



NLRB and the Joint Employer: Is Franchising on the Ropes?

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Lately, there is never a dull moment at the National Labor Relations Board (NLRB). Recent NLRB decisions have rewritten the labor law map in a variety of ways but nowhere more significantly than in the areas of franchising and outsourcing. With the decision in *Browning-Ferris Industries of California*, which dealt with a temporary staffing agency¹ and, more recently, in a decision by the NLRB's general counsel involving *McDonald's USA, LLC*,² the definition of a "joint employer" has grown exponentially broader. This portends a vast expansion of employer liability on a joint employer theory in almost every area of law imaginable from tort to employment discrimination litigation.

In the *McDonald's USA* case, the NLRB's general counsel authorized consolidated complaints in July 2014 against multiple McDonald's franchisees and their franchisor, McDonald's USA, as joint employers. On Dec. 19 the NLRB's general counsel commenced litigation alleging that McDonald's USA and its franchisees violated the rights of employees working at McDonald's restaurants around the country by, inter alia, "making statements and taking actions against them for engaging in activities aimed at improving their wages and working conditions, including participating in nationwide fast food worker protests about their terms and conditions of employment."³ As a result, McDonald's must defend 61 unfair labor practice charges involving 31 franchisees with 181 separate violations at 30 different locations.

On March 9, 2016, in his opening statement at the hearing which will determine if McDonald's will be held to be a joint employer, the NLRB's counsel argued that McDonald's uses business consultants—who monitor staffing and business practices and conduct periodic reviews of implementation of those practices—to exert control over its franchisees. Pointing to McDonald's operating manual and point-of-sale and scheduling systems, the NLRB has concluded that franchisees' control over the terms and conditions of their workers' employment is limited. The NLRB counsel added that McDonald's sets the times in which a burger should be served and the job classifications of workers, and sets a uniform computer scheduling system across the restaurants concluding that McDonald's USA co-determines the working conditions of franchisees' employees making it a joint employer under the NLRA.

McDonald's USA argued that it is essentially doing its due diligence as a franchisor. It further stated that the company does not tell business owners whom to hire or when to schedule its employees. Rather, McDonald's USA's counsel maintained that McDonald's USA exerts the level of control that any franchisor would expect to maintain a uniform customer experience across all franchisees, adding, "[a]ll franchisors, if they're successful, do precisely the same thing."

What Is a Joint Employer?

In *Browning-Ferris*, the NLRB, in a 3-2 decision, expanded who may be considered a joint employer under the NLRA. The board's decision significantly lowered the threshold for joint employer status, making it more likely that entities, such as staffing agencies and contractors, will be considered joint employers when it stated it will now evaluate the evidence to determine whether an alleged employer affects the means or manner of employees' work and terms of employment, either directly or indirectly.

The common thread in both *Browning-Ferris* and *McDonald's USA* is that the NLRB is rewriting the rules as to what constitutes a "joint employer" in the marketplace. So what is a "joint employer" from the government's standpoint? According to the NLRB's fact sheet, McDonald's USA should be deemed a joint employer because it "engaged in sufficient control over the franchisee's operations beyond protection of the brand, which makes it a putative joint employer with its franchises sharing liability for violations."

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The focus of a joint employer analysis in case law has always been on whether the putative joint employer had some element of "control" over the essential terms and conditions of employment, i.e., hiring, firing, disciplining, supervising, directing, assigning, training and scheduling of employees. This is known as the "economic realities test" outlined by the U.S. Court of Appeals for the Second Circuit in *Zheng v. Liberty Apparel Co.*⁴ and applied by the New York State Court of Appeals in *Matter of Ovadia v. the Office of Industrial Board of Appeals*.⁵

After *Browning-Ferris*, the NLRB now employs a "totality of circumstances" standard under which a joint-employer relationship is deemed to exist where "the putative joint employer wields sufficient influence over the working conditions of the entities' employees such that meaningful collective bargaining could not occur in its absence."⁶

In sum, the focus is now on the "industrial realities" as the NLRB posits citing to the significant expansion of "the diversity of workplace arrangements in today's economy..." Under the NLRB's new test there are many factors to analyze to be sure when assessing what it means to wield "sufficient influence over the working conditions of the entities' employees."⁷

At this point, the NLRB's general counsel has not outlined in detail the specifics supporting his view that McDonald's USA should be deemed a joint employer, but there is no question that the goal is to broaden employer liability in labor matters—at a minimum—to include franchisors. The end result will be that joint-employer status will be easier to establish, thus impacting workers' rights in the franchising/staffing industries.

