling back” on advice and support). Franchisees have a big stake in the goodwill of the brand that they support with advertising contributions. Bad publicity when a franchisee is accused of wage and hour violations hurts the brand. This is also an example of how the current climate and push for a more protective joint employer standard actually has the opposite, unintended effect.

loss of control over aspects of the business. So how should the franchise community proceed? The following general observations are provided for context.

First, the principles that any franchisor must protect its brand and, to that end, promote and enforce reasonable and necessary brand standards and consistency, must continue, even in the face of added costs and risks. These principles must inform the franchisor's decisions on the nature of the services it will provide and the control it will exercise over aspects of the franchisee's business to implement such services. Weighing heavily in the decision-making process is the always-changing joint employer standard. At a minimum, to protect the brand, the franchisor will need to learn to live with the shifting landscape. The franchise community simply cannot afford to wrap itself in red tape and trepidation.<sup>113</sup>

Second, no two franchise systems are alike, and no "one-size-fits-all" solutions exist. For example, the differences between product supply franchises versus business format franchises are substantial. Moreover, even business format franchises vary dramatically among each other, including the magnitude of the consequences of defending against joint employer claims arising out of labor and employment practices. For example, a quick service restaurant has different risks than a hotel, both of which are dramatically different from service businesses like daycare, tutoring, home health care, massage, or fitness brands where the franchisee's employees are working directly with the customer in an intimate setting.

The steps that an emerging brand should take to address joint employer risk are in some respects different from the steps that should be undertaken by a mature franchise system. Franchise systems that depend on an army of employees and contractors are far more likely to deal with the specter of joint employer liability. On one side of that continuum are food, large retail, and hospitality brands. These franchise systems face a unique set of socio-political and economic challenges, largely by dint of their size and the collective impact that they have on the economy and wages. On the other end of the spectrum are smaller brands, including brands that rely more on technology, automation, and less on "human capital." Although none of these businesses is immune from joint employer risk, it is probably not cost-effective for emerging, smaller, or technology-driven brands to simply adopt the "best practices" that are handed down by the larger, more established brands.

The third general observation results from the second: franchisors need to be thoughtful when determining appropriate solutions and strategies. In choosing services to provide and controls to employ, a system should consider what is truly necessary to preserve and promote the brand standards given the nature and size of the brand. They must think of creative ways to supply services and maintain necessary controls and support. And franchisors should consider collaborating with franchisees or their representatives on

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113. Although it seems unlikely that joint employer liability will become the "death knell" of franchising, these "best practices" still have a cost, and the *Browning-Ferris* "indirect" and "right to exercise control" standard will continue to hamstring the franchise community.

the content of these standards, so such brand standards can be cast as something other than “top-down” decision-making.

Following are some approaches franchisors can consider in order to maintain or enhance what may otherwise be viewed as “suspect” services under the joint employer standard.

#### A. *Use of Approved Suppliers*

One strategy to navigate the joint employer minefield may be hiding in plain sight and is being implemented by some systems with success. It involves leveraging a franchisor’s right to approve a wide range of suppliers. Many franchise systems take a somewhat rigid and formalistic view of what a supplier is and what it can and cannot do. So the franchisor may designate a supplier for uniforms and retail food packaging, but when it comes to traditional “franchise services,” the franchisor may stubbornly keep “ownership” of those roles. For example, based on the earlier-described informal survey, some franchisors have decreased or eliminated HR services including providing employment-related advice and tools such as computer software for employee screening, hiring, scheduling, and training, among others.<sup>114</sup> These services now sow fear in the minds of franchisors because, under the *Browning-Ferris* standard, they go directly to the employee relationship. To the extent the franchisor is involved with these aspects of the franchisee’s business, they can create the appearance of actual or reserved control over the franchisee’s relationships with employees—hiring, firing, and supervising.

One alternative is to designate or approve certain third-party suppliers to provide these services and tools under the franchisor’s brand standards. For example, for a franchisor that offers a system of child care services, it is critical to the brand that the franchisees only hire employees with no prior history of child abuse. Requiring the franchisees to use an approved supplier to handle these “HR” functions reinforces that the functions are themselves related to brand standards—and are not simply “reactive” measures intended to curtail employees’ rights. There are many potential applications of this concept.

