# Can a Franchisor be Deemed the Employer of a Franchisee's Employee?

## The Unsettled Landscape of Joint Employer Status

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It is long settled that a franchisor is not liable for the conduct of its franchisees merely based on the existence of the franchise relationship.[1] Recently, courts around the country have begun to question the validity of this maxim and tinker with the elements for finding joint employer status. More specifically, doubt has been expressed related to the concept that a franchisor is not an employer of an individual working for an independently owned franchise.[2] In the past year, both the National Labor Relations Board (NLRB)[3] and the New Jersey Supreme Court[4] have issued significant rulings that—albeit not specifically in the context of the franchisor and franchisee relationship—are likely to impact the obligations of a franchisor when relating to its dealings with the employees of its franchisees.

On Aug. 27, 2015, the NLRB issued a decision that dramatically altered the standard to assess 'joint employer liability' under the National Labor Relations Act (NRLA).[5] In *Browning-Ferris*, the NLRB changed a decades-old framework and applied the traditional joint employer doctrine to hold a company that retained services of a temporary employment service (and its temporary employees) could be deemed a joint employer if it shared or codetermined matters governing the essential terms and conditions of employment.[6] This decision will likely have a significant impact on franchises because, for the first time in decades, the NLRB considered 'indirect control' to be a factor in determining whether a joint employer relationship existed under the NLRA.

Similarly, the New Jersey Supreme Court's decision in *Hargrove v. Sleepy's LLC,*[7] in response to a question of law certified and submitted by the United States Court of Appeals for the Third Circuit, adopted the 'ABC' test[8] to determine whether a worker should be classified as an independent contractor or employee under the New Jersey Wage and Hour Law (WHL), at N.J.S.A. 34:11-4.1 to -4.14, and the New Jersey Wage Payment Law (WPL), at N.J.S.A. 34:11-56a to -56a38.[9] The ABC test begins with the presumption that the alleged employer is actually the employer and this presumption remains unless it can be shown that: 1) the individual has been and will continue to be free from control or direction over the performance of the services; 2) such services are either outside the usual course of the business or performed outside of all the places of business of the enterprise; and 3) such individual is customarily engaged in an independently established trade, occupation, profession, or business.[10] The failure by the employer to satisfy even one of the three criteria will result in a finding of 'employment.'

This article reviews both cases, the impact these cases may have on franchise relationships, and potential legislative responses. It concludes with a reminder of steps a franchisor can take to minimize the possibility of it being found to be an employer of its franchisees' employees.

### *Browning-Ferris*: Opening the Door to Franchisor Liability

Pre-*Browning-Ferris*, a company would be considered a joint employer if it *actually exercised* direct and immediate control over essential employment conditions and the terms of the workers at issue.[11] In light of the *Browning-Ferris* decision, one can be found a joint employer because it *merely possesses* sufficient control over the workers' essential employment terms.

*Browning-Ferris* involved a union's desire to organize the temporary workers of an independent contractor who worked at a recycling facility.[12] Browning-Ferris Industries (BFI) owned a recycling facility where it employed unionized machine operators who would move materials in preparation of sorting inside the facility.[13] BFI contracted with Leadpoint Business Services to provide temporary workers to sort the materials inside the facility.[14] The union claimed BFI and Leadpoint jointly employed the temporary workers.[15] Notably, the vast majority of workers were temporary workers.

In analyzing the issue, the NLRB looked to the operations, management, hiring, orientation and training, wages and bene-

fits, and discipline. Pursuant to an agreement between BFI and Leadpoint, Leadpoint would screen, hire, discipline and supervise the Leadpoint employees, with BFI being given the ability to involve itself in matters of hiring, discipline, scheduling and wages.[16] The agreement forbade Leadpoint from paying its employees more than it paid BFI's own employees, or from hiring employees BFI had already considered ineligible.[17]

The NLRB decided to 'return' to the 'traditional' joint employer test to determine whether a company incurs obligations to engage in collective bargaining with workers. Under the traditional test, two or more entities may be joint employers of a single workforce if: 1) they are both employers within the meaning of the common law, and 2) they share or codetermine those matters governing the essential terms and conditions of employment. The focus of the test is whether the alleged employer exercised significant control over the workers.[18] The NLRB found both BFI's control over the manner and method of operations and the language in the parties' agreement were sufficient to create joint employer liability.

