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Joint Employer/Vicarious Liability Practical Applications in Enforcing System Standards Without Exercising Too Much Control

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Practical Applications in Joint Employer Liability

I. Introduction

Franchising is facing external forces that threaten the franchise business model in several fundamental respects. These forces include the National Labor Relations Board's ("NLRB") efforts to deem franchisors joint employers of franchisees' employees, an increasing number of vicarious liability related lawsuits and other recent developments.

Franchisors and franchisees have vested and aligned interests in confronting these external forces. These forces also present opportunities for franchisors to reinforce and balance the roles and responsibilities of the franchisor, franchisee and system as a whole.

Franchisors rightly impose requirements and brand standards to assure uniformity in the franchise system and protect their trademarks. Those fundamental requirements should not be twisted by regulators or courts to impose liability on the franchisor for wrongdoing by the franchisee or the franchisee's employees.

This paper will focus on best practices of how to cope with the uncertain business and regulatory environments resulting from myriad joint employer and vicarious liability developments. In particular, we explore how a franchisor may craft its franchise agreement to address these issues and at the same time effectively implement and enforce brand standards, including training and communications, without incurring joint employer liability. We also consider ways a franchisor may approach training, field support, and employment related matters like the new overtime rules and minimum wage and hour compliance.

II. Legal Standards for Joint Employer Liability

Two questions often are raised in "joint employment" cases involving franchisors and franchisees: (1) is the putative employee actually an employee of either the franchisee or the franchisor and (2) even if the franchisor is not the employee's employer under standard employment tests, can it be liable under a theory of ostensible agency. Additionally, in certain circumstances involving service-based franchise systems, such as yard maintenance or janitorial services, cases have involved the question of whether a franchisee is an independent contractor or an employee of the franchisor. Although these three questions are related, these are distinct legal concepts, and they vary depending on whether the claims arise out of a federal or state law. The legal standards and scope of these concepts are outlined below.

A. Joint Employer Test

Joint employment claims can arise in almost any employment-related lawsuit brought by (or on behalf of) employees of a franchisee against not only the franchisee, but also the franchisor. These commonly range from wage and hour class actions to employment discrimination and harassment claims to NLRB collective bargaining claims.

Generally, and until very recently, a franchisor's liability in these cases turned on whether the franchisor controlled the hiring, firing, or supervision of the franchisee's employee, or whether the franchisor controlled the employment practices at issue. For example, in *Orozco v. Plackis*, the U.S. Court of Appeals for the Fifth Circuit held the franchisor was not the joint employer of its franchisee's employee.¹ The court applied the economic reality test, and held the franchisor was not the employee's joint employer because the franchisor did not (1) possess "the power to hire and fire the employees," (2) "supervise[] and control[] employee work schedules or conditions of employment," (3) determine "the rate and method of payment," or (4) maintain "employment records."²

Recently, however, both the NLRB and U.S. Department of Labor have come out with revised standards for determining joint employment, which are discussed below. These standards, together with the NLRB's actions against McDonald's, have resulted in uncertainty about what controls may impact a franchisor's ability to avoid being found a joint employer. This uncertainty is compounded by recently enacted laws in individual states that are changing the tests for who may be considered a joint employer.

On the one hand, several states have passed laws expressly exempting (or limiting) the franchisor-franchisee relationship from joint employer liability.³ On the other, some states are expanding the potential bases for such liability. In 2015, for example, California enacted Labor Code section 2810.3(b), which imposes liability on a "client employer" for the payment of wages and provision of workers' compensation coverage for workers supplied by a "labor contractor" to the client employer.⁴ Although there are no reported decisions applying this law in the franchise context, the authors of this

¹ 757 F.3d 445.

² *Id.* at 448; see also *Courtland v. GCEP-Surprise, LLC*, No. CV-12-00349-PHX-GMS, 2013 WL 3894981, at *4 (D. Ariz. July 29, 2013) (applying economic reality test, holding franchisor was not joint employer because "it did not have the right to hire, supervise and fire employees," it "did not train non-managerial staff," and it "did not provide assistance with respect to HR issues").

³ Ga. Code Ann. § 34-1-9 (2016); Ind. Code § 23-2-2.5-0.5 (2016); La. Stat. Ann. § 23:921 (2015); Mich. Comp. Laws § 418.120 (2016); Okla. Stat. tit. 59 § 6005 (2016); Tenn. Code Ann. § 50-1-208 (2015); Tex. Labor Code Ann. §§ 21.0022, 61.0031, 62.006, 201.021, 401.014, 411.005 (West 2015); Utah Code Ann. §§ 31A-40-212, 34-20-14, 34-28-2, 34-40-102, 34A-2-103, 34A-5-102, 34A-6-103, 34A-4-203 (West 2016); Wis. Stat. §§ 102.04, 104.015, 108.065, 109.015, 111.3205 (2016); Wyo. Stat. 27-1-116 (2017).

⁴ Cal. Lab. Code § 2810.3(b).

article are aware of at least one franchisee employee plaintiff in California asserting it as a basis for imposing wage and hour liability on a franchisor.

1. Common Law Joint Employment Tests

In general, the common law test for whether an individual is an employee of joint employers asks (1) whether the “individual renders services to at least one of the employers” and (2) whether “that employer and the other joint employers each control or supervise such rendering of services.”⁵ That test applies to any potential joint employers, including franchisors, and regardless of whether the case is one for discrimination or harassment or for wage and hour claims.

A noteworthy example of the application of this test in the franchise context arose in California in *Patterson v. Domino’s Pizza, LLC*, a case in which a Domino’s Pizza franchisee’s employee sued Domino’s, along with the franchisee and another employee for sexual harassment.⁶ In that case, the Supreme Court of California held that “potential liability” as a joint employer “requires that the franchisor exhibit the traditionally understood characteristics of an ‘employer’ or ‘principal;’ i.e., it has retained or assumed a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee’s employees.”⁷ Based on this test, the court held that Domino’s was not liable as a joint employer. The franchise agreement provided that “there was no principal-agent relationship between Domino’s” and the franchisee, that “no employment or agency relationship existed” between Domino’s and the franchisee’s employees, and that Domino’s had no right to direct the franchisee’s employees in store operations or “to establish a sexual harassment policy or training program” for the employees.⁸ Additionally, in practice, the franchisee “exercised sole control over selecting the individuals who worked in his store,” and was in control “*with respect to training employees on how to treat each other at work, and how to avoid sexual harassment.*”⁹ These facts, underlying not only the contractual relationship between franchisor and franchisee, but also the practical relationship between the two, were key to the court’s decision in *Patterson*, and are critical in any joint employment case.

In contrast to the decision and rationale in *Patterson*, the Attorney General for New York, Eric T. Schneiderman, sued Domino’s and three of its franchisees on May 24, 2016, for wage and hour violations, alleging that Domino’s “is a joint employer of the workers at the 10 franchise locations” subject to the suit.¹⁰ The focus of this lawsuit

⁵ Restatement of Employment Law § 1.04(b).

⁶ 60 Cal. 4th 474, 333 P.3d 723 (Cal. 2014).

⁷ *Id.* at 478.

⁸ *Id.* at 500-01.

⁹ *Id.* at 502 (emphasis in original).

¹⁰ Press Release, A.G. Schneiderman Announces Lawsuit Seeking To Hold Domino’s And Its Franchisees Liable For Systemic Wage Theft (May 24, 2016) (available at <https://ag.ny.gov/press-release/ag-schneiderman-announces-lawsuit-seeking-hold-dominos-and-its-franchisees-liable>).

relates to allegations that Domino’s “urged franchisees to use payroll reports from the company’s computer system (called ‘PULSE’), even though Domino’s knew for years that PULSE under-calculated gross wages.”¹¹

The Attorney General alleges that Domino’s was a joint employer because it exerted control over its franchisees’ employees in a number of ways: (1) directing discipline of specific employees; (2) dictating requirements for scheduling employees, as well as store hours and staffing; (3) imposing requirements for employee appearance and uniforms; (4) enforcing requirements through inspections by field coaches, one of whom told a franchisee’s employees “I’m the boss;” (5) pushing an anti-union policy on franchisees; and (6) requiring franchisees to keep prior staff in place when a franchisee purchased a company store.¹² In New York, the question of whether an entity like Domino’s is a joint employer under the Labor Law is determined using the Federal Court test for cases arising under the Fair Labor Standards Act (“FLSA”).¹³ That test considers numerous factors concerning the “economic realities” of the relationship between the parties in determining whether an entity is a joint employer.¹⁴ This case still is in its nascent stages, and it remains to be seen whether New York courts applying this test will agree with the Supreme Court of California’s conclusions in *Patterson*. By March 2017, the Attorney General had settled all of the claims he asserted against the individual franchisees, leaving Domino’s as the only defendant. A hearing on the Attorney General’s claims against Domino’s commenced on April 12, 2017.

2. “Single Employer” Test

In cases arising under Title VII of the 1964 Civil Rights Act,¹⁵ a number of courts have considered a different test known as the “single employer” test. Under the “single employer” test, a court examines four factors to determine if an entity can be held liable for the actions of another: “(1) interrelation of operations, i.e., common offices, common record keeping, shared bank accounts and equipment; (2) common management, common directors and boards; (3) centralized control of labor relations and personnel; and (4) common ownership and financial control.”¹⁶ The presence of any one of these factors is not conclusive, nor do all four criteria need to be present to find two entities operated as a “single employer,” and “even when no evidence of common control of labor relations policy is presented, the circumstances may be such that the Title VII

¹¹ *Id.*

¹² *Id.*

¹³ *Olvera v. Bareburger Grp. LLC*, 73 F. Supp. 3d 201, 206 (S.D.N.Y. 2014) (“Courts in this District have regularly applied the same tests to determine, under the FLSA and NYLL, whether entities were joint employers.”).

¹⁴ The “economic realities” test is described in greater detail below.

¹⁵ 42 U.S.C. § 2000e, et seq.