The authors are also aware of a system that “outsourced” legal counseling on employment-related issues. Working with the franchisee association, the franchisor agreed to have a law firm retained by the independent franchisee association provide seminars to franchisee groups on a regional basis. The parties agreed to certain parameters to protect privilege and avoid use of the advice or presentation content in future litigation between them. The franchisor agreed to pay counsel for the franchisee association a flat fee for each presentation/meeting as reimbursement.<sup>115</sup>

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114. *See supra* Section III.

115. Although the franchisor’s payment of the attorneys’ fees may raise some concerns or risk regarding the franchisor’s involvement, the authors think the arrangement can be established to minimize risks of joint employment findings because a third party is providing the guidance.

Existing approved suppliers may also provide related advice. For example, at least one insurer offering Employee Practice Liability Insurance (EPLI) coverage to franchisees has established a “hotline” where franchisee inquiries regarding employment matters that may previously have been addressed to the franchisor may be fielded by a third party with no connection to the franchisor other than it having been approved (and possibly paid) by the franchisor.<sup>116</sup>

There are multiple considerations, some competing, to evaluate in connection with outsourcing certain functions to approved suppliers. On the one hand, consideration should be given to approving multiple suppliers in order to provide more choices to the franchisees and, therefore, less direct control to the franchisor. On the other hand, by selecting a single supplier, the economies of scale may assist in lowering the cost through volume purchasing, thus offsetting what, as discussed later, is often an increased cost to the franchisees (and the system). Further, franchisors should consider transparently redirecting vendor rebates to further benefit the system as a whole. Also, the supplier selection process, as well as setting of standards, can be undertaken with input from the franchisees, as well as their independent associations and advisory committees.

For some, the use of approved suppliers may seem cynical—a further “fracturing” and “outsourcing” of the relationship between the franchisor, its franchisees, and the franchisee’s employees. To be sure, many franchisors already provide these services. And beneficially, any full-scale adoption of a third-party supplier of HR services and other services (i.e., legal, security, and training) would necessarily result in “leaner” operations and fewer franchisor employees. The typical franchisor has the contractual right to designate and approve suppliers. The franchisor is not expected to wear every conceivable hat—and indeed by ceding these roles, the franchisor may simultaneously improve services *and* lessen the risk of joint employer liability.

This, of course, has downsides too. Indeed, of the responses from franchisors indicating they have dealt with joint employer concerns by outsourcing through approved third-party suppliers, most also reported that this approach added costs to the franchisees and reduced the control and direct benefit that the brand previously enjoyed. Even if the franchisor absorbs some or all of the costs, it is unlikely there is a corresponding reduction in the franchisor’s overhead; thus increasing the cost to both the franchisor and its franchisees and materially altering the economic model. Indeed, many systems may not be able to afford the added costs.<sup>117</sup>

The use of third-party suppliers for franchisor services is one example of a proactive step that franchisors can take to reduce the risk of joint employer

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116. Both franchisor and franchisee advocates agree that franchisees should have EPLI and be required to name the franchisor (and area representatives/developers where applicable) as additional insureds on these policies.

117. As noted earlier, by combining the purchasing volume of all units, the cost increase may be mitigated. Even smaller systems may be able to take advantage of lower prices through greater purchases by joining an inter-brand buying group, or combining with other brands to negotiate with certain suppliers.

liability without sacrificing the services provided to franchisees that create joint-employment concerns.

### B. *Interaction with Franchisee Employees*

One of the most vexing areas of joint employer liability relates to the franchisor's interaction with "rank and file" employees of the franchisee. The conventional wisdom holds that under the *Browning-Ferris* standard, franchisor employees should have no interaction whatsoever with lower level employees of the franchisee, lest these interactions be construed as actual or reserved control over the terms of the franchisee's employment. Thus, franchisors are often advised to "train the trainers," meaning that training programs should be limited to the franchisee's managerial and supervisory employees, who may then train the franchisee's staff.<sup>118</sup>

That is fine in principle, but it assumes that the franchisee's "managers" are fully capable of transmitting the same level of information and are in possession of the same pedagogical tools. It also ignores the real time benefit of immediate assistance and training when it is warranted. So, the question becomes, when is it appropriate for franchisors to train those "lower" in the chain of command? As discussed earlier, this problem calls out for a solution that could be solved by involving a third-party supplier. Imagine a "Franchise Symposium" where *every* franchisee employee could receive hands-on information and "best practices" related to brand and system standards. This service could be provided by a designated third-party supplier, thus reducing the risk of joint-employer liability.