Relevant to the franchise context, the decision opens the door to the argument that a franchisor that exercises control through a franchisee, even without any direct interaction with the individual workers, yet reserves the ability to influence the employees' terms and conditions of employment, may qualify as a joint employer with the franchisee.[19]

### *Hargrove v. Sleepy's*: The ABCs of Joint Employer Status in New Jersey

In last year's New Jersey Supreme Court case, *Hargrove v. Sleepy's LLC*,[20] three plaintiffs who delivered mattresses for Sleepy's alleged that Sleepy's violated wage and hour laws by misclassifying them as independent contractors. The plaintiffs alleged that Sleepy's used independent driver agreements as a ruse to avoid paying employee benefits.[21]

The plaintiffs commenced a federal action in the United States District Court for the District of New Jersey. That court dismissed the claims at summary judgment, using the common law agency test that the United States Supreme Court adopted in *Nationwide Mutual Insurance Co. v. Darden*.[22] *Darden* involved the meaning of 'employee' under the Employee Retirement Income Security Act (ERISA), which is similar to other employee protection statutes in its circular definition of employee, which ERISA defines as "any individual employed by an employer."[23] In *Darden*, the United States Supreme Court held that where a statute defines a term with circular language, the meaning of the term should be construed according to the common law.[24]

The plaintiffs sought appellate review to the United States Court of Appeals for the Third Circuit, which certified a question of state law to the New Jersey Supreme Court on the issue of "which test should a court apply to determine a plaintiff's employment status for purposes of the New Jersey Wage Payment Law, N.J.S.A. [ ]34:11–4.1, *et seq*. and the New Jersey Wage and Hour Law, N.J.S.A. [ ]34:11–56a, *et seq*.?"[25] Among the two parties and the nine *amici*, no less than four employment status tests were proposed.

The Department of Labor (DOL), one of the *amici*, asked the court to adopt the ABC test, so called because it derives from Subsections (A), (B), and (C) of N.J.S.A. 43:21–19(i), a New Jersey's Unemployment Compensation Law statute for distinguishing independent contractors from employees.[26] The DOL had been applying the test to the WHL and the WPL for 20 years, so there was a developed body of law in its application.[27]

> The 'ABC' test presumes a worker is an employee unless the employer can make certain showings regarding the individual employed, including: (A) Such individual has been and will continue to be free from control or direction over the performance of such service, both under his contract of service and in fact; and (B) Such service is either outside the usual course of the business for which such service is performed, or that such service is performed outside of all the places of business of the enterprise for which such service is performed; and (C) Such individual is customarily engaged in an independently established trade, occupation, profession or business. The failure to satisfy any one of the three criteria results in an 'employment' classification.[28]

The ABC test is markedly different from other tests utilized to evaluate employment liability under other employee protection statutes in that many others are totality of the circumstances tests. A key distinction being that totality of the circumstances tests, while unpredictable for both workers and companies alike, preserve the traditional notion that a plaintiff must prove his or her case. By contrast, the ABC test arguably erodes this notion by beginning with the presumption that an individual is an employee.

The Supreme Court adopted the ABC test in this context for two reasons. First, deference was given to the DOL's opinion.[29] Second, the ABC test was viewed as more predictable than the multiple totality of the circumstances tests proposed. As explained by Judge Mary Catherine Cuff for an unanimous court, "the 'ABC' test fosters the provision of greater income security for workers, which is the express purpose of both the WPL and WHL."[30]

### Meaning of the Cases: It's All About Control

Both *Browning-Ferris* and *Hargrove* reflect the mounting public concerns in the use of non-traditional labor relationships. Collectively, these cases demonstrate a push toward the finding of a traditional employer-employee relationship. Arguably, such progressive decisions are

admirable in their efforts to provide increased protections for individual employees. Such determinations, however, also lend credence to the legal maxim that "hard cases make bad law."[31]