¹⁶ *Swallows v. Barnes & Noble Book Stores, Inc.*, 128 F.3d 990, 993–94 (6th Cir. 1997).

single-employer doctrine is applicable."¹⁷ The critical question, however, is which entity made final decisions regarding the employee claiming discrimination.¹⁸

This test is commonly used in Title VII, including those involving franchise systems, because it is less stringent than others, and effects Title VII's "remedial purpose."¹⁹ Even so, when a plaintiff is unable to show that a franchisor controlled day-to-day employment decisions or made final decisions regarding employment for a franchisee, the franchisor will not be considered a single employer along with its franchisee.²⁰ For example, in a case against *Pizza Hut*, the Tenth Circuit found that Pizza Hut and a franchisee were not a "single employer," notwithstanding evidence that (1) "the policies and procedures in effect at the [franchisee's] restaurant were those of Pizza Hut," (2) a Pizza Hut employee handled the plaintiff's "EEOC complaint against both [the franchisee] and Pizza Hut and set forth 'Pizza Hut's position,'" (3) a Pizza Hut employee referred to the plaintiff as being "employed by 'the Company'" in a position letter to the EEOC, and (4) a Pizza Hut vice president was also a vice president of the franchisee.²¹ The court held that although this evidence established "some common management between the two entities," it was insufficient "to satisfy the common management requirement of the single employer test," and held that the plaintiff had failed to satisfy her burden of proving Pizza Hut was her employer.²²

3. NLRB Test

Joint employment claims in the NLRB context arise when franchisees' employees claim violations of the National Labor Relations Act (the "NLRA"). The NLRA provides employees with certain rights to facilitate organization and collective bargaining.

Until recently, the joint employer standard for cases under the NLRA generally was traced back to *NLRB v. Browning-Ferris Industries of Pennsylvania, Inc.*, in which a Federal Court of Appeals held a joint employment relationship may exist when "one employer while contracting in good faith with an otherwise independent company, has retained for itself sufficient control of the terms and conditions of employment of the employees who are employed by the other employer."²³ Courts applying this standard consider three factors in determining whether a joint employer relationship exists:

- 1) Authority to hire and fire employees, promulgate work rules and assignments, and set conditions of employment, including compensation, benefits, and hours;

¹⁷ *Armbruster v. Quinn*, 711 F.2d 1332, 1337–38 (6th Cir. 1983) *abrogated on other grounds by* *Arbaugh v. Y&H Corp.*, 546 U.S. 500, 126 S. Ct. 1235, 163 L. Ed. 2d 1097 (2006).

¹⁸ *Lockard v. Pizza Hut, Inc.*, 162 F.3d 1062, 1070 (10th Cir. 1998).

¹⁹ *Id.* at 1069.

²⁰ *Id.* at 1071.

²¹ *Id.* at 1070-71.

²² *Id.* at 1071.

²³ 691 F.2d 1117, 1123 (3d Cir.1982).

2) day-to-day supervision of employees, including employee discipline; and

3) control of employee records, including payroll, insurance, taxes and the like.²⁴

No one factor is determinative, and a strong showing on one factor may offset weak showings on the other two.²⁵

i. The NLRB's new *Browning-Ferris* test

Until recently, the general consensus was that “the essential element in this analysis is whether a putative joint employer’s control over employment matters is direct and immediate.”²⁶ That standard was enforced both by the NLRB and the federal courts, which considered the following factors in analyzing questions of joint employment: whether the putative employer “(1) did the hiring and firing; (2) directly administered any disciplinary procedures; (3) maintained records of hours, handled the payroll, or provided insurance; (4) directly supervised the employees; or (5) participated in the collective bargaining process.”²⁷

That test, however, recently came under scrutiny in the NLRB’s 2015 decision in *Browning-Ferris Indus. of California, Inc.*, in which the NLRB announced a new two-part test to determine whether an entity was in fact a joint employer: (1) “whether there is a common-law employment relationship with the employees in question,” and (2) “whether the putative joint employer possesses sufficient control over employees’ essential terms and conditions of employment to permit meaningful collective bargaining.”²⁸ The NLRB made clear that, as had been advocated by the NLRB’s General Counsel, under the new test, there was no requirement that a putative employer’s control “be exercised directly and immediately. If otherwise sufficient, control exercised indirectly—such as through an intermediary— may establish joint-employer status.”²⁹ In a strongly worded dissent, Members Miscimarra and Johnson noted that among other things, this new test “threatens existing franchising arrangements.”³⁰

This new *Browning-Ferris* test, requiring only indirect control rather than direct control, has not yet been expressly followed in any court decisions and has been distinguished

²⁴ *Myers v. Garfield & Johnson Enterprises, Inc.*, 679 F. Supp. 2d 598, 607 (E.D. Pa. 2010).

²⁵ *Id.* at 608.

²⁶ *In Re Airborne Freight Co.*, 338 NLRB 597, 597 (2002) (citing *TLI, Inc.*, 271 NLRB 798 (1984), *enfd. mem.* 772 F.2d 894 (3d Cir. 1985)).

²⁷ *AT&T v. N.L.R.B.*, 67 F.3d 446, 451 (2d Cir. 1995), as clarified on reh’g (Sept. 29, 1995).

²⁸ *Browning-Ferris Indus. of California, Inc.*, 362 NLRB No. 186, at *2 (Aug. 27, 2015).

²⁹ *Id.*

³⁰ *Id.*

by at least one federal court.³¹ Additionally, whether it continues to be the prevailing authority within the NLRB during the Trump administration is an open question.³²

The decision was appealed by Browning-Ferris Industries, and oral argument was held in the D.C. Circuit Court of Appeals on March 9, 2017.³³ The judges on the appeals panel had numerous questions for the NLRB's attorney concerning the board's new definition of joint-employer and what "indirect control means," including how far the bounds of the definition go.³⁴ Whether the court will affirm the NLRB's decision and new joint-employer test, revert to the prior direct, immediate control test, or craft a different test entirely, remains to be seen. The court likely will issue a decision later this year.

ii. Freshii Advice Memo

The possible breadth of the NLRB's recent *Browning-Ferris* test is potentially curtailed per an Advice Memorandum issued by the NLRB's Office of the General Counsel, on April 28, 2015, prior to the NLRB issuing its decision in *Browning Ferris*. That Advice Memorandum addressed whether franchisor Freshii Development, LLC was a joint employer of one of its franchisee's employees.³⁵ This Advice Memorandum is important because it stated that Freshii should not be considered a joint employer under both the then-existing standard and the indirect or potential control standard proposed by the General Counsel (and subsequently adopted, in part, by the NLRB in *Browning-Ferris*).

In the Advice Memorandum, the Office of the General Counsel stated that Freshii was not a joint employer because it "played no role" in its franchisee's "decisions regarding hiring, firing, disciplining or supervising employees."³⁶ Specifically, the Advice Memorandum noted that, although Freshii provided guidance and recommendations with respect to — among other things — calculating labor costs and personnel policies, it did not require its franchisees to follow that guidance; nor did it have any involvement in increasing or decreasing its franchisee's wages or in hiring or firing employees.³⁷ The Advice Memorandum further noted that Freshii's requirements regarding "design,

³¹ See *Weis Builders, Inc. v. Int'l Union of Operating Engineers*, No. 15 C 2619, 2017 WL 497767, at *4 (N.D. Ill. Feb. 7, 2017) (describing case as "a far cry" from *Browning-Ferris Industries*, noting that, "at most," the alleged employer "had the power to indirectly pay certain operating engineers who had been designated by a subcontractor" for delivering material requested by the alleged employer to a requested location).

³² As of the publishing of this paper, two seats are open on the NLRB, and the general counsel's term is set to expire in November 2017.

³³ *Browning-Ferris Indus. v. N.L.R.B.*, No. 16-1028 (D.C. Cir.).

³⁴ Lydia Wheeler, *Appeals court wrestles with new joint-employer definition*, The Hill, March 9, 2017, <http://thehill.com/regulation/court-battles/323222-appeals-court-wrestles-with-new-joint-employer-definition>.

³⁵ Barry J. Kearney, Associate General Counsel, *Advice Memorandum re Nutritionality, Inc. d/b/a Freshii*, Cases 13-CA-134294, 13-CA-138293, and 13-CA-142297 (April 28, 2015).

³⁶ *Id.* at 6.

³⁷ *Id.* at 6-7.

decoration and décor of its franchisee’s restaurants,” “recipes and décor elements,” and “uniforms, initial training of employees, and store hours” were “not evidence of control over” its franchisee’s “labor relations but rather establish Freshii’s legitimate interest in protecting the quality of its product and brand.”³⁸ The Advice Memorandum noted these were not sufficient to establish liability under the old standard, as well as the General Counsel’s proposed standard because, under “the totality of the circumstances,” it was clear that “Freshii does not significantly influence the working conditions” of its franchisee’s employees.³⁹

iii. McDonald’s and the future

On December 19, 2014, NLRB General Counsel, Richard Griffin, Jr., issued complaints against McDonald’s Corp. and certain of its franchisees, asserting that McDonald’s was a joint employer of those franchisees’ employees and was liable for violations of the NLRA. Trial began in the proceedings in March 2016 and proceedings presently are continuing. These proceedings were commenced prior to the NLRB’s decision in *Browning-Ferris*, but obviously will be heavily influenced by that decision and the D.C. Circuit’s forthcoming decision on appeal. As with everything else involving the NLRB, there also are questions about what, if anything, will change under the Trump administration.

At this point in time, however, no courts have applied the NLRB’s new standard for determining whether an entity is a joint employer. Until that happens, it remains to be seen whether this new standard will be deemed to conflict with existing law, whether the NLRB will reconsider it, whether courts will work around it, or whether it will become the new normal. In the meantime, in December 2015, the President and CEO of the International Franchise Association sent a letter to Congress urging that it include a provision in legislation that would effectively reverse the NLRB’s *Browning-Ferris* decision.⁴⁰

4. Department of Labor Test

Joint employment claims under the FLSA arise when a franchisee’s employees claim violations of federally mandated minimum wages, overtime pay, and child labor standards.

The primary test for determining whether an entity is an employer under the FLSA is the economic reality test. The FLSA defines “employ” as “to suffer or permit to work.”⁴¹ Courts in turn have held that “[a]n entity ‘suffers or permits’ an individual to work if, as a matter of ‘economic reality,’ the entity functions as the individual’s employer,” and have

³⁸ *Id.* at 8.

³⁹ *Id.* at 9.

⁴⁰ Letter from Robert C. Cresanti, President and CEO of the International Franchise Association, to Members of Congress (Dec. 3, 2015), *available at* <http://www.franchise.org/sites>.

