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Challenges and Opportunities in International Franchising

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ARE YOU GETTING READY FOR A JOINT EMPLOYMENT CASE?

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1. Introduction

1.1. Overview of Topic.

(a) Can a master franchisor or direct franchisor be held liable today as a joint employer of the employees of its franchisees and subfranchisees?

Over the past year, one of the most prominent and controversial issues affecting franchising as a format for doing business is the concept of "joint employment" – where an employee of one organization can, simultaneously, be considered to be the employee of another organization. The significance of this determination affects many aspects of the employment relationship from wages and benefits to liability for acts of the employee. While this issue has received substantial coverage in news and trade publications in the United States since the McDonalds Cases arose,[1] the franchisors and franchisees in the United States are not alone. Similar issues have arisen in other countries. This paper will discuss how these issues affect franchise relationships in other countries and issues that need to be considered when a franchisor from one country is considering expansion to another country.

(b) Can a franchisor be the employer of its franchisees or their employees?

A related issue that has been affecting franchisors and franchisees for several years is whether and under what circumstances a franchisee will be considered to be the employee of a franchisor rather than an independent contractor. In the United States, this issue applies state law standards for an independent contractor relationship to a franchisor-franchisee relationship to determine if the franchisee is truly an independent business or more closely resembles an employment relationship. The consequences of re-characterizing a franchise relationship as an employment relationship are mindboggling. It affects everything from about the relationship. The scope of this issue is well beyond the scope of this paper and the program being presented. It is raised, however, because this issue is arising in other countries and needs to be taken into account when international franchise relationships are being created.

1.2. Countries Covered

While many countries have faced joint employment and independent contractor issues, we have chosen to focus on four countries to discuss how these issues have been addressed: Australia, Canada, Germany and United States.

2. Overview of Issues in Each Country

2.1. Australia

(a) Legislative Issues in Australia

Australian employment law is predominantly legislated by the federal *Fair Work Act 2009* (Cth) ("FWA"). In addition, some States maintain local state laws for certain employers (such as sole traders and partnerships in Western Australia). As the FWA covers a significant majority of employers who would operate in franchise networks, the focus of this section of the paper will be on the FWA. The FWA

[1] See Section 2.4(a) below.

provides, among other things, protections to employees by way of the National Employment Standards, [2] Unfair Dismissal remedies[3] and Adverse Action remedies.[4]

The FWA contains no specific provisions deeming one entity (such as a franchisor) to be a joint employer of another entity's (such a franchisee's) employees. However, section 550 of the FWA, which allows for civil accessorial liability for civil remedies[5] and penalties[6] arising from contraventions of the FWA may, in a given case, give rise to a similar outcome.

The section provides:

- A person who is involved in a contravention of a civil remedy provision is taken to have contravened that provision.

- A person is ***involved in*** a contravention of a civil remedy provision if, and only if, the person:

  (a) has aided, abetted, counselled or procured the contravention; or

  (b) has induced the contravention, whether by threats or promises or otherwise; or

  (c) has been in any way, by act or omission, directly or indirectly, knowingly concerned in or party to the contravention; or

  (d) has conspired with others to effect the contravention.

This section mirrors accessorial liability provisions in competition and securities laws in Australia and decisions relating to those laws have been applied in determining when a person will be liable as an accessory under this section.

The cases establish that to have accessorial liability, the person:

- Must have knowledge of the essential facts constituting the contravention;

- Must be knowingly concerned in the contravention;

- Must be an intentional participant in the contravention based on actual, not constructive, knowledge of the essential facts constituting the contravention - although constructive knowledge may be sufficient in cases of willful blindness; and

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[2] Further information on the National Employment Standards are available on the Fair Work Ombudsman website (https://www.fairwork.gov.au/employee-entitlements/national-employment-standards).

[3] Further information on Unfair Dismissals is available at https://www.fairwork.gov.au/ending-employment/unfair-dismissal.

[4] Further information in relation to Adverse Actions claims are available at https://www.fwc.gov.au/resolving-issues-disputes-and-dismissals/workplace-issues-disputes/general-protections.

[5] Under section 539 of the FWA

[6] Up to $54,000 per offence for a corporation, and $10,800 for a director

- Need not know that the matters in question constituted a contravention.

(b) Judicial Issues in Australia

Disputes in relation to an employee's employment or the termination of their employment are directed to the Fair Work Commission. The Fair Work Commission has the ability to conciliate a matter, as well as make a binding decision on the dispute brought by either party.

While Unfair Dismissal claims are dealt with purely in the Fair Work Commission, Adverse Action claims commence with a conciliation conference in the Fair Work Commission, and if the matter does not settle, is then brought in the Federal courts (or the Fair Work Commission by agreement of the parties).

The Fair Work Commission also deals with applications for approval of Enterprise Agreements, which seek to vary terms of the modern awards, which set an employee's minimum entitlements, such as minimum wage rates, overtime and weekend penalty rates.

The Federal Circuit Court is also an option for employees to make claims for underpayment of wages.

The concept of joint employment has not been embraced by the Fair Work Commission or any courts in Australia, despite the fact that it is becoming more and more common in Australia for multi-tiered employment relationships that arise where an organization will contract with a labor hire company to supply its employees for a specific purpose.

Certainly, there have been no cases in Australia where it has been held that a franchisor is a joint employer of employees who work in a franchisee's business.

(c) Administrative Issues in Australia

The Fair Work Ombudsman ("FWO") is a government body which reviews and enforces an employee's minimum entitlements. These include claims for underpayment of wages and entitlements by employees who do not believe that they have been correctly paid by their employers. The FWO has no judicial authority and cannot create new rules or laws.

While the FWO has the power to prosecute employers, it will more often investigate a claim by an employee, and make an order that either the employee is paid the correct amount, or conduct a mediation between the parties to settle a dispute about underpaid entitlements.

The FWO has full power to request from an employer their employee's records, to assist the FWO in reviewing an employee's claim. The FWO can also independently request an employer's records as a random audit, without an employee instigating the investigation.

Where an employer is in blatant breach of its obligations, or the employer has been investigated by the FWO and has been found to be in breach for a number of employees, the FWO has the power to commence proceedings against the employer.[7]

[7] Additional information in relation to the Fair Work Ombudsman is available at https://www.fairwork.gov.au/.

2.2. Canada

(a) Legislative Issues in Canada

The Ontario Ministry of Labour regularly launches inspections examining sector-specific employment issues in an effort to raise awareness and increase compliance with health and safety legislation.[8] In 2013 and 2014, the Ministry conducted 2,232 proactive inspections.[9] When violations are discovered, the question of employment liability arises. In the franchise industry, this question has been at the center of heated debate and legislative lobbying, following on the heels of recent employment decisions in the United States, muddying the waters of joint employment classification. The fear in Canada is that the legislation may embrace the trend in the United States, which may deem franchisors as joint employers by changing the definition of "control" as it relates to employees.

Last summer, the Ontario Ministry of Labour announced it would be conducting a Changing Workplace Review to determine how the *Employment Standards Act, 2000*[10] ("ESA") and the *Labour Relations Act, 1995*[11] ("LRA") could be reformed to better protect workers, while supporting business in the Ontario economy. In Canada, issues of labour and employment are legislated provincially and the ESA and LRA are the two governing statutes over labour and employment in Ontario. The Canada portion of this paper will focus on Ontario but the issues discussed are not isolated to just this province.

The Changing Workplace Review involved a consultation process to solicit feedback from stakeholders in effected industries regarding what changes, if any, should be made to the legislation. The consultation process examined workplace trends regarding: (i) the increase in non-standard working relationships, such as temporary jobs, involuntary part-time work, and self-employment; (ii) the rising prominence of the service sector; (iii) globalization and trade liberalization; (iv) accelerating technological change; and (v) greater workplace diversity.[12]

The Changing Workplace Review poses several questions in an attempt to solicit feedback from stakeholders and the public. The following questions have the most relevance with regard to the franchised service sector in Ontario:

a. As workplaces change, new types of employment relationships emerge, and if the long term decline in union representation continues, are new models of worker representation, including potentially other forms of union representation, needed beyond what is currently provided in the *LRA*?

b. In the context of changing workplaces, are changes required to the manner in which workers choose union representation under the *LRA*? Are changes needed in the way that bargaining units are defined, both at the time of certification and afterwards? Are broader bargaining structures required either generally or for certain industries? Are changes needed in regard to protecting bargaining rights?