The theme of unintended legal consequences is present throughout the *Browning-Ferris* dissent, which highlighted the potential impact of the majority's decision on multiple industries, including franchises.[32] It noted that "[f]or many years, the Board has generally not held franchisors to be joint employers with franchisees, regardless of the degree of indirect control retained" and that, in light of the absence of guidance on how the majority's decision effects franchise relations, it is likely the decision will be "momentous and hugely disruptive" to franchises.[33] Notably, the general counsel for the NLRB submitted an *amicus* brief in *Browning-Ferris* conceding that franchisors should be exempt from "joint employer status to the extent that their indirect control over employee working conditions is related to a legitimate interest in protecting the quality of their product or brand."[34] The majority's broad test, however, arguably supports a finding that a franchisor with this type of indirect control should be deemed a joint employer.

Franchisors have a self-interest in maintaining strict control of a franchisee. A franchisor's controls—whether it be how food is prepared, how signage is displayed, or what employees are to wear to work—all help create uniformity in the customer experience, to the benefit of both the franchisee and franchisor. However, often a franchisor's controls may have "nothing to do with a labor policy but rather compliance with federal statutory requirements to maintain trademark protections."[35] Under the Lanham Act, a licensor/franchisor is required to maintain sufficient controls over its marks and the failure to do so can be considered "naked franchising" and result in abandonment of the mark.[36] As such, a franchisor is placed in an untenable situation: Implement controls to protect its mark and be potentially subject to joint-employer status or fail to maintain sufficient controls to protect against joint employer status and risk abandonment of the mark.

*Hargrove*, on the other hand, was likely decided without consideration of its potential effects on franchisors. However, the language of the ABC test's three prongs is ripe for conflict. As noted, the test contains a presumption that an individual is an employee unless the employer can demonstrate three elements. Again, the focus of the ABC test utilized in *Hargrove* is whether the employee is free from direction and control. Similar to *Browning-Ferris,* a court's

analysis of control has the potential to cause a troublesome result for franchisors.

In sum, both of these opinions add new layers of uncertainty to an already fraught legal landscape of franchisor employment liability. How courts will interpret the employment tests in the franchisor/franchisee context is uncertain. In a case where a franchisee or its employees sue a franchisor for discrimination, the court is, by implication, faced with a decision that balances the broad remedial nature of social legislation against the intent of the parties that entered into the contractual franchise relationship. A court's perspective on these issues can influence the weight given to the particular facts of the case. This phenomenon is readily apparent in *Patterson v. Domino's Pizza, LLC*.[37]

*Patterson* was a sexual harassment case filed under California's Fair Housing and Employment Act (FEHA). The plaintiff, a franchisee's employee, alleged that one of the franchisee's managers had sexually harassed her.[38] The franchisee testified that representatives from Domino's had pressured him to fire the accused manager.[39] The franchisee did terminate the manager, but he also testified that the decision to terminate was ultimately his own.[40] The trial court found no employment relationship between Domino's and the plaintiff.[41] An intermediate appellate court disagreed.[42] In evaluating an employment relationship under the FEHA, California courts are to look to the totality of the circumstances, including the control exercised among the parties.[43] The California Supreme Court overturned the appellate court's ruling, finding that "no reasonable inference can be drawn that Domino's...retained or assumed the traditional right of general control of an 'employer' or 'principal'...of the franchisee's employees."[44]

Although ultimately absolved from liability, *Patterson* demonstrates the potential unintended consequences when analyzing a franchisor's control over the franchisee. Similarly, the recent decisions of *Browning-Ferris* and *Hargrove*, which employed a similar analysis, may spark claims against franchisors operating in New Jersey.