Franchising as Matter of Law

To properly debate and discuss the application of joint-employer liability to franchisors, it is proper to review what constitutes a franchise under the law. The New York State General Business Law Article 33, Section 681 defines a franchise as controlled by a contract by which a franchisee is:

granted the right to engage in business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by the franchisor, and the franchisee is required to pay, directly or indirectly, a franchise fee...⁸

At the outset, the law recognizes, as it should, that the franchise operates under a "marketing plan or system prescribed in substantial part by the franchisor." The reasons for this are elementary, to wit, the franchisor has invested time and money creating a business model that is successful enough to sell to entrepreneurs wishing to latch on to the franchisor's success. In order to do so, franchisees must abide by certain rules set by the franchisor and made part of the contractual agreement. McDonald's USA offers for sale the "McDonald's system" which is described in the McDonald's USA franchise agreement as "a comprehensive system for the ongoing development, operation and maintenance of McDonald's restaurant locations which have been selected and developed for the retailing of limited menus of uniform and quality food products...."⁹

McDonald's delivers to its franchisees "business manuals" which contain detailed information including "(a) required operations procedures; (b) methods of inventory control; (c) bookkeeping and accounting procedures; (d) business practices and policies; and (e) other management and advertising policies."¹⁰ As part of the obligation under the contract, the "franchisee acknowledges that every component of the McDonald's system is important to McDonald's and to the operation of the restaurant as a McDonald's restaurant" and the franchisee gives McDonald's "the right to inspect the restaurant to ensure that the franchisees operate in compliance with the standards and policies of the "McDonald's system."¹¹

As one would expect, the franchise agreement also provides that the "franchisees and McDonald's are not and do not intend to be partners, associates, or joint employers in any way and McDonald's shall not be construed to be jointly liable for any acts or omissions of Franchisee under any circumstances."¹² Finally, it is a material breach under the

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agreement if the franchisee fails to maintain and operate the restaurant "in compliance with the standards prescribed by the McDonald's system."¹³ One would argue that control is the bulwark of the franchise business. Without it, the center would not hold and things fall apart.

Thus, without this control over the product or services offered by McDonald's franchisees, there may be, in the end, fewer franchises because it is reasonable to conclude that the level of control assures consistency and association with a recognized successful product and service. Conversely, irrespective of what the franchise industry believes regarding the level of control it must wield, is the control that McDonald's exercises simply too much, such that it should be deemed a joint employer with its franchisee after applying a more realistic assessment of the business relationship between franchisor and franchisee?

While it might not have been the original intent behind the franchising concept, as the relationship between a franchisor and franchisee has been refined and evolved over time, should franchise employees now have rights under the National Labor Relations Act as against the franchisor that have thus far effectively been denied to them? The conflict is only too clear, and therein lies the conundrum for McDonald's and for every other franchisor for that matter: assert too much control and risk being deemed a joint employer—assert too little and the franchise business model disintegrates. This leaves McDonald's and many other like franchises left to search for the "Goldilocks' Zone" where they can avoid the slings and arrows an employer must inevitably bear in terms of legal liability while still operating a profitable franchise operation.

As for how the courts in New York have assessed the franchisor-franchisee relationship, up until now, it has been almost a forgone conclusion in New York courts that a franchisor is seldom, if ever, liable for the acts of the franchisee. For example, in a suit against Burger King Corporation (BKC), the Appellate Division, First Department, succinctly stated BKC's relationship was "merely franchisor-franchisee, and there is no showing of the existence of a parent-subsidary relationship, let alone of the means by which BKC purportedly exercised the complete domination and control of [the franchisee's] daily operations or how such control resulted in plaintiff's injury."¹⁴