But suppose the franchisor preferred to host the program directly. Here the issue boils down to three factors: intent, timing, and location.

Intent means that the sessions must actually be geared to brand standards, and not something else (i.e., it should not involve singling out employee discussions about hiring, direction, supervision, discipline, or discharge). As much as possible, these sessions should be framed as an exchange of ideas, and not a handing down of information from some higher authority. The franchisees themselves and their managers should also be involved, to underscore the educational purpose of the program. The authors also recommend making the sessions voluntary, at least as it relates to rank-and-file employees. So the franchisees are not required to send their employees to the programs, but by doing so they might get some reward, such as royalty reductions.

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118. Although this discussion is largely focused on the franchisor/franchisee dichotomy, the same issues apply to franchise systems that rely on area representatives/developers and similar intermediaries. Here, franchisors would be especially well advised to work in tandem with area representatives/developers to address these issues. In addition, franchisors should consider including area representatives/developers as those protected under the indemnification clause in the franchise agreement, and the franchisees in such three-tier systems should be required to name the area representatives/developers as additional insureds, which protects both the area representative/developer and the franchisee.

Timing means that the exchange should ideally occur early in the franchise relationship (or in connection with a transfer or major upgrade to the system). Such a program, therefore, hews more closely to the brand and is less likely to be perceived as invading the province of the franchisee and “everyday” business operations.

The third factor is location. Here, the authors think it is especially important to host the meetings offsite, meaning somewhere other than the franchise location or the franchisor’s place of business. An independent franchisee association or advisory council could also serve as the host. This approach lessens the perception that the franchisor is somehow “controlling” the workplace. Although these suggestions are not perfect, and increase cost and decrease effective training, they are measures to mitigate the risk.

The situation is different when it comes to enforcing brand standards through on-site inspections. Here, the authors continue to believe that under the *Browning-Ferris* standard the best practice involves limited or no interaction with franchisee rank-and-file employees. When conducting inspections and site visits, the franchisor’s personnel should review operations only with the franchisee or its manager. The franchisor’s personnel should give directions or suggestions directly to the franchisee’s owner or manager and not to its employees. Because indirect control may trigger joint employment status, any such directions or suggestions should be focused on enforcing standards necessary to protect the goodwill of the brand, not the franchisee’s employment or personnel matters. This process is sometimes less efficient and less effective than direct support, guidance, and corrective measures. But as long as the uncertainty is present, the risks of creating joint employer exposure are present to a large degree with direct, hands-on interaction.

### C. *Employee Manuals and Policies*

Many franchisors no longer supply franchisees with employee manuals or policies for fear that this action, by itself, will be deemed to be an indicia of actual or reserved control over employment terms. Although it is true that franchisors should not *require* that such policies be used (note that the authors are speaking of employee manuals and handbooks, and not brand standards for operations, marketing, and the like), franchisors may very well choose to make these documents available for inspection (subject to the usual confidentiality provisions). The manuals should clearly state that they only apply to corporate stores and are suggestive only.<sup>119</sup> The franchisees should be advised to adapt these manuals and policies for their own independent use. Of course, franchisors (in collaboration with the franchisees) can also designate an approved supplier for HR manuals and forms including

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119. In April 2015, the Advice Division of the NLRB issued a memorandum regarding the Freshii franchise system. The Division found that the franchisor was not a joint employer, despite the fact that it offered non-binding HR recommendations to its franchisees. Advice Memorandum, NLRB, Office of the General Counsel, *Nutritionality, Inc. d/b/a Freshii*, Case 12-CA-134294 (Apr. 28, 2015).

conformance to local laws. Providing sample documents creates some risk, but measured against the upside to the franchisees, and associated costs, that risk may be small enough warrant receiving the benefits.

Franchisors may also want to consider developing changes to their policies and procedures generally, including those reflected in manuals, in collaboration with franchisee representatives. Although the authors are aware of no case law that supports this proposition, it does seem more than plausible that a court would look differently at control exercised by the franchisor through the enforcement of a standard that was not unilaterally developed by the franchisor.