## A Possible Legislative Solution

Earlier this year, three states passed pro-franchisor laws that add certainty to a franchisor's relationship with its franchisees and its franchisees' employees.[45] This may be a good solution to the uncertain legal landscape. Tennessee law now provides that neither a franchisee nor a franchisee's employees will be "deemed to be an employee of the franchisor for any purpose."[46] Texas enacted a statute providing that a franchisor is not considered an employer for claims related to employment discrimination, wage payment, minimum wage and worker's compensation, unless a Texas court concludes the franchisor "exercises a type or degree of control over the franchisee or the franchisee's employees not customarily exercised by a franchisor for the purpose of protecting the franchisor's trademarks and brand."[47] Louisiana passed a law stating that "an employee of a franchisee may be deemed to be an employee of the franchisor only where the two entities share or co-determine those matters governing the essential terms and conditions of employment and directly and immediately control matters relating to the employment relationship such as hiring, firing, discipline, supervision, and direction."[48]

In addition, Congress has introduced legislation in an attempt to reverse the new *Browning-Ferris* standard.[49] Unfortunately, for practitioners representing franchisors, at this point no such revision to the New Jersey Franchise Practices Act has been formally proposed.

## Impact for Franchisors Going Forward

In the absence of legislation adding clarity to the status between franchisors and franchisees, franchisors should continue to follow the general practices they have (hopefully) been using in order to avoid unintended employment obligations. Franchisors *should not*:

- become too involved in the day-to-day operations of the franchised locations and the management of the franchisees' employees;
- control the pay rates and classifications of franchisee employees;
- set, control or modify the employment conditions of the franchisee employees (*e.g.*, scheduling, meal and rest breaks, timekeeping procedures, etc.);
- control the hiring, firing, promotion or demotion of franchisee employees;
- micro manage, train, or directly supervise franchisee employees;
- set the employment policies for franchisees; or
- run the payroll and benefits or maintain the employment records of franchisee employees. ⚖

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## ENDNOTES

1. *J.M.L. v. A.M.P.*, 379 N.J. Super. 142 (App. Div. 2005) (affirming summary judgment in the franchisor's favor in a Law Against Discrimination sexual harassment case involving allegations that the franchise owner had sex with the plaintiff); *see also Capriglione v. Radisson Hotels Int'l Inc.*, No. 10-2845, 2011 U.S. Dist. LEXIS 115145, at *7 (D.N.J. Oct. 5, 2011) (granting franchisor summary judgment in negligence

action because franchisor's "right to control uniformity of appearance, products and administration" was insufficient to impose duty of care upon franchisor); *Chen v. Domino's Pizza, Inc.*, No. 09-107, 2009 U.S. Dist. LEXIS 96362, at *10 (D.N.J. Oct. 16, 2009) (granting franchisor's motion to dismiss in a wage and hour action and explaining that "[c]ourts have consistently held that the franchisor/franchisee relationships does not create an employment relationships between a franchisor and a franchisee's employees");[1][1] *Simpkins v. 7-Eleven, Inc.*, No. 3702-06, 2008 N.J. Super. Unpub. LEXIS 2450, at *1-*2 (App. Div. April 7, 2008) (affirming summary judgment in the franchisor's favor in a tort action because the plaintiff "had not shown that [the franchisor] had exhibited sufficient control over the individual franchisee....").