⁴¹ 29 U.S.C. § 203.

identified at least six factors that may be considered in applying the economic reality test.⁴²

The Second Circuit, for example, has identified the following six factors to be considered:

- (1) whether [defendant's] premises and equipment were used for the plaintiffs' work;
- (2) whether the . . . business . . . could or did shift as a unit from one putative joint employer to another;
- (3) the extent to which plaintiffs performed a discrete line-job that was integral to defendant's process of production;
- (4) whether responsibility under the contracts could pass from one subcontractor to another without material changes;
- (5) the degree to which the defendants or their agents supervised plaintiffs' work; and
- (6) whether plaintiffs worked exclusively or predominantly for the defendants.⁴³

On January 20, 2016, the DOL issued an Administrator's Interpretation (AI 2016-1) addressing joint employment questions arising under the FLSA. AI 2016-1 notes that the standard for joint employment under the FLSA differs from the NLRA or other labor statutes because it is not based on "the common law control test" but rather "the broader economic realities of the working relationship" test.⁴⁴ AI 2016-1 announced a new analytical framework for both "horizontal" (where an employee works for both Company A and Company B, but the two companies are distinct economic units) and "vertical" (more applicable to franchising; where Company A and Company B are not related and do not hire the same employee, but agree that Company B's employee will perform services benefiting Company A) joint employment.

⁴² *Zheng v. Liberty Apparel Co. Inc.*, 355 F.3d 61, 66 (2d Cir. 2003).

⁴³ *Id.* at 71-72 (joint employer case, but adapting test from employee misclassification case: *Rutherford Food Corp. v. McComb*, 331 U.S. 722 (1947)); see also *Martin v. Selker Bros.*, 949 F.2d 1286, 1293 (3d Cir. 1991) (applying similar factors). Previously, the Second Circuit applied a different set of factors in the joint employer context: "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." *Herman v. RSR Sec. Servs. Ltd.*, 172 F.3d 132, 139 (2d Cir. 1999). The holding in *Herman* was expressly modified by *Zheng*, but the test continues to be used in other courts. See, e.g., *Moldenhauer v. Tazewell-Pekin Consol. Commc'ns Ctr.*, 536 F.3d 640, 644 (7th Cir. 2008).

⁴⁴ AI 2016-1 at 4.

The first question the DOL asks in a vertical joint employment case “is whether the intermediary employer . . . is actually an *employee* of the potential joint employer.”⁴⁵ If so, “then all of the intermediary employer’s employees are employees of the potential joint employer too,” and the analysis is over.⁴⁶ If not, then the analysis examines the “economic realities” of the relationship between the employee and the potential joint employer along the following lines:⁴⁷

- Does the potential joint employer direct, control, or supervise the work performed “beyond a reasonable degree of contract performance oversight;”
- Does the control influence decisions to “hire or fire the employee, modify employment conditions, or determine the rate or method of pay;”
- Does the employee have “[a]n indefinite, permanent, full-time, or long-term relationship” with the potential joint employer;
- Is “the employee’s work for the potential joint employer” rote, relatively unskilled, or requiring little or no training;
- Is “the employee’s work . . . an integral part of the potential joint employer’s business;”
- Does the employee perform “work on premises owned or controlled by the potential joint employer;”
- Does the potential joint employer perform administrative functions for the employee, “such as handling payroll, providing workers’ compensation insurance, providing necessary facilities and safety equipment, housing, or transportation, or providing tools and materials required for the work.”⁴⁸

To the extent the answer to any of these questions is “yes,” that supports a finding that the potential joint employer is an actual joint employer. This new test has been acknowledged by at least one court, but has not yet been specifically applied in any reported case.⁴⁹

B. Ostensible Agency

A secondary issue that arises in numerous cases is whether a franchisor—although not liable as a joint employer—may be held liable on a theory of “ostensible agency.” In ostensible agency cases, the franchisee is not a true agent of a franchisor at all, but a plaintiff employee reasonably believes that it is, and is permitted to hold the franchisor

⁴⁵ *Id.* at 10.

⁴⁶ *Id.*

⁴⁷ The “economic realities” test is described in greater detail below.

⁴⁸ *Id.* at 11-12.

⁴⁹ See *Jackson v. Fed. Nat’l Mortg. Ass’n*, 181 F. Supp. 3d 1044, 1054 (N.D. Ga. 2016).

liable as though there were an actual agency relationship between the franchisor and the franchisee.

An early case considering ostensible agency in the franchise context arose in California in *Kaplan v. Coldwell Banker Residential Associates*, a case in which the plaintiff sued his real estate agent, a Coldwell Banker franchisee, as well as Coldwell Banker itself, for issues arising out of a real estate purchase.⁵⁰ “Coldwell Banker was named as a defendant on a respondeat superior theory” based on the plaintiff’s allegations that he “placed great faith and trust in said defendants, and each of them, particularly because ... [the real estate agent] was part of the Coldwell Banker organization which had an established reputation for honesty, integrity and expertise.”⁵¹ The court rejected plaintiff’s claim that Coldwell Banker should be liable on a “true agency” theory,⁵² but held that factual questions remained for trial on “ostensible agency.” As noted by the *Coldwell Banker* court, the test for ostensible agency involves three requirements:

The person dealing with the agent must do so with belief in the agent’s authority and this belief must be a reasonable one; such belief must be generated by some act or neglect of the principal sought to be charged; and the third person in relying on the agent’s apparent authority must not be guilty of negligence.⁵³

Based on this standard, the court noted that Coldwell Banker had made “representations to the public in general, upon which appellant relied,” and it remained for the trier of fact to determine whether that reliance was reasonable or not.⁵⁴

More recently, theories of joint liability based on ostensible agency have had some traction in a pair of cases against McDonald’s in the Northern District of California: *Ochoa v. McDonald’s Corp.* and *Salazar v. McDonald’s Corp.*⁵⁵ In both cases, the courts rejected claims by the plaintiffs that McDonald’s was their joint employer based on the definition of “employer” in the California Labor Code, and granted summary judgment dismissing claims based on the statutory tests.⁵⁶ Notwithstanding these

⁵⁰ *Kaplan v. Coldwell Banker Residential Associates, Inc.*, 59 Cal. App. 4th 741, 69 Cal. Rptr. 2d 640 (1997).

⁵¹ *Id.* at 744.

⁵² *Id.* at 746. (“Absent a showing that Coldwell Banker controlled or had the right to control the day-to-day operations of [the real estate agent’s] office, it was not liable for [its] acts or omissions as a real estate broker on a true agency-respondeat superior theory.”).

⁵³ *Id.* at 747.

⁵⁴ *Id.* at 747-48.

⁵⁵ *Ochoa v. McDonald’s Corp.*, 133 F. Supp. 3d 1228 (N.D. Cal. 2015) (*Ochoa I*); *Salazar v. McDonald’s Corp.*, No. 14-cv-02096-RS(MEJ), 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016) (*Salazar I*).

⁵⁶ *Ochoa I*, 133 F. Supp. 3d at 1233-39 (considering following tests: “(1) to exercise control over wages, hours or working conditions, (2) to suffer or permit to work, or (3) to

decisions, the courts held plaintiffs' claims could proceed past summary judgment on theories of ostensible agency. Based on unrebutted declarations from plaintiffs "stating that they believed McDonald's was their employer, in part because they wear McDonald's uniforms, serve McDonald's food in McDonald's packaging, receive paystubs and orientation materials marked with McDonald's name and logo," and applied for jobs "through McDonald's website," the court held there was evidence "from which a jury could reasonably conclude" that McDonald's shared an ostensible agency relationship with its franchisee.⁵⁷

The ultimate impact of these decisions is mixed. In subsequent proceedings in *Ochoa*, the court certified a class of "all current and former employees at the [franchisee's] restaurants who worked as crew, crew trainers, or maintenance workers . . . and were paid on an hourly basis from four years before the complaint to final judgment or settlement."⁵⁸ Critical to its decision allowing class certification was the court's finding that the plaintiffs "tendered substantial and largely undisputed evidence that the putative class was exposed to conduct in common that would make proof of ostensible agency practical and fair on a class basis," including that they were "required to wear McDonald's uniforms, packaged food in McDonald's boxes, received paystubs, orientation materials, shift schedules and time punch reports all marked with McDonald's name and logo, and in most cases applied for a job through a McDonald's website."⁵⁹ The court also found informative "[t]he fact that each employee spent every work day in a restaurant heavily branded with McDonald's trademarks and name."⁶⁰ Three months after this decision, McDonald's settled with the class (of 800 employees) for \$3.75 million, including \$2 million in attorneys' fees.⁶¹

In *Salazar*, on the other hand, the court granted McDonald's motion to deny class certification on plaintiffs' ostensible agency claims.⁶² The court expressly distinguished the case from *Ochoa* based on the fact that in *Ochoa*, but not in *Salazar*, there was no evidence "at all" that indicated "any named plaintiff or putative class member did not believe McDonald's was their employer."⁶³ In *Salazar*, McDonald's presented evidence

engage, thereby creating a common law employment relationship"); see also *Salazar I*, 2016 WL 4394165, at *3-12.

⁵⁷ *Ochoa I*, 133 F. Supp. 3d at 1239-40; see also *Salazar I*, 2016 WL 4394165, at *12-13.

⁵⁸ *Ochoa v. McDonald's Corp.*, No. 3:14-CV-02098-JD, 2016 WL 3648550, at *1 (N.D. Cal. July 7, 2016) (*Ochoa II*). The class was certified for miscalculated wages claims, overtime claims, and maintenance of uniform claims, but not meal period and rest break claims or wage statement claims. *Id.* at *4-8.

⁵⁹ *Id.* at *3.

⁶⁰ *Id.*

⁶¹ Daniel Wiessner, Reuters, McDonald's to pay \$3.75 million in first settlement with franchise workers (Oct 31, 2016, 11:04am EDT) (available at <http://www.reuters.com/article/us-mcdonalds-settlement-idUSKBN12V1NJ>).

⁶² *Salazar v. McDonald's Corp.*, No. 14-cv-02096-RS(MEJ), 2017 WL 88999 (N.D. Cal. Jan. 5, 2017) (*Salazar II*).