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[8] http://www.labour.gov.on.ca/english/hs/sawo/blitzes/

[9] Sara Mojtehedzadeh, *Inspection Blitz Finds Three-Quarters of Bosses Breaking the Law"*, The Toronto Star, January 20, 2016, online: http://www.thestar.com/news/gta/2016/01/20/inspection-blitz-finds-three-quarters-of-bosses-breaking-law.html

[10] S.O. 2000, c. 41.

[11] S.O. 1995, c. 1.

[12] Ministry of Labour, *Changing Workplace Review: Guide to Consultations*, May 2015.

c. Are there specific employment relationships (e.g., those arising from franchising, subcontracting, or agencies) that may require special attention in the *ESA*?[13]

Lobbyists felt that it was imperative for stakeholders in the franchised business sector to actively engage in a comprehensive response to the Changing Workplace Review. Given the uncertainty of the effect the Review would have on franchised businesses, the Canadian Franchise Association ("**CFA**") sprang into action.

The CFA has acted as the authoritative voice for franchising in Canada for over 50 years, since its creation in 1967 as a trade association representing the shared interests of franchisors in Canada. The CFA submitted a well-reasoned submission to the Changing Workplace Review, lobbying for specific legislative changes with regard to the joint employment issue in franchising. The CFA recommended the following changes to the ESA and LRA:

a. Change the definition of "employee" in the ESA to reflect the nature of the franchise business model and specifically exclude franchisees from the definition to recognize that franchisees are not employees of their franchisor and that the relationship between franchisor and franchisee is based in contract and not an employment relationship. A number of jurisdictions have made this clarification in their laws governing employment and labour relations.

b. Maintain the sectoral exemptions in the ESA.

c. Maintain the provisions in the LRA as they relate to how employees choose union representation, bargaining structure and bargaining rights.

d. Maintain the current common law test for distinguishing between employer and independent contractors.[14]

For now, the legislation remains unchanged, with a hazy status as to the liability of franchisors for the conduct of their franchisees and their franchisees' employees. The final report and recommendations from the Changing Workplace Review are expected to be released in the summer of 2016.

(b) Judicial Issues in Canada – The Common Law Employer Doctrine

In Canada, jurisprudence has well established principles guiding issues of joint employment, namely in what is often referred to as the common law employer doctrine. The common law employer doctrine has been explained by scholars:

> The concept of associated or related employers extends liability for employment-related obligations among a group of related entities in ways that ignore the corporate legal form and do not require that a legal entity have a direct contractual relationship with an employee. It modifies the traditional binary contractual model by trumping privity when it comes to the employment contract or the collective agreement and by lifting corporate veils.[15]

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[13] Ministry of Labour, *Changing Workplace Review: Guide to Consultations*, May 2015.

[14] Canadian Franchise Association, *The Modern Workforce: The Contribution and Future Opportunity of Franchising in Ontario*, September 18, 2015

[15] Judy Fudge and Kate Zavitz. *Vertical Disintegration and Related Employers: Attributing Employment-Related Obligations in Ontario.* 13 C.LE.L.J. 107 (2007).

The test for common employer is meant to determine if an individual is employed by more than one entity at a single point in time. The test, first articulated in *Sinclair v. Dover Engineering Services Ltd.*[16] and later confirmed in the Ontario Court of Appeal, posits that, "as long as there exists a sufficient degree of relationship between the different legal entities who apparently compete for the role of employer, there is no reason in law or in equity why they ought not all to be regarded as one for the purpose of determining liability for obligations owed to those employees who, in effect, have served all without regard for any precise notion of to whom they were bound in contract".[17]

The test, as it is worded, leaves the ultimate finding to the discretion of the judiciary. Further, its impact on the franchised industry is also left unclear. The Ontario Labour Relations Board ("**OLRB**"), however, offered some clarification in a 2001 decision involving a franchise relationship.[18] In this case, the OLRB refused to find the relationship was that of a common employer, despite a finding the Sobeys, the franchisor, had a high degree of control over the franchisee and its employees. In fact, the grocery stores in question were formerly a part of Sobeys' corporate structure prior to a reorganization. When the relationship transitioned, it "was seamless. The employees were the same, the managers were the same. In general, the store manager was converted into a franchisee. Sobeys continued its substantial control over the store, albeit through a different persona, a franchise rather than corporate ownership".[19]

Ultimately, it was found that many elements of the control exerted by Sobeys were common in the franchise relationship and that this particular case did not meet the requirements for a finding of a joint employment. The Board ruled that "Sobeys' control is not different from what would apply if a bank were to have funded the investment which enabled the franchisee to obtain the franchise".[20]

Despite the outcome in Sobeys, there have been joint employment determinations by courts and administrative tribunals in Canadian jurisprudence in the franchise industry.[21] Lobbyists, like the CFA, believe that these decisions are a positive demonstration that the current standard is effective in reigning in franchisors when their control over franchisees and their employees is over exerted.

(c) Administrative Issues in Canada

The purposive interpretation of the legislation that guides the joint employment discussion is at odds with the administrative bodies that seek to impose liability on franchisors for the actions of their franchisees. The section of the LRA states:

> Where, in the opinion of the Board, associated or related activities or businesses are carried on, whether or not simultaneously, by or through more than one corporation, individual, firm, syndicate or association or any combination thereof, under common control or direction, the Board may, upon the application of any person, trade union or council of trade unions concerned, treat the corporations, individuals, firms, syndicates or

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[16] (1988) 49 D.L.R. (4th) 297 (B.C.C.A.) affirming (1987), 11 B.C.L.R. (2d) 176 (B.C.S.C.).

[17] *Downtown Eatery (1993) Ltd. v. Ontario,* 2001 CarswellOnt 1680, [2001] O.J. No. 1879 para 30.

[18] *The United Food and Commercial Workers' International Union, Local 175 v. Sobeys Ontario Division of Sobeys Capital Inc.,* 2001 CarswellOnt 3875, [2001] O.L.R.B. Rep. 1250 ["Sobeys"].

[19] *Id*, para 104.

[20] *Id*, para 125.

[21] Kent v. Stop 'N' Cash 1000 Inc., 2006 CarswellOnt 4062, [2006]; FCC/Pepsico Holdings Ltd. v. CAW-Canada, Local 3000, 2001 CarswellBC 2147 [2001]; Westfair Foods Ltd. and UFCW, Local 1518, Re, 2005 CarswellBC 4486 [2005].

associations or any combination thereof as constituting one employer for the purposes of this Act and grant such relief, by way of declaration or otherwise, as it may deem appropriate.[22]

The definition of common control in the LRA seeks not to impose liability on franchisors, but rather, to protect employees' and a union's bargaining rights. The OLRB has even declared in case law that "Section 1(4) (of the LRA) is designed to preserve or protect a union's bargaining rights from artificial erosion; to create or preserve viable bargaining structures; and to ensure direct dealing between a bargaining agent and the entity with real economic power over employees".[23] Yet, despite this, certain administrative bodies and government agencies in Canada are seeking to impose liability on franchisors instead of seeking payment from franchisees.

New menu labeling laws that will come into force in Ontario in 2017 are just one example of the threat of liability that franchisors must now be concerned by. The *Healthy Menu Choices Act* will require regulated food service premises with 20 or more locations in Ontario that are selling prepared ready-to-eat food to post itemized caloric content on menus.[24] While the definition leaves open the possibility that a franchisor is not always liable for compliance, the above reference to responsibility and control (as opposed to ownership) leaves open the more likely possibility that the government intends for every franchisor to be caught, as they arguably all exercise some measure of control, and therefore may be open to prosecution.

Another example involves Stewardship Ontario, a stand-alone quasi-governmental body that was established in response to new recycling legislation in 2002. The purpose of the new legislation sought to have companies that provide recyclable materials to consumers, like pizza boxes, for example, to compensate the province for the cost of running recycling programs. This law deemed franchisors to be the obligated steward for all of their Ontario franchisees.