2. *See, e.g., Meyers v. Garfield & Johnson Enter.,* 679 F. Supp. 2d 598 (E.D. Pa. 2010); *Contra Orozco v. Plackis,* No. A-11-CV-703 ML, 2013 WL 3306844 (W.D. Tex. 2013) (the court found that there was sufficient evidence to support a jury finding that the franchisor was a joint employer based on language in the franchise agreement that required the franchisee to comply with certain policies and procedures of the franchisor for the "selection, supervision, or training of personnel." The jury's finding was further supported by testimony from a representative of the franchisor that he had met with the franchisee to examine work schedules and had provided advice as to those work schedules to assist the franchisee.).
3. *Browning-Ferris Industries of California, Inc. d/b/a BFI Newby Island Recyclery*, 362 NLRB No. 186 (2015) (hereinafter, *Browning-Ferris*).
4. *Hargrove v. Sleepy's LLC*, 220 N.J. 289 (2015).
5. 29 U.S.C. §§ 151-169.
6. *Browning-Ferris*, *supra*.
7. *Hargrove*, 220 N.J. at 289.
8. The ABC test is derived from the New Jersey Unemployment Compensation Act (UCA), N.J.S.A. 43:21-1, *et seq*.
9. *Hargrove,* 220 N.J. at 295.
10. *Id.* at 305.
11. *TLI, Inc.*, 271 NLRB 768 (1984); *Laerco Transp.*, 269 NLRB 324 (1984).
12. *Browning-Ferris*, *supra*.
13. *Id.* (slip op. at 2).
14. *Id.* (slip op. at 3).
15. *Id.*
16. *Id.* (slip op. at 3-6).
17. *Id.* (slip op. at 4).
18. While in a slightly different context, the United States Court of Appeals for the Third Circuit has determined in *In re Enterprise Rent-a-Car Wage & Hour Employment Practices Litigation*, No. 11-2883, 2012 WL 2434747 (3d Cir. June 28, 2012), that courts should consider the following factors when determining whether a company is a joint employer under the Fair Labor Standards Act: 1) the alleged employer's authority to hire and fire the relevant employees; 2) the alleged employer's authority to promulgate work rules and assignments and to set the employees' conditions of employment: compensation, benefits, and work schedules, including the rate and method of payment; 3) the alleged employer's involvement in day-to-day employee supervision, including employee discipline; and 4) the alleged employer's actual control of employee records, such as payroll, insurance, or taxes.
19. The general counsel for the NLRB has publically stated "there is no interest or attempt in any way, shape or form [in the *Browning-Ferris* decision] to target the franchise industry" but whether or not franchises are targeted has yet to be determined. *See* Brian Mahoney, *Agency edition: Weil on the gig economy*, (Dec. 22, 2015, 11:16 a.m.), politico.com/tipsheets/morning-shift/2015/12/agency-edition-weil-on-the-gig-economy-griffin-on-joint-employer-211687.
20. *Hargrove,* 220 N.J. at 295.
21. *Id.* at 295-96.
22. *Hargrove v. Sleepy's LLC*, No. CIV.A. 10-1138 PGS, 2012 WL 1067729, at *5 (D.N.J. March 29, 2012) (*citing Nationwide Mutual v. Darden,* 503 U.S. 318 (1992)).
23. *Darden*, 503 U.S. at 318.
24. *Darden*, 503 U.S. at 327-28.
25. 220 N.J. at 296 (editing marks omitted).
26. *Id.* at 311.
27. 220 N.J. at 316.
28. *Hargrove*, 220 N.J. at 305 (internal citations and editing marks omitted).
29. *Id*. at 301-02, 313.
30. *Id*. at 301-02.
31. *Northern Securities Co. v. United States* 193 U.S. 197, 400 (1904) (Homes, J., dissenting)
32. *Browning-Ferris*, *supra*. (slip op. at 45).
33. *Id.*
34. *Id.*
35. *Id.*
36. *See* 15 U.S.C. § 1064(5)(A); *see also Barcamerica Int'l USA Trust v. Tyfiled Imps., Inc.* 289 F.3d 589, 596 (9th Cir. 2002).
37. *Patterson v. Domino's Pizza, LLC*, 60 Cal. 4th 474, 507 (2014), *reh'g denied* (Sept. 24, 2014).
38. *Id.* at 477.
39. *Id.* at 485.
40. *Id.* at 483.
41. *Id.* at 477.
42. *Id.* at 503.
43. *Id*. at 500.
44. *Id.* at 504-05.
45. *See* Tenn. Code Ann. § 50-1-208 (2015); Act of June 19, 2015, Texas S.B. 652, 84th Leg., R.S. (2015); LA. Stat. Ann. § 23:921 (2015).
46. Tenn. Code Ann. § 50-1-208 (2015).
47. Act of June 19, 2015, Texas S.B. 652, 84th Leg., R.S. (2015), available at capitol.state.tx.us/billlookup/history.aspx?legsess=84r&bill=sb652 (codified as amended in scattered sections of Labor Code).
48. LA. Stat. Ann. La. § 23:921 (2015).
49. Protecting Local Business Opportunity Act, H.R. 3459, 114th Cong. (1st Sess. 2015).