#### *D. Crisis Management, Data Security, Privacy, and Other Hot-Button Issues*

Many franchisors have chosen not to provide preventative and preparatory crisis management support and take a similar hands-off approach to issues like safety, data security, and privacy. Other franchisors require that their franchisees develop and adopt detailed policies related to these issues and use an approved supplier to do so, but do not provide the required policy to the franchisees. Here, given the gravity and potential risks, many franchise systems (particularly larger systems) develop “across the board” policies that apply to all franchisees (and designate approved suppliers to implement and run them). The franchisee should be required to follow policies and procedures adapted by the franchise (with help from qualified advisors, such as lawyers in various practice areas retained by a franchisee association).

The potential harm to a brand resulting from data breach and similar system-damaging events at a unit dictates that franchisors establish mandatory policies, procedures, and required vendors for data security, data breach, and crisis management. Although this control over a non-employment aspect of the unit operations may be used as an argument to establish joint employer status, the potential for catastrophic harm to the brand warrants the risk.

#### *E. Administrative Functions*

Generally speaking, the franchisee—not the franchisor—should perform all administrative functions regarding the franchisee’s employees, including handling payroll, providing workers’ compensation insurance, scheduling, and providing the tools, materials, or safety equipment required for employees’ work. There are some exceptions to this principle. For example, many franchisors provide hiring “portals,” and these are valuable services. As noted earlier, multiple respondents to the interviews reported reducing or eliminating this type of support. However, there are a few ways that franchisors choosing to provide this service may reduce joint-employer risk. If the franchisor solicits employee applications on behalf of the franchisees, those applications should not be handled by the franchisor and should be forwarded directly to the franchisee. A disclaimer should be included on the web page visible to the applicant. That disclaimer should clearly state that the franchisor is merely acting as conduit and has no influence over the hiring process.

The same can be said of scheduling software and revenue management support. Although there is no prohibition against recommending or requiring these tools, the franchisor should defer to the franchisee when it comes to actual day-to-day implementation.

#### F. *Indemnification and Insurance*

Finally, franchise agreements should require the franchisee to indemnify and defend the franchisor for, among other things, claims arising from the franchisee's employment and personnel decisions, including alleged misclassification by the franchisee and wage-and-hour violations. In addition, the franchisor should consider requiring the franchisees to name the franchisor as an additional insured under the franchisee's insurance policies.<sup>120</sup> A number of insurance products related to joint employer risk are available and can be utilized to provide support and the related services through that third-party.<sup>121</sup> These include EPLI and even insurance products that are specific to joint employer liability and wage and hour claims.<sup>122</sup> Franchisors should work with an experienced insurance broker and legal counsel to identify and evaluate such policies. Skeptical franchisees, who may object to the costs of such policies, should understand that these premiums are likely significantly less than the costs associated with third-party claims or demands for indemnification from the franchisor. Ultimately the presence of insurance may facilitate a freer flow of information and services between the franchisor and the franchisee.

### V. Conclusion

In the absence of federal legislative action providing a clear standard for establishing a joint employer relationship, franchisors will remain at risk of crossing an ever-shifting line that may result in legal liability for employment practices by their franchisees. However, franchisors must not lose sight of the fact that the value franchisors bring to the franchise relationship, in addition to the brand, includes the benefit of the franchisor's experience, operational expertise, and scale to the franchisee. Franchising will not continue to thrive as a business model if franchisors do not remain focused on the value proposition franchising can afford franchisees.

The survey that served as the basis for this article revealed that seventy-five percent of respondents had decreased or eliminated services previously provided to the franchisees, although increasing costs for items like insurance

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120. For systems with area representatives/developers, also consider adding area representatives/developers to the definition of indemnified parties and as required additional insureds to ensure that area representatives/developers are protected and fully aligned with the franchisor if defending a joint employment claim from an employee of a franchisee, especially when allegations of joint employment arise out of conduct by the area representative/developer.

121. See *supra* Section IV(a).

122. As noted earlier, at least one EPLI carrier now offers franchisees a twenty-four hour hotline to address state-by-state HR issues and concerns.

and crisis management. Decreased services, increased costs, and the risk of reputational damage to the brand as a result of a loss of control and consistency throughout the franchise system are a losing proposition for franchisors, franchisees, and customers.

Litigation risk is a cost of doing business. Prudent franchisors engage in risk management, such as adopting the best practices outlined in this article. The reality is that in order to protect the business model in which both franchisors and franchisees have invested, franchisors must exercise those brand controls required to protect the brand, including providing support and training, as a matter of sound business strategy, even if exercising such controls invites more scrutiny with respect to joint-employer claims.