Another area where administrative bodies seek to impose liability on franchisors is through workers compensations claims. The British Columbia Court of Appeal has found franchisors responsible under the *Workers Compensation Act*[25] for ensuring the health and safety of employees of franchisees.[26] In one situation, an employee at a Petro-Canada gas station was struck when he attempted to stop a fleeing truck that had not paid for their gas. In another, an employee at a different Petro-Canada gas station was robbed at knifepoint. Following an inspection by the Workers Compensation Board, issues were ordered against the franchisor, imposing the liability on them, and not the franchisees. These orders against the franchisor were affirmed by higher courts.

2.3. Germany

The vivid discussion currently ongoing in the United States with respect to the question if and under which circumstances a franchisor is held jointly liable with a franchisee as an employer of the

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[22] *Labour Relations Act*, S.O. 1995, c. 1. s.1(4).

[23] *Supra* Sobeys, at para 115.

[24] S.O. 2015, c. 7.

[25] R.S.B.C. 1996, c. 492.

[26] *Petro-Canada v. British Columbia (Workers' Compensation Boar*d), 2008 BCSC 841, B.C.W.L.D. 7087.

franchisee's employees has not yet reached Germany. And, taking a closer look at the legal environment in Germany, it seems rather unlikely that this will ever be the case – at least not in the same way.

When, in November 2014, the largest Burger King franchisee in Germany was requested to shut down 89 restaurants immediately after termination of the franchise agreements by the franchisor because the franchisee violated Burger King's rules on the treatment of employees and did not adhered to hygienic standards, 3,000 jobs were at stake. Even in a situation like this, where incidents had been reported to the franchisor and where the franchisee was also said to have withheld employees' pay and bonuses, the aspect of joint employment was never an issue.

Nevertheless, there have always been debates in Germany related to employment law issues in connection with franchise systems and recently those debates have been fueled in connection with the introduction of new legislation pertaining to the payment of minimum wages. Also, trade unions in Germany have a long tradition in criticizing the franchise model as being the "safe harbor" for low wages, a practical instrument for franchisors to circumvent statutory provisions aiming at the protection of employees, and seeing in the franchise model the ultimate way to ignore the standards and agreements which trade unions fight for on behalf of the individuals working in the respective industries they represent. Another reason to beware of the motto "never say never" and to pay heed to it …

Also, one would think that the age-old question related to the qualification of the franchisee as an employee as opposed to a self-employed individual and the related consequences could be answered for good after two landmark decisions of the German Federal Court of Justice and the German Federal Labor Court in 1997 and in 1998, as well as subsequent case law based on the principles defined in those decisions. Unfortunately, however, taking that view would be missing the point: each and every individual situation needs to be evaluated in the individual circumstances as courts keep to emphasize.

The potential pitfalls related to employment law and social security law aspects are not the only ones to be aware of as a franchisor in Germany: recent case law indicates that the requirements for proper and fair commercial practices by franchisors in relation to advertisements and marketing activities on behalf of their franchisees are more demanding than ever. The same is true for compliance with statutory obligations to inform.

The following outline will briefly summarize the major aspects of the current status of discussions foreign franchisors should be aware of in connection with employment law and social security law aspects in Germany as well as with regard to the potential for a franchisor's liability for unfair commercial practices resulting from advertisements and promotional activities.

(a) Legislative Issues in Germany

There are no statutory provisions in Germany dealing with the contract type of a franchise agreement: neither in the Third Book of the German Civil Code where many different types of contracts are regulated, nor in the Commercial Code, nor in any of the countless statutes and ordinances in Germany a reference to franchising or the franchise agreement can be found. As of today, franchise law in Germany is determined by an incoherent case law and by statutory provisions related to general contract law, commercial law, corporate law, antitrust law, laws against unfair competition, consumer protection law, data protection law, employment law, social security law, and many others. And only few of those statutory provisions actually "fit" to the franchise model.

In the context of this paper, the following statutory provisions and legislative acts are of particular relevance.

The major novelty relates to the recently introduced statutory minimum wage: Germany was one of the last EU-member states to pass legislation (*Gesetz zur Regelung eines allgemeinen Mindestlohns – MiLoG;* Minimum Wage Act) providing for a statutory minimum wage[27]. With that, 22 out of the 28 jurisdictions in the EU have a statutory minimum wage[28]. Since January 1, 2015 a minimum wage of EUR 8.50 per hour applies to persons in dependent employment and to interns in Germany. Self-employed individuals, persons in quasi-employment, and home workers do not fall within the scope of the Minimum Wage Act and therefore have no right to claim payment of the minimum wage. The obligation to pay minimum wages applies to all companies including, regardless of their size.

After more than one year after its introduction the statutory minimum wage itself appears to be widely accepted in the franchise industry. However, many franchise systems and the German Franchise Association criticize and disapprove of the tremendous time expenditure resulting from the new statutory administrative tasks such as a detailed record keeping[29]. Violations of the Minimum Wage Act constitute an administrative offence and as such are subject to fines amounting to up to EUR 500,000 pursuant to section 21 of the Minimum Wage Act.

In order to understand why the question "employee or self-employed?" has always been a regular topic in court proceedings in Germany even before the statutory minimum wage for employees became effective in 2015, one has to have a closer look at the labor laws and the social security system in Germany: apart from employment related protection (e.g. against termination) the status of an employee ensures a high degree of statutory protection against various risks under the social security system, e.g. in case of illness, accidents, social hardship and other incidents. And since the functioning of the social security system depends on the contributions of its members the respective self-governing bodies of the individual social insurance institutions and their representatives have a great interest in obtaining judgments from courts confirming their legal assumption of an employment relationship which will then entitle them (retroactively) to demand payment of social security contributions from both, the franchisee (in this context actually treated as an employee) and the franchisor (actually considered as an employer).

The social security system in Germany comprises five different statutory pillars: long-term care insurance, pension insurance, accident insurance, unemployment insurance, and health insurance. As an employee as defined in section 7 of the Fourth Book of the Social Code, one becomes automatically a member of those insurances (except for the health insurance). The compulsory contributions which are payable on the basis of certain percentages of the employee's gross salary are equally split between the employee and employer.

In 2016, the statutory contribution payable to the social security institutions by each, the employee and the employer, amounts to 19.325% of the respective employee's gross salary (up to a ceiling of an annual gross salary of EUR 74,400 in West-Germany and EUR 64,800 in East-Germany). The employer is responsible for taking all necessary steps to register his employees for the social security and to ensure that the contributions are correctly calculated and paid for. A self-employed individual may also choose to contribute to the social security system, but in this case has to bear all the costs related thereto alone.

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[27] *Mindestlohngesetz (MiLoG)* of August 11, 2014 (BGBl. I S. 1348), as amended by article 2 para 10 of the Act of February 17, 2016 (BGBl. I S. 203)

[28] As of January 1, 2016, all EU-member states except Denmark, Finland, Italy, Austria, Sweden, and Cyprus have statutory minimum wage regulations

[29] http://www.franchiseverband.com/blog/tag/mindestlohn/

(b) Judicial Issues in Germany

As already mentioned before, the question whether or not a franchisee actually qualifies as an employee has been presented to courts at various occasions in the past. Two landmark decisions in 1997[30] and in 1998,[31] which both involved the franchise system "*Eismann*", determined the legal discussion and formed the basis for another landmark decision in 2002[32], the "*Vom Fass*" ruling of the Federal Court of Justice. The courts' considerations in these rulings are still valid and applicable as of today and are therefore to be kept in mind by franchisors in the course of defining the elements and details of the franchise relationship.

- The "*Eismann*" rulings

"*Eismann"* is a franchise concept for the delivery of frozen food by trucks. The disputes leading to the two landmark rulings involved the question which court would be competent to hear the respective case: the franchisees took the view that their status as truck drivers corresponded to the status of employees. In their opinion, the competent courts for claims raised by the franchisor under the franchise agreement were the labor courts and not the civil courts. The franchisor took a different view and filed action with the civil law court. Each of the disputes went through all instances of the labor courts and of the civil courts respectively, until one of them ended up before the Federal Labor Court as the last instance, and the other one before the Federal Court of Justice as the last instance of the civil law courts. Interestingly enough, both courts came to the same conclusion in the cases presented to them.