⁶³ *Id.* at *6.

that “crew members did not receive the same orientation materials” or “job training,” they received “different information regarding the agency relationship,” and some class members even understood “that McDonald’s does not employ them.”⁶⁴ Subsequently, on March 10, 2017, on a renewed motion for summary judgment, the court dismissed the ostensible agency claim against McDonald’s.⁶⁵ The court rejected the plaintiffs’ argument that McDonald’s could be a joint employer based on ostensible agency because the relevant statutory definition of “employer” included the phrase “through an agent.”⁶⁶ The court held that the test for whether McDonald’s was an employer applied regardless of whether the employment relationship was direct or through alleged agents (ostensible or otherwise), and that because the definition of “employer” conflicted with general provisions of California law codifying ostensible agency, the specific wage order definitions took precedence.⁶⁷

C. Employee Misclassification Tests

Closely related to the question of whether an entity is a joint employer is the question of whether an individual is an independent contractor or an employee. With respect to franchising, this issue arises most frequently in cases involving service franchise systems, like janitorial, painting, or landscaping businesses. In general, there are two different tests that are used to determine whether an individual is an employee or independent contractor: (1) a common law test that looks to whether a potential employer has “the right to control” a worker’s actions, and (2) a statutory test, known as the “ABC Test,” which adds to the common law test two additional elements that a potential employer must satisfy to show that it actually is not an employer. These tests are explained in greater detail below.

1. Common Law Test

As with the test for determining whether an entity is an employer, the traditional “common law” test for determining whether an individual is an employee or an independent contractor is based on whether the putative employer has the “right to control” the worker’s actions. This test is utilized in numerous states as well as in the District of Columbia.⁶⁸ Although the common law test varies slightly from state to state (and seemingly case to case), its common elements include: (1) whether the worker has the right to control work details and has control over the manner and means by which the job is performed, including the right to perform the work at a time and place of the worker’s choosing and the right to hire a substitute without the employing unit’s knowledge or consent; (2) the worker’s opportunity for profit or loss depending on his or her managerial skill; (3) the worker’s investment in equipment or materials, or

⁶⁴ *Id.* at *3-4.

⁶⁵ *Salazar v. McDonald's Corp.*, No. 14-CV-02096-RS, 2017 WL 950986 (N.D. Cal. Mar. 10, 2017) (*Salazar III*).

⁶⁶ *Id.* at *2.

⁶⁷ *Id.* at *3.

⁶⁸ See http://www.workerclassification.com/classification-tests#State_Tests (last visited April 20, 2017) (collecting and summarizing state employee misclassification tests).

employment of helpers; (4) whether the service rendered requires a special skill; (5) the permanence of the working relationship; (6) whether the service rendered is an integral part of the employer's business; (7) whether the worker's services are available to the general public on a continuing basis; (8) whether the worker is paid on a job basis and is responsible for all incidental expenses; and (9) how the parties view the relationship.⁶⁹ This test is utilized in Title VII employment discrimination cases, ERISA cases, NLRB enforcement actions, cases under the Uniform Services Employment and Re-Employment Act, and many state employment laws.⁷⁰

There is a split in the courts applying this test as to whether exercising such controls over workers is required or whether merely having the "right" to control workers is sufficient to hold a company liable as an employer.⁷¹

The IRS also follows the common law "right to control" test, but applies its own 20-factor test to evaluate the "right to control." The factors the IRS has considered are: (1) level of instruction; (2) amount of training; (3) degree of business integration; (4) extent of personal services; (5) continuity of relationship; (6) flexibility of schedule; (7) demands for full-time work; (8) need for on-site services; (9) sequence of work; (10) requirements for reports; (11) method of payment; (12) payment of business or travel expenses. (13) provision of tools and materials; (14) investment in facilities; (15) realization of profit or loss; (16) work for multiple companies; (17) control of assistants; (18) availability to public; (19) control over discharge; and (20) right of termination.⁷² Today, the IRS focuses on three primary concepts: (i) behavioral – whether the company controls or has the right to control what the worker does and how the worker does his or her job; (ii) financial – whether the business aspects of the worker's job are controlled by the payer (i.e., how worker is paid, whether expenses are reimbursed, who provides tools/supplies, etc.); and (iii) type of relationship – whether there are written contracts or employee type benefits (i.e. pension plan, insurance, vacation pay, etc.), whether the relationship will continue and whether the work performed is a key aspect of the business.⁷³

⁶⁹ See generally *Restatement (Second) of Agency* § 220(2).

⁷⁰ David J. Kaufman, et al., *A Franchisor is Not the Employer of Its Franchisees or Their Employees*, 34 *Franchise L.J.* 439, 471 (2015). This article presents an in-depth analysis of the various legal pressure points associated with the myriad joint employer related legal theories and claims.

⁷¹ *Compare FedEx Home Delivery v. NLRB*, 563 F.3d 492 (D.C. Cir. 2009) (control lacking when putative employee's "position presents the opportunities and risks inherent in entrepreneurialism") with *In re Fedex Ground Package Sys., Inc., Employment Practices Litig.*, 74 *Fed. R. Serv.* 1079 (N.D. Ind. 2007) (rejecting argument that contractual right to control, if not in fact exercised, was insufficient to establish the "right to control" necessary to support an employment relationship).

⁷² Rev. Rul. 87-41, 1987-1 C.B. 296.

⁷³ IRS Pub. 1779.

2. ABC Test

Another test used in numerous states—particularly in the context of unemployment statutes—is the “ABC” test.⁷⁴ Under the ABC test, in order to avoid being deemed an employer, the putative employer must show that the individual’s services are performed (a) free from control or direction of the putative employer; (b) outside of the usual course of business, or outside of all the places of business, of the putative employer; and (c) as part of an independently established trade, occupation, profession, or business of the worker.⁷⁵ If a putative employer fails to establish any one of the three prongs of the test, the services in question will constitute employment within the meaning of the applicable statute. The first prong essentially is the same as the common law test, while prongs B and C are additions to that test.

Massachusetts, notably, has a different and stricter version of the ABC test that also applies beyond the context of unemployment. Specifically, rather than applying to services provided “outside the usual course of the business . . . or . . . **outside of all the places of business of the enterprise**,”⁷⁶ prong “B” of the test in Massachusetts is limited to services “performed outside the usual course of business of the employer.”⁷⁷

III. The Practical Approach to Joint Employment Risk

Having described the uncertainties arising from these joint employer developments, the balance of this paper focuses on how a franchisor can do what it needs to do in order to fulfill its role as a franchisor and grow, protect and evolve its franchise system and brand, including its right and obligation to protect its trademarks. We identify best practices that a franchisor can consider regarding how it conducts its training programs and field support, as well as how to address these joint employment issues in its franchise agreement and operations manual.

A. The Operations Manual

To minimize joint employment risk, franchisors should treat their operations manual with the same level of legal care as other documents crucial to forming the franchise relationship, such as the franchise agreement. The franchisor’s operations manual should appropriately balance the roles and responsibilities of the franchisor and franchisee. The franchisor’s role is to protect, grow, and evolve its brand and system. The franchisee is responsible for the day-to-day operation of the franchised business.

⁷⁴ See *supra* n. 69.

⁷⁵ See, e.g., 820 Ill. Comp. Stat. Ann. 405/212.

⁷⁶ *Id.* (emphasis added).

⁷⁷ See Mass. Gen. Laws ch. 149, § 148B (limiting B prong of test to services “performed outside the usual course of the business of the employer”). That prong recently was ruled to have been preempted by the Federal Aviation Administration Authorization Act in the context of same-day delivery; it is unclear what impact that decision will have outside of that specific context. See *Massachusetts Delivery Ass’n v. Healey*, 821 F.3d 187 (1st Cir. 2016).

The operations manual reinforces the nature and scope of controls, but it should also distinguish between required brand standards, on the one hand, and the recommendations, guidelines and best practices to achieve such standards, on the other hand.

Franchisors should constantly evaluate whether system requirements currently in place or capable of being imposed on franchisees are truly necessary to protect, grow and evolve the franchisor's brand or whether they are merely a suggestion of one approach that meets a required brand standard. It is important to understand the difference between appropriately mandating brand standards versus unnecessarily mandating the manner and means of meeting the standards. It is often more appropriate to identify guidelines, recommendations or best practices to meet the standards. For example, one brand standard in every franchise relationship is the requirement that franchise owners adhere to all laws related to the operation of the business. However, franchisors may not always establish specific "steps" or "controls" that an owner must take to meet this brand standard. Rather, franchisors can identify a number of recommendations and suggested practices concerning compliance with laws, including a recommendation that the franchisee contact their own lawyer to make sure they understand and comply with all laws applicable to the franchised business.

Of course, a franchisor's operations manual may detail the franchise operating system designed to protect the brand and maintain a uniform customer experience.⁷⁸ If the franchisor harbors any doubt as to whether a section of its operations manual relates to appropriate brand protection, a best practice is for the operations manual language to be expressed in terms of recommendations, optional guidelines, and non-mandatory tools.⁷⁹ Recent court decisions suggest that franchisors might even provide recommendations or optional guidelines in their operations manual on topics such as

⁷⁸ See *Uninsured Employers' Fund v. Crowder*, No. 2015-SC-000362-WC, 2016 WL 2605624 (Ky. May 5, 2016) ("While the franchise agreement and operating manual do provide detailed instructions on how to manage the restaurants on a day-to-day basis, these guidelines were instituted to protect the brand which QFA sold"); *Brunner v. Liautaud*, 2015 U.S. Dist. LEXIS 46018 (N.D. Ill. Apr. 8, 2015) ("A franchisor, which may have thousands of stores located throughout the country, often imposes comprehensive and meticulous standards to protect its brand and operate the franchises in a uniform way in order to maintain a consistent customer experience"); (*Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474, 497 (Cal. 2014) ("a comprehensive operating system alone" cannot impose vicarious liability on the franchisor for the wrongful conduct of the franchisee's employees); *Courtland v. GCEP-Surprise, LLC*, 2013 U.S. Dist. LEXIS 105780 (D. Ariz. July 29, 2013) ("The fact that BWWI maintained strict guidelines as to the presentation and operation of the Restaurant does not establish, without more, that BWWI had control over the Restaurant's managerial staff.").