Potential Impact

The *McDonald's USA* case involves unfair labor practice charges and *Browning-Ferris* involved petitioners seeking to hold representative elections—both of which are within the authority of the NLRB. Focusing on the NLRB solely, a broader definition of what it means to be an employer opens a whole new world of employees being in a position to seek to participate in representative elections under the National Labor Relations Act which may have been impossible otherwise. In the *McDonald's USA* case, if it is finally found that McDonald's USA is a joint employer for unfair labor practice purposes, then it is not a bridge too far to argue that McDonald's should be deemed to be an employer in a representative election, potentially forcing McDonald's USA to collectively bargain with the employees of its franchises located in practically every city and every state. This would constitute a game changer within the union movement, most probably resulting in a vast expansion of union membership.

Furthermore, before you think that this will only impact matters before the NLRB, think again. The NLRB's thinking has already permeated the U.S. Department of Labor which issued an "administrator's interpretation" on Jan. 20, 2016, discussing the distinction between employees and independent contractors under the Fair Labor Standards Act. That guidance emphasized the importance of whether an individual's services are an integral part of the company's business and downplayed the importance of whether the business actually controls an individual's work.¹⁵

Likewise, in a recently discovered draft of an Occupational Safety and Health Administration's (OSHA) internal memorandum, the OSHA investigators advised that "a joint employer's standard may apply where the corporate entity exercises direct or indirect control of the work conditions, has the unexercised potential to control working conditions or based on economic realities."¹⁶

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The expansion of liability for employers and the corresponding avenues by which employees may seek relief against their newly identified employers under the law is striking. If the courts embrace the joint-employer standards established by the NLRB, it is only a matter of time before they are applied in a wide range of cases. In addition to holding franchisors liable for unfair labor practices committed by franchisee owners across the country, the franchisors may be responsible for Workers' Compensation claims, unemployment insurance, OSHA compliance, wage and hour violations and liability under state and federal discrimination statutes. The list seems almost endless. Add to that respondeat superior liability for the common slip and fall, and one can see how the world will change dramatically depending upon whether the joint-employer "2.0" standard, over time, becomes the law of the land.

The questions are: Will franchisors adapt to this new environment by exerting less control to avoid these outcomes? If so, does the face of franchising change so that it is a less desirable investment for entrepreneurs causing it to eventually disappear from the economic landscape? Or will the courts come to the employer's rescue and reject the NLRB's approach? The answer is probably several years off, but with this much at stake, it is clear that the outcome could be a game changer.

¹ *Browning-Ferris Industries of California, Inc. d/b/a BFI Newby Island Recyclery and FRR-II LLC d/b/a Leadpoint Business Services and Sanitary Truck Drivers and Helpers Local 350, International Brotherhood of Teamsters*, Case No. 32-RC-109684.

² *McDonald's USA and Fast Food Workers Committee and Service Employees International Union, CTW, CLC*, Case No. 02-CA-093893.

³ <https://www.nlr.gov/news-outreach/news-story/nlr-office-general-counsel-issues-consolidated-complaints-against>.

⁴ *Zheng v. Liberty Apparel Co.*, 355 F.3d 61 (2d Cir. 2003).

⁵ *Matter of Ovidia v. the Office of Industrial Board of Appeals*, 19 N.Y.3d 138 (2012).

⁶ *Browning-Ferris Industries of California, Inc.*, Case No. 32-RC-109684, 362 NLRB No. 186.

⁷ *Id.*

⁸ McKinney N.Y. Gen. Bus. Law §681(3)(a).

⁹ McDonald's franchise agreement.

¹⁰ *Id.*

¹¹ *Id.*

¹² *Id.*

¹³ *Id.*

¹⁴ *Schoenwandt v. Jamfro Corp.*, 261 A.D.2d 117 (1st Dept. 1999); *Hart v. Marriott Int'l*, 304 A.D.2d 1057 (3d Dept. 2003); *Martinez v. High Powered Pizza*, 43 A.D.3d 670 (1st Dept. 2007).

¹⁵ U.S. Department of Labor, Wage and Hour Division Administrators Interpretation No. 2016-1 (www.dol.gov/whd/flsa/Joint_Employment_AI.htm).

¹⁶ http://edworkforce.house.gov/uploadedfiles/osha_memo.pdf.