In the "*Eismann*"-decisions the Federal Court of Justice and the Federal Labor Court for the first time defined the criteria applicable for the evaluation whether a franchisee is to be considered as economically independent or as employee. Further, a discussion which had been led among legal scholars for many years with respect to the question whether the existence of a franchise relationship would preempt a franchisee's status as an employee was ended for good – and the views taken by the Higher Regional Courts of the precedent instances were history. The courts ruled:

> *Whether a Party is an employee or has a 'quasi-subordinate status' is to be determined exclusively upon whether such person is personally dependent, or, even so legally independent, economically dependent and therefore in need of protection in a way comparable to an employee.*
>
> *The fact that a franchisee is bound by commitments which are typical for such a legal relationship does not exclude the assumption of an employment relationship.* [33]

In the *Eismann* rulings the courts pointed out that the degree of personal dependence of a franchisee would be the essential criterion in the determination of the status of an employee on the one hand and an "employee-like-person" *(arbeitnehmerähnliche Person).* Because of the lack of integration of employee-like-persons into a business organization and the fact that they are essentially free to determine their working hours they are not as personally dependent as employees are. Whereas

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[30] Ruling of the Federal Labor Court (*Bundesarbeitsgericht – "BAG")* of July 16, 1997; 5 AZB 29/96, NJW 1997, 2973

[31] Ruling of the Federal Court of Justice (*Bundesgerichtshof – "BGH")* of November 4, 1998; VIII ZB 12–98, NJW 1999, 218

[32] Ruling of the Federal Court of Justice (*Bundesgerichtshof – "BGH"*) of October 16, 2002; VIII ZB 27/02, NJW-RR 2003, 277

[33] Non-official translation of the two guiding principles ("*Leitsätze*") of the Federal Labor Court's "*Eismann*" ruling as confirmed by the Federal Court of Justice

employees are personally dependent and bound by instructions from their employer, the criterion for a status as an employee-like-person is to be determined based on the degree of economic dependence and a need for protection which is comparable to the one of an employee.

The courts came to the conclusion that the status of the franchisees in the *Eismann*-system actually corresponded to the position of employed truck drivers with no possibility to employ other individuals and the obligation to personally fulfill the sales obligations due under the franchise agreement within defined time frames and in a defined manner leaving no room for their own business organization. In this context, the courts not only looked at the terms of the franchise agreement but also referred to the franchise manual the content of which was binding for the franchisees.

- "*Vom Fass*" ruling

A few years after the *Eismann* rulings, the Federal Court of Justice once again had a chance to define generally applicable criteria for the determination of the employment status or the employment-like-status of franchisees as opposed to a status as self-employed persons.

Here, it is noteworthy that the Federal Court of Justice in the "*Vom Fass*" case referred to a statutory provision in the German Commercial Code, namely section 84 para 1 Commercial Code (*Handelsgesetzbuch – HGB).* Section 84 is the first provision of Chapter 7 of the Commercial Code which deals with commercial agents.

Section 84 of the Commercial Code defines a commercial agent as a self-employed tradesperson who is permanently engaged by another person (the principal) to transact business either as an intermediary or in the principal's name. Self-employed is one who is essentially free to organize his business activities and to determine the working hours.

The court came to the conclusion that, by evaluating all aspects of the case presented to it, the franchisee was essentially free to organize her business activities and was not limited by the franchisor (who was the claimant in this proceeding) to an extent which would make her position comparable to the one of an employee.

It ruled that the franchisee's status would also not qualify as the status of an employee-like-person as defined in section 5 para 1 of the German Labor Court Act (*Arbeitsgerichtsgesetz – ArbGG).* In its reasoning the court referred to the *Eismann*-rulings regarding the element of the economic dependence and pointed out that the additional element of a need for social protection would have to be present in order to assume an employee-like-status. And this need for social protection was denied.

The franchisee in the "*Vom Fass"* – case was considered to be not in need of such social protection because her situation in the view of the court was not comparable to the one of an employed sales person. The franchisee:

- *was free to organize her business operations*
- *had leased the premises of her business independently*
- *was free to employ other individuals*
- *was free to determine her sales prices*
- *was not integrated in the franchisor's settlement system*
- *was not bound to provide the services under the franchise agreement in person to the extent that any other business activities would be excluded.*

Even though developed more than 10 years ago, the above criteria are still the ones applied by courts today. Franchisors are therefore well advised to examine carefully whether the business relationship with their franchisees in theory and in practice would adhere to the degree of independence resulting therefrom.

2.4. United States

In years past, courts and federal labor agencies generally held that franchisors were not joint employers with their franchisees in any legal context unless the franchisors had significant control over the employment relationship.[34] For example, in *Singh v. 7-Eleven, Inc.*,[35] an employee sought to hold liable a franchisor for FLSA violations. The court held that the franchisor was not a joint employer because pursuant to the franchise agreement, the franchisee had "exclusive right and responsibility to control the hiring and firing decision."[36] Further, the franchisor did not compensate employees or exercise control over the terms of employment, including training, assigning job duties, and scheduling.[37]

Where courts have found joint employer liability, the franchisor or putative owner has had significant involvement in day-to-day employee management.[38]

(a) The NLRB's 2015 BFI Case and McDonald's

In *Browning-Ferris Industries of California, Inc.*[39] ("*BFI*)", the National Labor Relations Board ("NLRB") made a dramatic change in its joint employer standard. Overruling three decades of precedent, albeit not in the franchise context, the Board held that separate companies could be found to be joint employers if one entity exercised "indirect," "potential," or "ultimate" control over the other entity's employees. The Board found a manufacturer in that instance to be a joint employer with a staffing services company based on a detailed and counter-intuitive examination of the contractual and practical indicia of control indirectly possessed by the user company.

The dissenting opinion in *BFI* accused the NLRB majority of creating a "limitless" standard that would "fundamentally alter" business-to-business relationships in myriad industries. The dissenters specifically identified franchising as one potentially affected industry. The Board majority disclaimed any intent to address any case that was not immediately before it; but the Board did not offer any reason to believe that the expanded joint employer standard would not apply to franchising either, simply leaving the issue open for a future ruling.

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[34] *Raines v. Shoney's, Inc.*, 909 F. Supp. 1070, 1078 (E.D. Tenn. 1995) (Generally, "a franchisor is not the employer of employees of the franchisee.").

[35] No. C-05-04534, 2007 U.S. Dist. LEXIS 16677, 2007 WL 715488 at *3-6 (N.D. Cal. March 8, 2007).

[36] 2007 U.S. Dist. LEXIS 16677, at *4.

[37] *Id.; see also Reese v. Coastal Restoration and Cleaning Services, Inc.,* No. 1:10cv36, 2010 U.S. Dist. LEXIS 132858, 2010 WL 5184841 at *3 (S.D. Miss. Dec. 15, 2010).

[38] *See e.g., Miller v. D.F. Zee's, Inc.,* 31 F. Supp. 2d 792, 806 (D. Or. 1998). *Compare Nutritionality*, Inc., NLRB Div. of Advice, No. 13-CA-134294, (4/28/15) (advice memorandum of NLRB General Counsel finding a franchisor exercised insufficient control over its franchisee to qualify as a joint employer).

[39] 362 NLRB No. 186 (Aug. 31, 2015).

The future arrived soon enough, as the NLRB's General Counsel proceeded to trial against McDonald's Corporation, alleging that the franchisor was a joint employer with 31 of its franchisees in an unusually large, consolidated unfair labor practice complaint. The General Counsel counsel actually filed the complaint prior to issuance of the BFI decision, but the case is now being tried under the new standard before an Administrative Law Judge.[40]

(b) Other Administrative Agency Rulings On Joint Employer Standards

The FLSA expressly recognizes joint employment for purposes of minimum wage and overtime pay requirements. The regulations interpreting the Act provide that "[a] single individual may stand in the relation of an employee to two or more employers at the same time under the Fair Labor Standards Act of 1938 . . . ."[41] Recently, the Wage Hour Administrator of the Department of Labor, David Weil, issued a new Administrator's Interpretation No. 2016-1, entitled "Joint Employment Under the Fair Labor Standards Act…." The Interpretation considers various, often conflicting court decisions issued over the years and adopts a broad and expansive view of the case precedents on joint employment. The new Interpretation does not specifically address franchising situations but its principles declares generally that joint employment has become "more common."