⁷⁹ See *Pope v. Espeseth, Inc.*, 2017 U.S. Dist. LEXIS 4928 (W.D. Wis. Jan. 11, 2017) (holding that franchisor was not joint employer upon finding that "the critical issue here is that [the franchisee] did not have to follow the manual as drafted by [the franchisor].")

effective staffing and planning,⁸⁰ the hiring process,⁸¹ training,⁸² people management,⁸³ and when the franchisee's employees report into their franchise owner.⁸⁴ Franchisors certainly take significant risks if they include any of the above-referenced topics in the operations manual without clear admonitions that the franchisee is not required to use or follow the particular guidelines or tools.

An example of how language in the operations manual can protect a franchisor on joint employment claims is *Pope v. Espeseth, Inc.*, where a joint employment claim was filed against the franchisor Fish Window Cleaning. The court's decision in favor of Fish Window Cleaning turned in-part on this language in an operations manual: "all personnel-related documents and recommendations that Fish Window Cleaning provides . . . are optional and should be modified and customized as the franchisee deems appropriate to suit the individual franchisee's window cleaning business; and that franchisees should review all sample documents Fish Window Cleaning provides and make modifications to suit their own business needs."⁸⁵ Another good example is *Salazar v. McDonald's Corp.*, where the court found persuasive that the "People" section of the operations manual stated: "Franchisees are independent employers who make their own decisions and policies regarding employment-related matters pertaining to their employees. Franchisees may choose to use part, all, or none of the contents in these materials that will be helpful to them in operating their own McDonald's restaurants."

Numerous disclaimers by the franchisor in the operations manual may be appropriate. For example, the operations manual may inform the franchisee that the franchisee alone is responsible for following the system, the day-to-day operations of the franchised business, and all employment-related matters related to the operation of the franchised business; that the operations manual includes recommendations or suggested practices related to various operational aspects of the business; that the franchisor will specifically identify any instances where an item in the operations manual is a required standard to protect the franchise system, trademarks, and brand; that the franchisee has certain discretion to modify and customize the manual contents to suit

⁸⁰ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (handbook with guidelines for "effective staffing and planning" was optional).

⁸¹ *Id.* (handbook titled "Consistent Hiring Process Guidelines" was optional tool).

⁸² *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (training section of operations manual explained to franchisee that it was optional)

⁸³ *Id.* ("People" Section of operations manual explained to franchisee that was optional)

⁸⁴ *Pope v. Espeseth, Inc.*, 2017 U.S. Dist. LEXIS 4928 (W.D. Wis. Jan. 11, 2017) (Franchisor provided the franchisee with an optional operations manual that said employees should report to franchisee management at 7:00 a.m. every day of the training period and on Mondays, Wednesdays, and Fridays thereafter. However, the franchisee was free to adapt and modify the manual as he wished.)

⁸⁵ *Pope v. Espeseth, Inc.*, 2017 U.S. Dist. LEXIS 4928, at 12-13 (W.D. Wis. Jan. 11, 2017)

the franchisee's specific business needs; and that franchisees should consult their own legal counsel regarding compliance with laws, including employment and labor laws.

If a franchise system includes company-owned locations in addition to those run by franchisees, the franchisor should be careful not to provide identical operations manuals to both franchisees and company-owned locations.⁸⁶ Of course, unlike the manuals for the franchisee locations, any manual for company-owned locations may include requirements regarding employment as well as specific steps for the location to meet brand standards.

B. Training

Franchisors, their field support staff, and their franchisees should recognize that different approaches may be required in the joint employment context in connection with the training of the franchise owner, the franchise owner's managerial employees, and the franchise owner's non-managerial employees. Franchisor's field support staff members must know when their passion for helping franchisees could be distorted into excessive control of the franchisees. Franchisees must understand that they alone are ultimately responsible for training their employees, although there may be exceptions for a limited number of designated managerial employees. To minimize the risk upfront, the best practice is for the franchise agreement and operations manual to reiterate that any particular training standard is not intended to exercise control over the franchisee or the franchisee's employees and that the franchisee alone is responsible for such control over its employees.

For practical and obvious reasons, franchisors train the franchise owners.⁸⁷ Joint employment liability is unlikely to attach as a result of training of the franchise owner.⁸⁸ Indeed, a franchise owner's initial training is a good opportunity for the franchisor to reinforce the appropriate roles and responsibilities of the franchisor and the franchisee. The ideal approach would be for the franchisor to limit training to the franchise owners, who, in turn, determine and implement how their employees would be trained.⁸⁹ Still, franchisors incur joint employment liability risk if they impose mandatory training on their franchise owners regarding employment-related matters, although one recent decision suggests a one-time training on wage and hour issues will not necessarily invoke joint

⁸⁶ This caveat applies to any materials shared with franchisee employees, not just operations manuals.

⁸⁷ However, franchisors who train their franchisees may face allegations that their franchisees are employees of the franchisor, not independent contractors. This is a somewhat different issue from joint employment of the franchisee's employees.

⁸⁸ See *Orozco v. Plackis*, 757 F.3d 445, 451 (5th Cir. 2014) ("It is reasonable to assume that a franchisor would provide training to new franchisees and their employees.").

⁸⁹ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016).

employment liability to the franchisor.⁹⁰ As a safer alternative, a franchisor may consider providing franchise owners with optional training resources on employment matters.⁹¹

Franchisors also often require and carry out training of one or more managerial employees of the franchisee. This approach is understandable because managerial employees lead the presentation of the franchisor's brand to the consuming public. Courts have increasingly held that franchisors do not become joint employers for requiring and conducting training of a franchisee's managerial employees.⁹² To minimize the joint employment liability risk, franchisors should focus managerial training on protecting the brand, such as training on how to serve, store, and present the franchisor's trademarked products.⁹³

On the other hand, franchisor training of non-managerial employees of franchisees can support finding of both joint employer liability⁹⁴ and ostensible or

⁹⁰ *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (franchisor was not joint employer where it had consultants directly train managers on wage and hour issues, but those consultants did not participate in the decision-making process after the training was complete).

⁹¹ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer where it provided franchisee with optional training tools and nonmandatory advisory materials related to hiring, staffing, planning, and human resources).

⁹² *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer where it required at least "Certified Franchised Restaurant Manager" and provided some training to individuals in the "person-in-charge position"); *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (franchisor was not joint employer where it required every restaurant to be managed by a graduate of Hamburger University, offered an optional "Restaurant Department Managers" initiative, and had consultants directly train managers, including on wage and hour issues); *Wright v. Mt. View Lawn Care, LLC*, 2016 U.S. Dist. LEXIS 31353 (W.D. Va. Mar. 11, 2016) (franchisor was not joint employer where it required franchisee's business to be under the direct full-time supervision of someone trained by franchisor).

⁹³ *Courtland v GCEP-Surprise, LLC*, 2013 U.S. Dist. LEXIS 105780, at *3 (D. Ariz. July 29, 2013) (franchisor trained general manager, operational manager, and assistant manager about product presentation).

⁹⁴ *Ocampo v. 455 Hospitality LLC*, 2016 U.S. Dist. LEXIS 125928 (S.D.N.Y. Sept. 14, 2016) (Plaintiff stated a plausible joint employment claim against franchisor because complaint alleged that the franchisor imposed mandatory training programs for employees at the franchised hotel, which was a pre-condition for the hotel's opening, and a requirement for ongoing operations); (*Myers v Garfield & Johnson Enters*, 679 F Supp 2d 598, 600 (ED Pa 2010) (denying franchisor's motion to dismiss joint employer claim where the franchisor required the plaintiff to attend a class with instructional materials prepared by the franchisor, complete several of the franchisor's training

apparent agency liability.⁹⁵ Franchisors that insist on training non-managerial employees of their franchisees may consider a couple of limitations on such practice that may make it less risky. First, they might consider training franchisee's employees only when those individuals are new employees of a new franchisee.⁹⁶ Second, as a more risk-conscious and perhaps more realistic approach, franchisors might provide franchisees with optional training resources that the franchisee may, at the franchisee's sole discretion, pass along to its non-managerial employees.⁹⁷

In the end, the best practice from a joint employment liability perspective is to leave the training of non-managerial employees to the discretion of the franchise owner whenever possible.⁹⁸ If, however, a franchisor does conduct training for a franchisee's managerial or non-managerial employees, the franchisor should take demonstrative steps to make it very clear that the role and focus of the training is on protecting the brand and not to exercise any control over the day to day operations of the franchised business or any employment related matters. A franchisor also should have each such franchisee employee sign an acknowledgement form, prior to beginning any training, that the employee fully understands that he or she is an employee of the franchisee and not the franchisor and that nothing during or as a result of the training will change that employment relationship with the franchise owner or create any type of joint employment relationship.

modules, and take the franchisor's "readiness" test before she began non-managerial employment)

⁹⁵ *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (evidence that plaintiffs were subject to training by franchisor, interacted regularly with franchisor's consultants, received a document titled "McDonald's Store Policies," and received orientation materials with franchisor's content all supported plaintiffs' ostensible agency theory against franchisor).

⁹⁶ See *Orozco v. Plackis*, 757 F.3d 445, 451 (5th Cir. 2014) ("It is reasonable to assume that a franchisor would provide training to new franchisees and their employees.")

⁹⁷ *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (franchisor was not a joint employer where it dictated the content of orientation packets and videos); *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer where it provided franchisee with non-mandatory advisory materials related to training franchisee's employees); NLRB General Counsel's Advice Memorandum at 2-3, Case Nos. 13-CA-134294, 13-CA-138293, and 13-CA-142297, available at: <http://apps.nlr.gov/link/document.aspx/09031d4581c23996> (franchisor was not joint employer for providing sample employee handbook to franchisee).

⁹⁸ See *Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474, 502 (Cal. 2014) (franchisor was not liable for misconduct of franchisee's employee because, although franchisor provided franchisee's new employees with orientation materials, the franchisee implemented his own sexual harassment and training program for his employees).

C. Field Consultants

Franchisors' field support staff should be passionate about helping franchisees succeed and grow their businesses. But, field staff also must conduct themselves with an understanding that each franchisee is an independent contractor who has sole control over the day-to-day operations of its business, that the franchisee is not an agent of the franchisor, and that the franchisee fully appreciates that the franchisee is ultimately responsible for all aspects of its business operations. It is the franchisee who should do everything possible to be the employer of choice in the franchisee's community and focus on how to effectively hire, retain, and motivate its employees.