The joint employer analysis under Title VII, the Americans with Disabilities Act ("ADA") and the Age Discrimination in Employment Act ("ADEA") is similar, if not identical to that under the FLSA. In general, courts appear to rely on some variation of the following three factors when making this determination: (1) [A]uthority to hire and fire employees, promulgate work rules and assignments, and set conditions of employment, including compensation, benefits, and hours; (2) day-to-day supervision of employees, including employee discipline; and (3) control of employee records, including payroll, insurance, taxes and the like.[42] Moreover, "[t]he parties' beliefs and expectations regarding the relationship between the plaintiff and defendant are also relevant."[43]

3. Ramifications for Franchisors, Franchisees and Employees

3.1. Australia

From a unit franchisee's perspective any whole or partial introduction of concepts of joint employment will add no further ramifications – if they break the law, they will be liable as the primary employer.

From the perspective of an employee of a franchisee, any whole or partial introduction of concepts of joint employment will give them another potentially "deep pocket" source from which to seek compensation, namely the franchisor.

From the perspective of a franchisor (including a master franchisee) any whole or partial introduction of concepts of joint employment will substantially increase the risks of doing business as a franchisor because of the added prospective liability to employees of franchisees.

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[40] *Fast Food Workers Committee and SEIU v. McDonald's USA LLC*, Case Nos. 02-CA-093893 et al (ALJ Esposito).

[41] 29 C.F.R. §791.2(a).

[42] *Myers v. Garfield & Johnson Enters., Inc.*, 679 F. Supp. 2d 598, 607 (E.D. Pa. 2010). "No single factor is dispositive and a weak showing on one factor may be offset by a strong showing on the other two." *Id.* at 608.

[43] *Id. See also, Rivas v. Fed. de Asociaciones Pecuarias*, 929 F.2d 814 (1st Cir. 1991) (insufficient evidence that defendant exercised the degree of control necessary to sustain a finding that it was a joint employer)

Franchisors and master franchisees who do not wish to wind down their franchise structure, will need to implement an onerous regime of educating and auditing franchisees to minimize the risk of non-compliance and be prepared, to the extent possible, to go down the franchise termination path in respect of non-complying franchisees. Franchisors and master franchisees will need to seek insurance indemnifying them in respect of franchisee employee claims.

All of the above will substantially add to the cost of doing business.

Franchise agreements may need to be amended to enable the franchisor to pass on some or all of these costs to the franchisee.

Finally, it has always been a ramification of being a franchisor that if your franchisee does something wrong, such as being involved in a scandal, such as occurred with 7-Eleven, this has the potential to cause huge brand and reputational damage and the social need for the franchisor to be seen to be rectifying the situation, often by making compensatory payments to affected franchisees and employees.

A further issue for franchisors is that the *Franchising Code of Conduct* ("Code") prohibits a franchisor from immediately terminating a franchise agreement if a franchisee has violated workplace laws. If this occurs, the franchisor must first serve a notice of breach giving the franchisee an opportunity to cure the breach within a reasonable period[44] and it is only if the franchisee does not cure the breach, that a right to terminate contained in the franchise agreement can be exercised.

Thus, franchisee could violate then cure, time and time again and frustrate the franchisor's ability to forcefully remove them from the network.

This problem was recently recognized in the March 2016 Australian Senate Education and Employment References Committee Report entitled *"A National Disgrace: The Exploitation of Temporary Work Visa Holders"*, which is referred to in the future developments section below.

- *The 7-Eleven Scandal*

In late 2015, an illegal exercise within a large part of the 7-Eleven franchise network was exposed by the Australian media. Many employees of 7-Eleven franchisees are foreign students on student visas. Student visa holders can only work up to a maximum of 20 hours per week during semester.

Many franchisees required such employees to work in excess of 20 hours per week, but they were only paid for 20 hours. Their pay slips recorded the correct hourly rate but on the basis they worked only 20 hours (which was false). When the affected employees came forward to complain about being underpaid, they were threatened with being reported to Australia's immigration authorities and being deported.

Once the story broke, some franchisees stopped this illegal activity, but replaced it with another illegal activity whereby they paid their employees the correct amount, then demanded cash back from them under threat of reporting the employee to immigration authorities.

The media reports made serious allegations that the franchisor's managers had told an undercover employment advocate that "there were ways around paying award wages". Such a manager, offering advice or counsel about breaching the FWA might constitute aiding and abetting under section 550,

[44] Which need not exceed 30 days

although a recent report issued by the FWO has stated that, to date, it has received insufficient evidence to sustain a claim under this section.

Recent press reports have suggested that the extent of the underpayments could be as much as $100 million.

When this illegal activity was exposed by the media, it sent 7-Eleven into damage control. Its founder and Chief Executive Officer ultimately stood down from their positions.

Under the then 7-Eleven system, 57% of the gross profit of the business was kept by the franchisor to cover occupancy costs, equipment costs, maintenance of buildings, premises and equipment, utility costs and advertising and an optional payroll service that relied upon correct information being provided by the franchisee. The remaining 43% of gross profit was applied towards employment wage costs and the like and the remaining expenses of operating a store, with anything left being profit.

Although the real culprits were the franchisees, they were portrayed in the media as being innocent victims of a flawed system under which they could not make money without exploiting employees. In essence, the franchisor was primarily blamed.

The franchisor immediately went on the offensive by:

- Appointing the former chairman of the Australian Competition and Consumer Commission ("ACCC") to receive and investigate claims of employee exploitation;
- Creating a system whereby:
    - The franchisor would meet the first $25M of legitimate claims lodged by exploited franchisees;
    - Franchisees meeting the next $5M; and
    - Remaining claims being split 50/50 between the franchisor and the relevant franchisee.
- Re-negotiating franchise agreements so that the split of the gross profit became a sliding scale depending on the income of the store, but was ultimately closer to 50/50.

But the real take out from this situation is how a scandal such as this can affect a brand and its value, create chaos for the franchisor, and cost the franchisor huge sums of money.

3.2. Canada

Canada has the second largest franchise industry in the world, trailing only the United States.[45] North of the border, the franchise industry alone accounts for over $100 billion in sales annually, stemming from over 76,000 franchise operations, operating under 900 different brand names.[46] The sales figures are astonishing, and so too are the employment numbers. Franchising in Canada employs over one

[45] *Canadian Franchise Statistics & Info*, online: http://www.franchiselink.ca/canadian-franchise-faqs/canadian-franchise-statistics-info/

[46] *Id.*

million people, which translates to 1 out of every 14 working Canadians being employed by a franchise. So, what threat does a changing definition of common employer pose to the industry in Canada? This paper will argue that the effect may be so devastating that it poses a fundamental threat to the foundation of this $100 billion industry, and as a result, the Canadian economy.

Franchising is formed on a business model that encourages growth, allowing franchisors to sell franchises and expand rapidly. One of the fundamental tenets of this model is the transfer of risk from the franchisor to the franchisee. However, a determination of common employment over the employees of a franchisee transfers that risk back to the franchisor by exposing franchisors to a plethora of vicarious liability claims.[47]

For current franchisors, the blurring of the line for common employment will cause significant changes in the way they interact with their franchisees. One option, in fear of the increased liability, will see franchisors increase their control over their franchisees to ensure compliance with relevant legislation. This option will not be well received by franchisees; increased franchisor control means decreased franchisee autonomy, a fundamental aspect of the franchise relationship, in addition to the increased insurance premium costs that will be passed on to franchisees.

The other option, in an attempt to eliminate the appearance of control, would see franchisors stepping back from their involvement with franchisees. This could mean decreased support, training, guidance, and direction. This option seems at odds with the franchising model, beginning to separate the formerly shared goals of franchisors and franchisees. A successful franchise model should have all parties striving to pull the rope in the same direction. Less franchisor control would cause a dilution of the brand quality and uniformity – again, completely at odds with the franchise model.

3.3. Germany

(a) Self-employed or employed?

As described in Section 2.3 above, franchisors in Germany are well advised to examine carefully whether the franchisees in their daily business operations enjoy enough freedom to actually qualify as entrepreneurs rather than as employees or as employee-like-persons. Binding instructions as to working hours and the organization of the business operation in general are as improper as a total integration into the franchisor's business organization.

At a first glance this seems to be everything but too big as a challenge, in particular, because the structuring of the franchise relationship lies entirely in the hands of the franchisor. However, despite the *Sword of Damocles* of having to pay retroactively contributions to the social security institutions and other disadvantages related to the status of the franchisee as an employee or an employee-like-person, many franchisors still insist on regulating each and every single detail of the franchisee's business.

For example, in 2011 the Higher Regional Court of Saarbrücken confirmed the decision of the lower court which had dismissed a franchisor's motion for a preliminary injunction against a (former) franchisee by stating that it was not the competent court to decide on the case because the labor courts would have exclusive jurisdiction over the dispute[48]. In the case presented to the courts the franchisee

[47] These claims include: liability for notice under the ESA; potential actions for statutory and common law severance obligations, in addition to wrongful dismissal claims under the ESA; liability under workers compensation laws; liability under federal tax laws and federal employment insurance premiums for failing to withhold source deductions for employees; liability for Canada Pension Plan contributions, in addition to a number of additional claims.

[48] Higher Regional Court of Saarbrücken (*OLG Saarbrücken)*, ruling of April 11, 2011, 5 W 71/11, http://www.saarland-olg.de

owned and operated a specialty restaurant for Alsace pizza (flaming cake; "*Flammkuchen")* under the franchisor's brand. After several warning letters from the franchisor for reason of non-compliance with contractual obligations she terminated the franchise agreement and continued to operate the restaurant with the same specialties in the same location under another name. The franchisor filed a preliminary injunction for cease and desist based on section 3 of the Act against Unfair Competition (*Gesetz gegen den unlauteren Wettbewerb - "UWG"*) for reason of unlawful imitation of the franchisor's concept – and lost the case. The courts took the view that by adhering to the provisions in the franchise agreement and the instructions in the manual the franchisee's dependence would be comparable to the one of an employee. She was considered to be economically and socially dependent.

(b) Is this criminal behavior?

Determining the franchisee's status as employee or employee-like-person is anything but academic. And it's not only about the money: in particular circumstances the management may be held criminally liable for the franchisor's failure to pay social security contributions.

In a case decided by the Higher Regional (Criminal) Court of Frankfurt in 2014,[49] the public prosecutor had accused the sole managing director of a limited liability company (*Gesellschaft mit beschränkter Haftung - GmbH)* of a violation of section 266a of the German Criminal Code for withholding and misappropriation of employment remuneration in an amount exceeding EUR 7.2 Mio.. A detention warrant against the managing director was issued.

The company's business purpose was to provide the services of foreign (mainly Eastern European) care givers to private families and elderly people in need of support. To that aim the company entered into franchise agreements with self-employed and independent care givers. The care givers then entered into a care service contract with the respective person (or his or her relatives). The care service agreement was drafted by the company and it regulated in detail the services to be provided by the respective care giver.

The public prosecutor took the position that despite the title of the contract which was headed with "Franchise Agreement" the company in fact had the status of an employer. In that capacity the company would have been required to pay social security contributions for about 5,900 (!) Eastern European care givers for which the company had acted as an intermediary in a period of more than 5 ½ years from 2007 to 2012.

The criminal court evaluated each element of the contractual relationship. It came to the conclusion that despite a very strict framework the company would have no right of direction which would be comparable to the one of an employer – also because the actual service agreement was to be entered into directly between the care givers and the families rather than with the company. Further, after having heard several witnesses the court answered the question whether the care givers were bearing the entrepreneurial risk of their services to the affirmative and acknowledged that they would have a certain degree of flexibility. As a result of a detailed and careful evaluation the court denied the company's status as an employer and revoked the arrest warrant against the managing director.

(c) Minimum wage violations

The newly introduced statutory minimum wage law in Germany provides for heavy fines in case of violation. Pursuant to section 21 of the Minimum Wage Act a fine of up to EUR 30,000 may be imposed on employers violating record keeping obligations, insurance requirements, or others. A fine of

[49] Higher Regional Court of Frankfurt a. M., March 7, 2014, 1 Ws 179/13, BeckRS 2014, 17893.

up to EUR 500,000 may be imposed on employers who fail to pay the minimum wage in time and on those who do not pay at all.

The risk for franchisors to be held liable for minimum wage violations of their franchisees is rather a theoretical one under the statutory liability regime provided for in German civil law statutes. One would have to interpret the relationship between franchisor and franchisee as a relationship between a general contractor and a sub-contractor in order to be able to argue a direct liability of the franchisor. And there are no serious voices arguing this. However, a franchisee's violation of his employer obligations under the statutory minimum wage law may have a disastrous impact on the entire franchise system's reputation and brand credibility. Franchisors are therefore well advised to not only actively address the aspect of compliance with statutory minimum wage with their franchisees but to implement processes allowing them to react immediately in case that violations occur.

3.4. United States

The franchise model in the U.S. has until recently fulfilled the important function of allowing businesses to have greater certainty as to their employment liabilities. The law provided that where such businesses lacked day-to-day operational control over franchisees they would not be subject to liability based on the actions of these third parties. This, in turn, enabled small businesses to develop and larger businesses to expand. It remains to be seen how far the NLRB's new BFI joint employer standard will go in the franchise context, and how far the courts will allow the Board (or other labor agencies) to go. The recent changes to the joint employer standard, however, if ultimately expanded so as to subsume the franchise model threaten to saddle franchisors with increased uncertainties and increased liabilities, and threaten a real possibility that economic harm will result.

4. Issues for Franchisors and Master Franchisees Doing Business

4.1. Australia

Until there are any changes to Australian laws or judicial pronouncements creating a concept of joint employment foreign franchisors exporting their system into Australia, should in their master franchise agreement or area developer agreement pass all burdens associated with Australian workplace laws to the master franchisee or area developer.

Foreign franchisors that either directly enter into unit franchise agreements with franchisees or do so via an Australian subsidiary should also do likewise.

Simple contract terms requiring the master franchisee, area developer or franchisee to become fully appraised of and comply with all relevant workplace laws and any industrial instruments governing the employees of the franchisee should suffice, although they still have to be careful about being willfully blind.

Any franchisor or master franchisee must decide the level of control it seeks. There are really only two options:

- Being "all in" by directly, or in conjunction with the master franchisee or area developer:
    - Providing to and educating franchisees all information necessary for franchisees to comply with workplace laws;
    - Ensuring all information is updated as soon as there is any changes to workplace obligations (this would be hard for foreign franchisors without them putting an

experienced workplace law firm or adviser on retainer to perform this task for the network and have that firm or advise to offer some form of "hotline support" to franchisees[50]);

- Rigorously auditing franchisees' compliance with workplace laws and taking strong action when violations are discovered; or

- Being "no in" by passing all burdens workplace law compliance to the franchisee as outlined above – even with this option, franchisors should rigorously audit franchisees' compliance with workplace laws and take strong action when violations are discovered.

4.2. Canada

The NLRB decision in *Browning-Ferris* is not binding in Canada, but there have been similar decisions in Canadian jurisprudence. The important issue to note for foreign franchises entering Canada is that Canada operates on a completely different set of legislation and common law. What applies in the United States, does not necessarily apply in Canada. Having said that, there is a decision from the OLRB in Ontario that issued a similar finding, albeit not in the context of franchising.