Franchisors can and should provide field staff with appropriate and ongoing training, guidelines and best practices to enable them to effectively fulfill the key roles they play for the system. In doing so, it is vital for the franchisor to educate its field staff so that they do not get involved in a franchisee's human resources matters. Rather than provide direct support on employment matters, field staff should be prepared to direct the franchisee to optional human resource tools, including any of the outside third party service providers who can capably assist franchisees. The field staff also should understand the difference between the training provided to a franchisee and the franchisee's obligation to train its employees. Field staff must understand when their passion for helping franchisees succeed could be distorted into excessive control of franchisees and liability for franchisor.

The routine inspections often conducted by field consultants are integral to a franchisor's ability to monitor and protect its brand and trademarks, and do not ordinarily lead to joint employer liability.⁹⁹ However, franchisors can minimize their risks if field consultants limit their communication with franchisees to brand protection matters, including marketing, general business advice, operational advice, and compliance with required contractual and brand standards.¹⁰⁰ To the extent field consultants communicate with non-managerial employees, those communications are best focused

⁹⁹ See *Vann v. Massage Envy Franchising LLC*, 2015 U.S. Dist. LEXIS 1002, at *20 (S.D. Cal. Jan. 5, 2015); *Courtland*, 2013 US Dist LEXIS 105780, at *14 (franchisor's periodic inspections did not result in joint employer liability); *Singh v. 7-Eleven, Inc.*, 2007 U.S. Dist. LEXIS 16677, at *14-15 (N.D. Cal. Mar. 7, 2007). However, plaintiffs will routinely cite inspections as evidence of control over the franchisee's employees. See *Olvera v Bareburger Group LLC*, 2014 U.S. Dist. LEXIS 94401, at *13 (S.D.N.Y. July 10, 2014) (denying franchisor's motion to dismiss joint employer claim because it "enforced requirements for the operation of franchises" and "had the right to inspect the facilities and operations of franchises")

¹⁰⁰ *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016); *Courtland v. GCEP-Surprise, LLC*, 2013 U.S. Dist. LEXIS 105780 (D. Ariz. July 29, 2013) ("Although the FA allowed for periodic evaluations, they were to ensure compliance with plant maintenance, customer service, and sanitation guidelines.")

on brand standards, for example uniforms or compliance with applicable laws.¹⁰¹ Additionally, field staff should avoid any involvement with employment-related decisions, including employee discipline, during inspections.

D. Point of Sale Systems and Other Software

Franchisor-required computer systems, usually point-of-sale systems, are integral to high-performing franchise networks. Computer systems are “as a practical matter . . . necessary for a franchisee to use.”¹⁰² A uniformly-required computer system in a franchise system promotes uniform operations among franchisees, improves franchisees’ efficiency and operations, safeguards customer information, and leads to greater success for franchisees and their franchisor. Thus, franchise agreements routinely require that franchisees purchase and use a computer system chosen by the franchisor.

Despite all their advantages, computer systems at franchised locations have been identified by regulators and plaintiffs’ attorneys as evidence of franchisor’s control of employment matters. For example, the NLRB’s General Counsel in 2014 argued that “current technological advances have permitted franchisors to exert significant control over franchisees, e.g., through scheduling and labor management programs that go beyond the protection of the franchisor’s product or brand.”¹⁰³ The NLRB’s General Counsel indicated that franchisors risk joint employment liability when their franchisee’s computer systems “keep track of data on sales, inventory, and labor costs; calculate the labor needs of the franchisees; set and police employee work schedules; track franchisee wage reviews; track how long it takes for employees to fill customer orders, accept employment applications through the franchisor’s system; and screen applicants through that system.”¹⁰⁴ Fortunately for the franchising community, to date most courts have not adopted this view.¹⁰⁵

¹⁰¹ *Singh v. 7-Eleven, Inc.*, 2007 U.S. Dist. LEXIS 16677 (N.D. Cal. Mar. 7, 2007) (franchisor was not joint employer where its field consultant inspected the employees’ uniforms and equipment and instructed employees to check customer’s identification when selling alcohol and cigarettes).

¹⁰² *Ochoa v. McDonald's Corp.*, 2015 U.S. Dist. LEXIS 129539, at *23 (N.D. Cal. Sept. 24, 2015).

¹⁰³ Amicus Brief of the NLRB General Counsel, *In re Browning-Ferris*, Case 32-RC-109684, at 15 (Jun. 26, 2014).

¹⁰⁴ Amicus Brief of the NLRB General Counsel, *In re Browning-Ferris*, Case 32-RC-109684, at 15 (Jun. 26, 2014).

¹⁰⁵ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer where it provided franchisees with optional scheduling software); *Ochoa v. McDonald's Corp.*, 2015 U.S. Dist. LEXIS 129539 (N.D. Cal. Sept. 24, 2015) (“simply providing the ISP software is not enough to convert McDonald's into an employer”); *Vann v. Massage Envy Franchising LLC*, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 5, 2015) (finding franchisor not joint employer even though the franchise agreement required franchisees to “obtain the Computer System,

Franchisors can take a few steps to minimize the joint employment liability risk stemming from the required use of uniform computer systems by franchisees. One best practice is to make any employment-related functions in the software optional.¹⁰⁶ Franchisors can also be deliberate about the types of reports and data they monitor and pull from the computer system, whether automatically or upon request, because courts will likely view monitoring of operational performance as less of a concern than monitoring wages or hours.¹⁰⁷ To that end, franchisors should, if possible, disclaim any potential for or actual access to information regarding employee scheduling and compensation levels or structure. A final best practice that reinforces a common theme is for a franchisor to clearly articulate, in its writings and actions, the role of the computer system and how the franchisee will use the computer system in the operation of its business.

software licenses, maintenance and support services, and other services related to the Computer System from the suppliers we specify); *McFarland v. Breads of the World, LLC*, 2011 U.S. Dist. LEXIS 20703 (S.D. Ohio Feb. 1, 2011) (holding that franchisor was not a joint employer where it had access to the point of sale cash register records required to pay royalties and franchise fees); *Reese v. Coastal Restoration & Cleaning Servs.*, 2010 U.S. Dist. LEXIS 132858, 11-12 (S.D. Miss. Dec. 15, 2010) (holding that the franchisor was not a joint employer where the franchise agreement required the franchisee to obtain the computer hardware and software as the franchisor required). *Contra Ocampo v. 455 Hospitality LLC*, 2016 U.S. Dist. LEXIS 125928 (S.D.N.Y. Sept. 14, 2016) (denying franchisor's motion to dismiss joint employment claim where franchisor required a particular computer system to track revenue and operations); *Cano v. DPNY, Inc.*, 287 F.R.D. 251, 257, 260 (S.D.N.Y. 2012).

¹⁰⁶ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer where it provided franchisees with optional scheduling software); *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (franchisor was not joint employer where it required particular software to track and process transactions, but made optional the software's features related to timekeeping, discipline, scheduling, payroll, and restaurant inventory, and made optional additional software tools called "Dynamic Shift Positioning" and "Staffing, Scheduling, and Positioning"); *Ochoa v. McDonald's Corp.*, 2015 U.S. Dist. LEXIS 129539 (N.D. Cal. Sept. 24, 2015) (franchisor was not a joint employer for mandating a computer system with optional functions for timekeeping, scheduling, and time punches).

¹⁰⁷ *Ochoa v. McDonald's Corp.*, 2015 U.S. Dist. LEXIS 129539 (N.D. Cal. Sept. 24, 2015) (franchisor's ability to use franchisee computer systems to monitor performance was not evidence of franchisor's control over wages, hours, and working conditions); *McFarland v. Breads of the World, LLC*, 2011 U.S. Dist. LEXIS 20703 (S.D. Ohio Feb. 1, 2011) (holding that franchisor was not a joint employer where it had access to the point of sale cash register records required to pay royalties and franchise fees). See also NLRB General Counsel's Advice Memorandum, Case Nos 13-CA-134294, 13-CA-138293, and 13-CA-142297 (Apr. 28, 2015) (franchisor was not a joint employer where the computer system passively monitored sales and costs).

E. Communications to Franchisee's Employees or Regarding Employment Matters

Franchisors who communicate on employment-related matters with their franchisees and/or their franchisee's employees can reduce the joint employment liability risk by providing recommendations rather than requirements. Again and again, on various human resources matters, franchisors who provided non-mandatory guidance have equipped themselves with strong arguments to defeat joint employment claims before trial. This approach of non-mandatory guidance also properly balances the roles and responsibilities of the franchisor and the franchisee on employment related matters.

Communications to franchisee's employees, whether from the franchisor or the franchisee, should put the franchisee's employee on notice that he or she is not employed by the franchisor. This approach is important in limiting the franchisor's exposure to ostensible or apparent agency employment claims. Further, the franchisee must conspicuously identify itself and its business as an independent franchise owner in all dealings with the franchisee's employees. This requirement can be met by including appropriate statements on signage at the franchised business, the franchisee's websites or social media accounts (which should not use the franchisor's domain name), employment applications, acknowledgements signed by employees prior to any training, employment manuals, and the like. Although, as noted below, franchisors may exercise some control over payroll functions, a best practice for franchisors is to implement a requirement that franchisee employee paychecks and earning statements contain the name of the franchisee employer, not the franchisor, and should not contain the franchisor's marks or logos. For example, U.S. Lawns, Inc. won summary judgment on an apparent agency claim by a franchisee's employees after the court found that the plaintiff's paystub listed the franchisee's name and the plaintiff's personnel records either listed the franchisee as the employer or stated at the bottom: "This U.S. Lawns 'Franchise' is an independently owned and operated enterprise and is a separate and distinct entity from the U.S. Lawns 'Franchisor.'"¹⁰⁸

Three topics that regularly arise in the joint employment context as to the franchisor's communications to a franchisee or the franchisee's employees are payroll, supervision and scheduling, and hiring.

1. Payroll

One aspect of a franchisee's business in which a franchisor may exercise some control is handling payroll functions. If the functions carried out by the franchisor are purely ministerial, such as keeping and generating time records, withholding and paying taxes, generating paychecks, and providing annual W2's, such activities should not, in and of

¹⁰⁸ *Wright v. Mt. View Lawn Care, LLC*, 2016 U.S. Dist. LEXIS 31353 (W.D. Va. Mar. 11, 2016).

themselves, constitute sufficient control to create a joint employment relationship.¹⁰⁹ Provided that the franchisor does not set a franchisee's employees' wages, use its funds to pay those employees, or provide any kind of employment benefits to those employees, such activities should not subject the franchisor to joint employer liability.¹¹⁰ Several courts, moreover, have held that a franchisor may even require its franchisees to use the franchisor's payroll services without franchisor incurring joint employer liability.¹¹¹

Although such payroll systems may not ultimately result in liability for franchisors, numerous courts have permitted joint employment claims to survive motions to dismiss on the pleadings based on the existence and required use of a franchisor's payroll system.¹¹² Additionally, when franchisors become involved in the substance of a

¹⁰⁹ See *Singh v. 7-Eleven, Inc.*, No. C-05-04534RMW, 2007 WL 715488, at *6 (N.D. Cal. Mar. 8, 2007) ("Providing a 'payroll service to a franchisee's employees does not in any manner create an indicia of control over labor relations sufficient to demonstrate that the franchisor is a joint employer.") (quoting *Hatcher v. Augustus*, 956 F. Supp. 387, 392 (E.D.N.Y.1997)).

¹¹⁰ *Id.*; see also

¹¹¹ See *Gessele v. Jack in the Box, Inc.*, No. 3:14-CV-1092-BR, 2016 WL 7223324, at *13 (D. Or. Dec. 13, 2016) ("Even though franchises are required to use Defendant's payroll system and Defendant's system aggregates the data and sends it to franchisees' payroll providers, the *Singh* court noted such "ministerial functions are insufficient to support plaintiffs' argument that [defendant] controls labor relations."); *Aleksick v. 7-Eleven, Inc.*, 205 Cal. App. 4th 1176, 1190–91, 140 Cal. Rptr. 3d 796, 806 (2012) ("the mandatory nature" of a payroll service "does not change the outcome" that it does not create joint employer liability).

¹¹² See *Cano v. DPNY, Inc.*, 287 F.R.D. 251, 257-61 (S.D.N.Y. 2012) (permitting amendment to add franchisor as party to case based in part on franchisor "requiring the use of a trademarked, computerized record-keeping system . . . that, among other things, tracked hours and wages and retained payroll records, all of which were regularly submitted to and monitored by the Proposed Defendants"); also *Reed v. Friendly's Ice Cream, LLC*, No. 15-CV-0298, 2016 WL 2736049, at *3 (M.D. Pa. May 11, 2016) (denying motion to dismiss joint employment claim in part because franchisor "uses the same payroll system at all restaurants"); *Cordova v. SCCF, Inc.*, No. 13CIV5665-LTS-HP, 2014 WL 3512838, at *5 (S.D.N.Y. July 16, 2014) (denying motion to dismiss joint employer claim in part because franchisor "requires that the Franchise and Non-Franchise Defendants use certain record keeping systems, including systems for tracking hours and wages and for retaining payroll records and therefore, . . . knew or should have known of, and had the authority to exercise control over, the accuracy of records concerning Plaintiffs' hours and wages and those of similarly situated employees."); *Garcia v. Right at Home, Inc.*, No. SUCV20150808BLS2, 2016 WL 3144372, at *3 (Mass. Super. Jan. 19, 2016) ("The Complaint also alleges that RAH provides extensive and uniform instruction to KELLC with regard to all aspects of its operations (e.g., hiring, invoicing, payroll, and administration), and that RAH otherwise

franchisee's payroll, however, they risk assuming joint employer liability. For example, advising a franchisee on how to reduce payroll costs by cutting certain positions could expose a franchisor to liability.¹¹³ That said, a federal court recently noted that merely making a "recommendation regarding the method of employee compensation does not, on its own, amount to control over employees' working conditions."¹¹⁴ As with all other factors affecting joint employer liability, the key question is whether the franchisor actually had control over the terms and conditions of an individual's employment; if all the franchisor did was provide a ministerial service, that conduct is unlikely to trigger liability.

Handling payroll functions should not be confused though with a franchisee's sole responsibility for wage and hour compliance, provided that a franchisor may suggest third parties who can support franchisees in such compliance or a franchisor may recommend to franchisees that the franchisees form a discussion group among themselves to share best practices or retain the services of an employment lawyer or other outside professionals.

2. Supervision and Scheduling

There are some aspects of the franchised business where it may be appropriate for a franchisor to play a role in supervising franchisee's employees in order to protect the brand and the trademarks.¹¹⁵ For example, franchisors may generally require, and field consultants may comment on, that franchisee's employees wear appropriate uniforms displaying the franchisor's trademarks.¹¹⁶ That said, to minimize the risk of

controls KELLC's employment policies and practices, including the travel time and travel expense policies at issue.").

¹¹³ See *Orozco v. Plackis*, 952 F. Supp. 2d 819, 824 (W.D. Tex. 2013), *rev'd*, 757 F.3d 445 (5th Cir. 2014). On appeal, the Fifth Circuit held that merely providing "non-binding advice" was insufficient for a jury to "reasonably conclude" that the franchisor "had the authority to hire or fire" the employee. *Orozco v. Plackis*, 757 F.3d 445, 449 (5th Cir. 2014). It is an open question, however, whether other Circuits will follow *Orozco*, or what outcome would arise if the advice were binding.

¹¹⁴ *Pope v. Espeseth, Inc.*, No. 15-CV-486-JDP, 2017 WL 108081, at *5 (W.D. Wis. Jan. 11, 2017). The court held that the franchisor was not a joint employer notwithstanding evidence that the franchisor provided franchisees with training materials that "instruct[] franchisees to pay window cleaners an hourly wage during the initial 10-day training period and then pay them a 30 percent commission on all of the glass that they clean, plus a 10 percent bonus if they follow suggested standards," and that "suggests that they may not be successful if they do not 'pay on a percentage.'" *Id.* at *3.

¹¹⁵ See *Courtland v. GCEP-Surprise, LLC*, 2013 U.S. Dist. LEXIS 105780 (D. Ariz. July 29, 2013) ("Employee and operational supervision does not equate joint employment if the franchisor exercises it for a specific purpose and it is different than the control exercised by an employer").

¹¹⁶ *Vann v. Massage Envy Franchising LLC*, 2015 U.S. Dist. LEXIS 1002 (S.D. Cal. Jan. 5, 2015) (franchisor was not joint employer for imposing brand uniformity policies on

apparent or ostensible agency claims, franchisors and franchisees should consider communicating to the franchisee's employees that wearing a trademarked uniform does not make that person an employee of the franchisor.¹¹⁷ Franchisors may also require, and field consultants may comment on, that franchisee's employees must follow procedures especially applicable to maintain the franchisor's brand in their specific line of business, such as convenience store employees must check customer identifications when selling alcohol or cigarettes¹¹⁸ or franchise restaurant shifts must have one person with food safety certification.¹¹⁹

The key for franchisors and their field consultants is whether their supervision is plainly about brand protection rather than controlling employment matters. In order to reinforce this distinction it is important for a franchisor to consistently remind franchisees that it is the franchisee's sole responsibility to comply with all applicable laws, including employment laws like wage and hour and overtime legal compliance.

When a franchisor communicates about supervising or scheduling the franchisee's employees, as expected, it is generally a good idea to make that communication a recommendation rather than a requirement.¹²⁰ For example, as discussed herein, computer software programs regarding scheduling that are optional, not mandatory, provide the franchisor with some protection in the event of a joint employment liability lawsuit.

attire of franchisee's employees); *Singh v. 7-Eleven, Inc.*, 2007 U.S. Dist. LEXIS 16677 (N.D. Cal. Mar. 7, 2007) (franchisor was not joint employer for its field consultant inspecting the uniforms worn by the franchisee's employees).

¹¹⁷ *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (the requirement that plaintiff's wear a uniform emblazoned with the McDonald's trademark was evidence that the franchisor may be liable to franchisee's employees on ostensible agency theory).

¹¹⁸ *Singh v. 7-Eleven, Inc.*, 2007 U.S. Dist. LEXIS 16677, at *14-15 (N.D. Cal. Mar. 7, 2007) (franchisor was not joint employer where its field consultant instructed franchisee's employees to check customer's identification when selling alcohol and cigarettes).

¹¹⁹ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer for requiring someone certified in food safety on a shift).

¹²⁰ *Pope v. Espeseth, Inc.*, 2017 U.S. Dist. LEXIS 4928 (W.D. Wis. Jan. 11, 2017) (franchisor was not joint employer for recommending that franchisees not schedule weekend work); NLRB General Counsel's Advice Memorandum at 2-3, Case Nos. 13-CA-134294, 13-CA-138293, and 13-CA-142297, available at: <http://apps.nlr.gov/link/document.aspx/09031d4581c23996>.(franchisor was not joint employer for providing non-mandatory guidance on scheduling employees)

3. Hiring

Franchisors understandably want their franchisees to hire excellent employees who will best present the brand to customers. When franchisors decide to provide information to franchisees about employee hiring and firing, they should provide non-mandatory guidance. In fact, a number of franchisors have provided optional hiring tools to franchisees without ultimately incurring joint employer liability.¹²¹

As with other aspects of the franchisor-franchisee relationship, best practices in connection with hiring focus on emphasizing to applicants and employees, at each step of the employment relationship, the distinction between the two entities, and that the franchise location is owned and operated by an independent franchisee who is the employer. This would include prohibiting the use of the franchisor's name on employment-related documentation used in connection with hiring, such as employment applications, offer letters, employment agreements, and I-9 forms. Additionally, if a franchisor's website provides information about employment opportunities at franchisee locations, the franchisor should include a disclaimer that the franchisees are the sole employers for all advertised positions, and that those franchisees are not acting as the franchisor's agent. Similarly, if the franchisor also advertises opportunities at company-owned locations, the website should clearly differentiate those opportunities from positions at franchised locations. And, if franchisees post job openings on their own websites or on job boards, the franchisee should be required to clearly identify that the job opportunities are with the franchisee, not the franchisor. Finally, any advertisements or other statements to the public by the franchisor should avoid statements that appear to include franchisee employees under the franchisor's "umbrella." For example, franchisors should avoid statements like "we have more than 10,000 [franchise employee positions] across the country" or "our [franchise employee positions] have an average of five years of experience."