In a case involving a paper a recycling company, the Board sought to determine whether the recycling company and the staffing agency that hired the employees were common employers. The Board was unable to determine which entity exerted greater control over the day to day working conditions of the staff, and held both entities to be common employers.[51]

Franchises entering the Canadian market should discuss their business operations with Canadian counsel. Franchisors must work with counsel to find the middle ground of control without exposing themselves to liability, while still protecting the quality and uniformity of their brands. It is imperative that franchisors remove themselves from the day to day control of employees of franchisees, and counsel should include contractual language indicating such in franchise agreements and master franchisee agreements.

4.3. Germany

(a) Minimum wage law and pre-contractual disclosure obligations

In Germany, franchisors have a pre-contractual obligation to disclose relevant information to franchise prospects allowing them to evaluate the chances and risks related to the franchise relationship they are about to enter into. With the newly implemented statutory wage law which came into effect as of January 1, 2015, the documentation used by franchisors prior to that date may no longer be accurate: franchisors must ensure that the documentation they provide to franchise prospects in the pre-contractual phase does not contain outdated and therefore inaccurate information which are based on experiences and profitability forecasts relating to the time before the Minimum Wage Act came into effect, for example if the introduction of the minimum wage had an impact on the calculation of working hours. At a least, the respective documentation should be accompanied by a corresponding note. Failing to update the pre-contractual disclosure documentation in that respect bears the risk for franchisors of being held liable for damages claimed by franchisees for reason of having been misled when making their decision.

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[50] In Australia, the Subway franchisee organization, IPCA, supported by the franchisor, has done this.

[51] *Teamsters, Local 419 v. Metro Waste Paper Recovery Inc*., 2009 CarswellOnt 9240, [2009] O.L.R.B. Rep. 911.

(b) Franchisors: watch out for stand-alone franchises!

As discussed above, a franchisee's and a franchisor`s respective obligation to pay their equal share of contributions to the social security insurances depends on the franchisee's status as an employee or an employee-like-person. However, in exceptional circumstances, a franchisee – despite the fact that his status is confirmed to be the one of a self-employed and independent entrepreneur - is required nevertheless to pay statutory pension insurance contributions.

In case of the so-called "stand-alone" franchise businesses the courts in Germany have repeatedly ruled that franchisees are in need of the protection granted by the statutory pension funds. They were therefore held liable for payment of the statutory pension contribution which currently corresponds to 18.7% of the earnings[52].

Section 2 sentence 1 no. 9 of Book 6 of the Social Code provides that an entrepreneur who essentially works for only one principal and who has no employees for whom social security payments are due has a statutory obligation to pay contributions to the pension funds. Several courts have ruled that the criterion "working essentially for one principal only" is fulfilled in case of franchise businesses that are operated by one individual franchisee. In such constellations, the court held that the franchisor was the one and only principal, and not the franchisee's customers buying products or services at the franchisee's shop. Recent court rulings include cases of a bakery shop operated by a single franchisee[53], a concept for tutoring children[54], and in 2014 the case of a PC-service provider[55].

Pursuant to sections 169 and 171 of Book IV of the Social Code the contributions to the pension funds must be borne by the entrepreneur (franchisee) alone. Franchisors offering franchise concepts allowing the business operation by individual franchisees with no further employees are therefore not obliged to pay 50% of the contributions to the pension funds (unlike in the cases where the franchisee's status is confirmed to correspond to the one of an employee).

However, franchisors of such concepts should be aware of the fact that they have an obligation to include the information on the potential for the franchisee to be subject to statutory pension payments in their pre-contractual disclosure documentation. Failure to inform a franchise prospect on that aspect gives rise for the franchisee to challenge the validity of the franchise agreement for reason of improper (because incomplete) pre-contractual obligation and to claim damages.

(c) Promotions and Advertisements: a real challenge for franchisors

While the joint employment issue may not (yet) be of great relevance for franchisors in Germany, and while the pitfall of overregulating the franchisee's business operation with the result of being a de facto employer can easily be avoided by franchisors, highest degree of attention is owed to aspects related to consumer protection and to fair commercial practices. A recent decision of the Federal Court of Justice[56] involving the German franchise concept "Fressnapf", the market leader of pet supplies in

[52] Up to a contribution ceiling of EUR 74,400 per year in the "old" federal states (West-Germany) and EUR 64,800 in the "new" federal states (former East-Germany"

[53] Federal Social Court (*Bundessozialgericht – "BSG")*, November 4, 2009, B 12 R 3/08 R, NJW 2010, 2539

[54] Social Court Cologne, April 17, 2012, S 7 R 406/10 WA, BeckRS 2012, 69153

[55] Social Court Düsseldorf, September 11, 2014, S 27 R 1367/12, ZVertriebsR 2015, 164

[56] Bundesgerichtshof (*BGH*), February 4, 2016, I ZR 194/14, http://juris.bundesgerichtshof.de

Europe, confirmed the major challenges for franchisors when using marketing materials in connection with special offers.

The franchisor of the Fressnapf-concept in a 24-pages color brochure had advertised special offers for certain products which were made available in certain Fressnapf franchise shops in a defined period. On the front page of the brochure and on each of the following pages the franchisor had placed the following disclaimer: "All offers are exclusively non-binding recommended retail prices and are available in participating stores only." On the last page of the brochure the franchisor had placed the information "Fressnapf-markets in your area" and a list of eight Fressnapf-markets with full address and phone numbers.

The claimant, a consumer protection organization, filed suit claiming the violation of statutory provisions aiming at the protection of fair competition (sections 8, 5a, 4, and 12 of the German Act against unfair competition – *UWG)* for reason of lack of transparency and misleading information: a consumer would not be able to determine which Fressnapf markets would actually be participating in the promotional activity.

After the court of the first instance had rejected the claim for injunction and for reimbursement of the expenses related to the warning, the court of the second instance granted the injunction. The appeal (revision) filed by the franchisor had no success, the Federal Court of Justice confirmed the ruling of the Higher Regional Court of Düsseldorf stating that the disclaimer used by the franchisor was insufficient: instead, the franchisor would have been obliged to identify clearly which of the eight Fressnapf-markets listed on the last page were participating in the promotion. By failing to do so the franchisor was held to withhold information which was considered essential for the decision making process of the customer and therefore misleading within the meaning of sections 3 and 5 of the Act against unfair competition.

4.4. United States

Franchisors entering the U.S. should become conversant with the above described recent changes in joint employer standards and should review their franchise agreements and practices to determine whether any "red flags" exist under the recent NLRB, DOL, and EEOC rulings. Particular attention should be given to avoiding the appearance of exercising direct or indirect control over the employees of franchisees, specifically with regard to hiring, discipline, firing, supervising, scheduling, and training.

5. Conclusions and Future Developments

5.1. Australia

At the moment, there is no recognized concept of joint employment in Australia, with the only area for potential exposure for franchisor arising under the accessorial liability provisions of the FWA. The fact that in one franchise network alone, there has been up to $100 million in underpayments means that governments will be looking for ways to provide more protection for affected employees.

During 2015, the Australian Senate Education and Employment References Committee was primarily set up to investigate the impact of Australia's work visa programs on the Australian labor market. Mid-way through its hearings, the news broke about the illegal activity within 7-Eleven, thereby causing the Committee to consider issues such as joint employment and the termination restrictions in the Code referred to above.

Relevantly, the Committee, in its March 2016 report, has recommended:

- That Treasury and the ACCC review the Code with a view to assessing the responsibilities of franchisors and franchisees regarding compliance with workplace law and whether there is scope to impose some degree of responsibility on a franchisor and the merits of otherwise doing;
- That Treasury and the ACCC review the Code with a view to clarifying whether the franchisor can terminate the franchise agreement without notice where there are reasonable grounds for believing that serious contraventions of the FWA have occurred; and
- That consideration be given to amending the Code to allow a franchisor to terminate the franchise agreement without notice where there are reasonable grounds for believing that serious contraventions of the FWA have occurred.

The first relatively soft recommendation was made in the face of submissions by a large trade union and the ACTU (the peak trade union body in Australia) that joint employment legislation be introduced. Implicitly the Committee rejected those submissions, whilst recognising that laws may become necessary imposing some responsibilities on franchisors. The Franchise Council of Australia does not support laws imposing some responsibilities on franchisors and will no doubt lobby heavily against the introduction of such laws.

The Greens Party (a minor political party in Australia) has introduced a Bill into Federal Parliament[57] which, if passed, would allow employees employed under a franchise system to obtain unpaid entitlements from the franchisor.

This Bill has not yet been debated and given the current composition of the Australian Parliament, is unlikely to be passed, primarily because our Liberal National Party Coalition government, which controls the House of Representatives, is conservative, pro-business and pro-employer. Its former minister for small business is now the Chairman of the Franchise Council of Australia and it is expected he will heavily lobby against the passage of the Bill.

However, Australia goes to the polls this year, perhaps as early as July. If the Australian Labor Party (pro-employee, pro-union) is elected, it may bow to the pressure of the Greens Party (which itself is more left-wing) and vote in favour of this Bill.

In addition, influential commentators are publicly advocating that franchisors should bear some responsibility for the illegal employment activities of franchisees. It is hoped that the Franchise Council of Australia will seek to balance the public debate.

Finally, given recent concerns raised by the FWO about the high threshold required to prove accessorial liability, it is possible that future governments may seek to amend section 550 of the FWA in a way that makes it easier to prove accessorial liability.

Whether any law imposing liability of franchisors comes into existence, franchisors must become more vigilant in monitoring and auditing franchisees' compliance with workplace laws and taking stern action if violations are discovered. They must also be alert to obvious signs of possible violations and act accordingly.

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[57] *Fair Work Amendment (Recovery of Unpaid Amounts for Franchisee Employees) Bill 2015*

5.2. Canada

As mentioned earlier, the Changing Workplace Review is expected to issue their final report in the summer of 2016. It is hopeful that, on the backs of successful lobbying by stakeholders and the CFA, that Ontario's path (and Canada's, in turn) will diverge from the United States on the common employer issue. If not, the 76,000 different franchise operations and their over one million employees in Canada might be in jeopardy.[58]

5.3. Germany

In the current legal environment in Germany, the risk for a franchisor to be held jointly liable with the franchisee as an employer or the franchisee's employees is practically non-existent. Nevertheless, no franchisor can afford to ignore a franchisee's violation of statutory minimum wage laws or other obligations in view of the tremendous risk of damages to the good reputation of the system and the brand credibility.

Further, a franchisor regulating a franchisee's business operation in each and every regard should not be surprised to be considered as the franchisee's employer with all the obligations associated therewith. This can be avoided by leaving enough flexibility for the franchisee to organize his own business.

The major challenge for franchisors in Germany in these days seems to be to comply with all statutory provisions dedicated to protect consumers' interests and to bridge the gap between the duty to inform and practicability. Here, once again, the franchise model does not really fit into the legal landscape of statutory law in Germany.

5.4. United States

The new NLRB and other standards for joint employment in the U.S. are unsettled and have not yet been tested in the courts. It also remains unclear whether and to what extent the new standards apply to the various aspects of franchising agreements. Nevertheless, franchisors and franchisees should carefully monitor legal developments and take prudent steps to avoid the appearance of excessive control over franchisee employees.

[58] *Canadian Franchise Statistics & Info*, online: http://www.franchiselink.ca/canadian-franchise-faqs/canadian-franchise-statistics-info/

SPEAKER BIOGRAPHIES

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Maury Baskin is a shareholder in the Washington, D.C. office of Littler Mendelson, the world's largest law firm focused exclusively on labor and employment law and employee benefits. As a member of Littler's Workplace Policy Institute, Maury focuses on national labor policy, challenging excessive government regulation on behalf of small and large business, including franchisors and franchisees. Maury has litigated against changes to U.S. joint employer standards and advised franchises regarding compliance. He is currently leading federal court challenges against the US Department of Labor and the National Labor Relations Board on behalf of industry coalitions. Maury was named the Washington DC Lawyer of the Year 2015 by "Best Lawyers in America."

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Philip Colman is a partner in Melbourne, Australia based law firm, MST Lawyers. He is a member and, former head of, MST's franchising practice group, which acts for a large number of local and internationally based franchise systems. Philip's practice currently focuses on dispute resolution, litigation and regulatory investigations involving franchisors, franchisees and master franchisees and he has had significant experience in drafting franchise agreements, disclosure documents and transactional documents. Philip is a nationally accredited mediator and a member of the legal committee of the Franchise Council of Australia. Philip is the author of numerous legal papers relating to developing issues in franchising in Australia and the laws affecting participants in the franchising sector, particularly under Australian competition law.

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Dagmar Waldzus is a partner in the Hamburg office of Buse Heberer Fromm, a full-service law firm with 6 offices in Germany. She studied law at the universities of Passau and Hamburg and earned a Master's in International Legal Studies from New York University in 1996. Dagmar is the head of the firm's Commercial Team and her practice is focused on franchise, sales and distribution law. She is an associated expert with the German Franchise Association and a frequent author on various topics in franchise and distribution law. As a speaker she has presented programs for the German Franchise Institute, the International Bar Association, and the International Franchise Association. Dagmar frequently advises franchisors in connection with the internationalization of their concepts - inbound and outbound.

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Larry is a partner at the Toronto law firm of Cassels Brock & Blackwell LLP. Since 1989 he has had a practice that specializes in franchise law and providing all necessary legal services to franchisors. He is a member of the International Franchise Association, where he currently serves as Chair of its Supplier Forum Advisory Board, and on the IFA Board of Directors, and the Canadian Franchise Association, where he serves as Chair of the CFA's Legal and Legislative Committee and on the CFA Board of Directors. He is also currently Vice Chair of the International Bar Association's International Franchising Committee and the Immediate Past-Chair of the Ontario Bar Association's Franchise Law Section. Larry was the founder of, and to date has organised and chaired four Ontario Bar Association annual franchise law conferences. He is a member of the American Bar Association's Forum on Franchising, and in 2006, he was the first Canadian lawyer to be appointed Director of the ABA Forum's International Division and to a leadership role on its Governing Committee. In 2009 he had the honour of being Co-chair of the ABA's 32nd Annual Forum on Franchising conference. In 2004 he acted as co-

editor of the ABA Forum on Franchising's book entitled ***Fundamentals of Franchising-Canada***. As well he was co-editor and co-author of the Canadian Franchise Association's first and still only official book publication entitled, ***How To Franchise Your Business***. He is a co-author of the chapter on Canada for the ABA Forum's book entitled ***International Franchise Sales Laws***. In 2004, 2005, and each year from 2009 to 2016 Larry was named by Franchise Times to their "Legal Eagles" list of the top franchise lawyers in the United States and Canada. He and Cassels Brock are each listed in the *Lexpert*® Canadian legal directory as being among the leaders in Canada in franchise law. In 2014, 2015 and 2016 Larry received Who's Who Legal's one and only worldwide Lawyer of the Year award for Franchise law, and in 2014, the *Lexpert*® Zenith Award. Larry was called to the Bar of the Province of Ontario in 1989.

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Jeff Brimer is the Chief Operating Office of Alexius, LLC, a managed legal services company based in Denver, Colorado USA. He was formerly with Faegre Baker Daniels LLP and Snell & Wilmer, LLP and was Vice President and General Counsel of Medicine Shoppe International, Inc. Jeff is a graduate of the University of Missouri-St. Louis and the University of Missouri-Columbia School of Law. He is a member of the American Bar Association, the Colorado and Missouri Bars and the International Bar Association. He also holds a Certified Franchise Executive designation from the International Franchise Association. He is a past member of the Governing Committee of the ABA Forum on Franchising; and, is a member of the International Franchise Association Legal-Legislative Committee; an Officer and Newsletter Co-Editor of the International Franchising Committee of the International Bar Association; and, a member of the International Chamber of Commerce Franchise Task Force. Jeff has written and spoken on a wide variety of franchise topics for the ABA Forum on Franchising, the International Franchise Association, the International Bar Association and at other franchise events. Jeff has been recognized for his expertise in franchising by The International Who's Who of Franchise Lawyers, Franchise Times "Legal Eagles," Chambers USA and Chamber's Global: America's Leading Lawyers for Franchising, Best Lawyers in America and Super Lawyers.