There is, however, one aspect of hiring where it may be appropriate for franchisors to exercise some control. Franchisors in our service-based economy are rightly concerned about damage to their brands that can arise from serious wrongful conduct of a franchisee's employee. It may take only one act by a single employee of one franchisee to damage the entire franchise system. As a result, some franchisors mandate that their franchisees run background checks on the franchisees' potential

¹²¹ *Gessele v. Jack in the Box, Inc.*, 2016 U.S. Dist. LEXIS 172061 (D. Or. Dec. 13, 2016) (franchisor was not joint employer for providing franchisees with optional "Hiring the Right People" process); *Salazar v. McDonald's Corp.*, 2016 U.S. Dist. LEXIS 108764 (N.D. Cal. Aug. 16, 2016) (franchisor was not joint employer for providing optional website tool called "Hiring to Win"); NLRB General Counsel's Advice Memorandum at 2–3, Case Nos. 13-CA-134294, 13-CA-138293, and 13-CA-142297 (franchisor was not joint employer for providing non-mandatory guidance on hiring).

employees during the hiring process. At least one franchisor has successfully argued that its requirement for background checks was not evidence of joint employment.¹²²

The bottom line on hiring, firing and other similar employment-related matters is for the franchisor to emphasize, at every turn of the franchise relationship, including the early franchise development and training stages, that, as important as it is for the franchisee to follow the brand standards, it is equally important for the franchisee to embrace rather than shirk its role to be solely responsible for employment matters for its business.

IV. Sample Franchise Agreement and Operations Manual Language

This section includes sample language that a franchisor should consider including in its franchise agreement and operations manual to address the joint employment liability pressure points noted in this paper, as well as sample language to include in a franchisee employee acknowledgment, whether or not the franchisor is providing training to franchisee's employees.

Example Franchise Agreement Provisions

Any required standards exist to protect our interests in the System and the Trademarks and not for the purpose of establishing any control or duty to take control over those matters that are reserved to you. The required standards generally will be set forth in the Operations Manual or other written materials. The Operations Manual also will include guidelines or recommendations in addition to required standards. In some instances, the required standards will include recommendations or guidelines to meet the required standards. You may follow the recommendations or guidelines or some other suitable alternative, provided you meet and comply with the required standards. In other instances, no suitable alternative may exist. In order to protect our interests in the System and Trademarks, we reserve the right to determine if you are meeting a required standard and whether an alternative is suitable to any recommendations or guidelines.

Any training we provide to any of your employees will be limited to training or guidance regarding the delivery of approved services to clients in a manner that reflects the client service standards of the System. You are, and will remain, the sole employer of your employees at all times, including during all training programs, and you are solely responsible for all employment decisions and actions related to your employees. You are solely responsible for ensuring that your workers receive adequate training.

You are, and will remain, an independent contractor responsible for all obligations and liabilities of, and for all losses or damages to, the Restaurant and its assets, including

¹²² *Reese v. Coastal Restoration & Cleaning Servs.*, 2010 U.S. Dist. LEXIS 132858, 11-12 (S.D. Miss. Dec. 15, 2010) (holding that the franchisor was not a joint employer where the franchise agreement required the franchisee to conduct background checks on franchisee's employees).

any personal property, equipment, fixtures, or real property, and for all claims or demands based on damage to or destruction of property or based on injury, illness, or death of any person, directly or indirectly, resulting from the Restaurant's operation. Further, we and you are not and do not intend to be partners, joint venturers, associates, or employees of the other in any way, and we will not be construed to be jointly liable for any of your acts or omissions under any circumstances. We are not the employer or joint employer of the Restaurant's employees. You or your Operating Principal is solely responsible for managing and operating the Restaurant and supervising the Restaurant's employees. You agree to identify yourself conspicuously in all dealings with customers, suppliers, public officials, Restaurant personnel, and others as the Restaurant's owner, operator, and manager under a franchise we have granted and to place notices of independent ownership at the Restaurant and on the forms, business cards, stationery, advertising, e-mails, and other materials we require from time to time.

We will not exercise direct or indirect control over the working conditions of Restaurant personnel, except to the extent such indirect control is related to our legitimate interest in protecting the quality of our services or brand. We do not share or codetermine the employment terms and conditions of the Restaurant's employees and do not affect matters relating to the employment relationship between you and the Restaurant's employees, such as employee selection, promotion, termination, hours worked, rates of pay, other benefits, work assigned, discipline, adjustment of grievances and complaints, and working conditions. To that end, you must notify Restaurant personnel that we, as the franchisor of [brand] Restaurants, are not their employer and do not engage in any employer-type activities for which only franchisees are responsible, such as employee selection, promotion, termination, hours worked, rates of pay, other benefits, work assigned, discipline, adjustment of grievances and complaints, and working conditions. You also must obtain an acknowledgment (in the form we specify or approve) from all Restaurant employees that we are not their employer. No employee of yours will be deemed to be an employee of ours for any purpose whatsoever, and nothing in any aspect of the System or the Trademarks in any way shifts any employee or employment related responsibility from you to us. You alone are responsible for hiring, firing, training, setting hours for and supervising all employees.

It is the intention of the parties to this Agreement that we shall not be deemed a joint employer with you for any reason. If we incur any cost, loss, or damage as a result of any actions or omissions of you or your employees, including any that relate to any party making a finding of any joint employer status, you will fully indemnify us for any such loss.

To the extent you use any Trademark in employment-related materials, you must include a clear disclaimer that you (and only you) are the employer of Restaurant employees and that we, as the franchisor of [brand] Restaurants, are not their employer and do not engage in any employer-type activities for which only franchisees are responsible, such as employee selection, promotion, termination, hours worked, rates of pay, other benefits, work assigned, discipline, adjustment of grievances and complaints, and working conditions. You also must obtain an acknowledgment (in the form we

specify or approve) from all Restaurant employees that you (and not we) are their employer.

You should consult with your own legal counsel regarding compliance with applicable laws, including state and federal employment and labor laws.

You recognize there are substantial costs for the employer associated with recruiting, hiring, and training new management employees (including, where applicable, sending an employee to complete one of our manager training programs), and that you, we, our affiliates, and current and future [brand] Restaurant franchisees (whom you expressly acknowledge to be third-party beneficiaries of this provision) have a legitimate, protectable interest in maintaining a stable management team. You therefore agree to pay us, our affiliates, or any other [brand] Restaurant franchisee liquidated damages in the amount of _____ Dollars (\$____,000) if you or any of your owners hires our or its management employees after any solicitation or recruitment in violation of this subparagraph. You acknowledge this sum to be a reasonable estimate of the damages likely to be incurred in the event of a wrongful solicitation or recruitment in violation of this subparagraph and expressly agree it is not a penalty.

Example Operations Manual Language

General disclaimer on the first page of the manual:

As a _____ franchisee, you alone are responsible not only for following the system, but also for the day-to-day operation of your individual Store. For example, only you are responsible for the control of your employees in the daily operation of the Store, as well as the safety and security of the Store, your employees, and customers. In this Operations Manual, we identify a number of recommendations or suggested practices related to various operational aspects of the Store, which we recommend that you implement at your Store. Our experience is that following the recommended or suggested practice will enhance the likelihood that you will be in compliance with brand standards relating to the operation of your Store. We also in some instances outline required standards rather than recommendations or suggested practices. In those instances the required standards exist to protect our interests in the _____ system and the _____ trademarks and not for the purpose of establishing any control or duty to take control over those matters that are reserved to you.

As outlined in your Franchise Agreement with us, we have established a number of brand standards that Store owners must meet. For example, one such brand standard is the requirement that owners adhere to all laws related to the operation of the Store. This requirement to adhere to all applicable laws is a key brand standard of the system. However, we do not establish specific “steps” or “controls” that an owner must take to meet this brand standard. Rather, in this section, we identify a number of recommendations and suggested practices concerning compliance with laws. Please note that compliance with applicable laws and regulations deserves special attention because they clearly are your sole responsibility. We always recommend that you contact your own lawyer to make sure you understand and comply with all laws

applicable to your business. No information that we provide to you in these areas shifts any part of this responsibility from you.

Example Franchisee Employee Acknowledgment

The undersigned acknowledges that he or she is an employee of the Franchise Owner designated below and not an employee of _____ (____).

The undersigned further acknowledges that (i) one of the Franchise Owner's key roles and responsibilities is to properly train his or her employees; (ii) neither the training program that the undersigned is attending at the time he or she signs this Acknowledgement nor any recommendations, guidelines or suggestions received from the ___ Training Department or any other ___ representative in any way modifies the Franchise Owner's training obligations or is intended to exert or exercise any direct, indirect or potential control over an employee, the Franchise Owner's training obligations or any aspect of the Franchise Owner's employment relationship with the undersigned or any other employee.

The training program is not intended in any way to change or modify the undersigned's employment relationship with the Franchise Owner. _____ is not an employer or joint employer of any employee of a Franchise Owner.

V. Conclusion

There is no cure-all to inoculate franchisors against being named defendants in joint employment liability lawsuits. Protective language in franchise agreements and operations manuals can help upfront, but such written provisions alone are not always enough.¹²³ Indeed, many franchisors that move to dismiss joint employment lawsuits early in litigation lose the motion to dismiss or find that the court will permit the plaintiffs to file an amended complaint with more substantial allegations. In contrast, many franchisors in recent years have succeeded in defeating joint employment claims in the middle stages of litigation because they had expertly crafted franchise agreements and operations manuals, imposed requirements only where necessary for brand protection, clearly differentiated between system requirements and optional guidelines and recommendations, and put the franchisee and its employees on notice that the franchisee is an independent business owner solely responsible for all employment-related matters of its business.

The lesson is that franchisors can best manage their liability exposure when franchisees operate as independent businesses as part of a franchise system that has

¹²³ See *Ocampo v. 455 Hospitality LLC*, 2016 U.S. Dist. LEXIS 125928 (S.D.N.Y. Sept. 14, 2016) (denying franchisor's motion to dismiss joint employment claim and holding that "economic realities, not contractual labels, determine employment status for the remedial purposes of the FLSA."); *Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474, 501 (Cal. 2014) ("the parties' characterization of their relationship in the franchise contract is not dispositive.").

appropriate brand standards to protect the brand. This balance between independence and controls begins with the franchise development process and initial training, as franchisors reinforce the roles and responsibilities of the franchisor and the franchisee. When the roles and responsibilities are balanced properly, the franchisees are fully engaged and the franchisor and the franchisees can focus on effective collaboration on customer-centric initiatives and activities that reinforce an undying devotion to the brand.