Portfolio Media. Inc. | 860 Broadway, 6th Floor | New York, NY 10003 | www.law360.com
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

For Franchisors, There's More Than Just Browning-Ferris

Joel R. Buckberg

Law360, New York (September 30, 2015, 11:01 AM ET) -- Franchisors have heard much said and seen much written about the Obama administration's efforts to change labor laws by administrative action on the issue of whether franchisors and franchisees are joint employers. The decision in Browning-Ferris Industries of California Inc. et al. and Local 350, International Brotherhood of Teamsters (Case 32-RC-109684, August 27, 2015) drops a footnote (no. 120) on page 20 that states the decision does not apply to franchisor-franchisee relationships, reserving a decision for more specific facts and circumstances.

On April 28, 2015, the office of the general counsel of the National Labor Relations Board issued an advice memorandum holding that the Freshii restaurant system and its franchise agreements did not create a joint-employer relationship between franchisor and franchisee. Advice Memorandum 177-1650-0100, Nutritionality Inc. d/b/a Freshii Cases 13-CA-134294, 13-CA-138293 and 13-CA-142297. This memorandum is more significant in the broader context of franchising than the BFI decision and remains, as of this writing, the current thinking of the NLRB's general counsel on franchising and joint-employer status.

Freshii uses a fairly typical franchise agreement with controls over operations, marketing and other aspects of the franchisee's business consistent with business format franchising. The operations manual supplied to franchisees by the franchisor includes suggestions but not requirements for human resources management. Freshii even goes so far as to provide a sample employee handbook that is an example but franchisees are under no obligation to use the form provided. Freshii's prescribed point-of-sale software system does not include a labor scheduling component, and there was no evidence that Freshii injected itself into human resources management of its franchisees.

A complicating factor is Freshii's deployment of a development agent system that engages franchisees in recruitment, training and support of other franchisees, in exchange for a revenue split with the franchisor. Like most programs of this type, only the franchisee and the franchisor have a contractual relationship. The franchisor delegates certain of its contractual duties to the development agent, including the off-site and on-site training of each new franchisee and its store staff. After opening, the development agents monitor store operations and send notes to the franchisee about any observed deficiency or areas of noncompliance. There was no evidence that any franchisee employee was disciplined or dismissed because of any comment or note from a development agent.

The general counsel concluded that the Freshii relationships did not create joint-employer status for franchisor and franchisees under the former standard used by the NLRB: "To

establish such status, a business entity must meaningfully affect matters relating to the employment relationship "such as hiring, firing, discipline, supervision, and direction," citing a test from Laerco Transportation, 269 NLRB 324, 325 (1984). This is the actual control test that the BFI decision abandons for temporary help arrangements.

Freshii also eschewed support of labor scheduling by its franchisee. The franchisor provided no instructions, algorithms or other decision tools by which to affect crew scheduling decisions by the franchisee. There was no evidence that the franchisor used its reserved power to terminate under the franchise agreement as an indirect means to affect terms and conditions of employment or human resource decisions of the franchisee.

When the Freshii opinion issued in April, the proposed joint-employer standard of the NLRB that was articulated in the amicus brief of the general counsel filed in BFI was applied to the facts and found not to change the result — Freshii was not a joint employer under the old standard or the new standard. The Freshii model was held to represent neither direct nor indirect control over the franchisee's core terms and conditions of employment for its employees that would cause a joint-employer relationship to exist.

There is another policy aspect to expanding joint-employer status — penalizing franchisors if they do enforce federal labor law against franchisees. This policy first made its appearance when the New York Legislature enacted a requirement that franchisors report retail sales revenues of franchisees, under the theory that "deputizing" franchisors would enhance and leverage the sales tax audit function. Franchisors would force franchisees to report revenues and pay taxes accurately, based on point-of-sale system monitoring and better data collection. There is no evidence reported that this force-multiplying has had the desired effect on sales tax revenue reporting or compliance.

On a grander scale, the U.S. Occupational Safety and Health Administration has circulated a memo adopting the BFI test of indirect control for joint-employer status with regard to OSHA compliance. At a hearing on Sept. 23, 2015, before the Senate Subcommittee on Regulatory Affairs and Federal Management, Sen. Lamar Alexander, R-Tenn., asked Mary Beth Maxwell, principal deputy assistant secretary and head of the Office of the Assistant Secretary for Policy at the U.S. Department of Labor, why the policy change had been made without any legislation or an administrative rule promulgation or rulemaking proceeding.

Maxwell said the inspectors need to determine who is responsible for workplace conditions. The specter of individual OSHA inspectors making field determinations that a franchisor is a joint employer based on a single visit to a franchisee location is too frightening to contemplate. The notion that franchisors have sufficient power and authority to command OSHA compliance by franchisees, solely by virtue of the threat to terminate the franchise agreement, is shockingly naive and dangerous.

So what should franchisors do and consider? First and foremost, the use of prescribed crew scheduling software, algorithms and other methodologies for controlling labor costs must be scrubbed and reviewed for congruity with Freshii. Second, franchise agreements with springing management rights that give franchisors step-in rights or operational control if certain contingencies occur should be rethought. Finally, the full spectrum of contractual and practical control over franchisee human resources should be reviewed for real or perceived rights and practices that could be construed as direct or indirect control.

On a broader and more strategic basis, franchisors may wish to consider how significant to the brand's presentation and success is tight control over unit-level human resources. If the system needs more hands-on direction beyond training and perhaps external industrywide certifications (e.g. ServSafe, Automotive Service Excellence certifications), then the franchise model may be a higher risk approach to expanding the business footprint than raising equity and building corporate stores. Franchisors with management affiliates may

model and business plan for more build to suit outlets with financing coming from local or national investors, augmented by enhanced working capital lines and equipment financing. If the franchise is a service business and brick and mortar outlets are not as significant for mobility and service technicians with skills, then a business opportunity model that turnkeys an unbranded business and supplies a branded product inventory, with advertising cooperatives or pull through advertising (check local listings for an outlet near you) may offer less risk and a reasonable return.

At the heart of the joint-employer challenge to franchising is the political motivation to reduce barriers to collective bargaining, and to force business structures that will facilitate union organizing and membership. This agenda is occurring without any legislation or administrative rulemaking. The current administration's process to make radical changes in settled law uses administrative law policy changes and articulated standards of policy review. Given the announced support of certain candidates for president in 2016 by the unions pushing this agenda, any change of course or reversal of this policy onslaught is subject to political winds sooner and judicial review later. Both are uncertain, and unlikely to occur before early 2017.

Given all of the other challenges to growth and managing a franchise system, for the first time in recent memory, the federal legal environment is not inviting. While the U.S. Small Business Administration continues to provide substantial support and billions of dollars in liquidity to the lending markets used by many franchisees for development loans, its federal counterparts at OSHA, the NLRB and DOL articulate an aversion to franchising.

The federal trademark law known as the Lanham Act has promoted the concept of franchising since 1946 with the adoption of the "related companies" policy in its Section 5 (15 U.S.C. Sec. 1055). The Federal Trade Commission's franchise rule has been in effect to promote the informed offer and sale of franchises since 1978. An observer's confusion over these conflicting federal policies is understandable. What should a franchisor's board do? Keep the brand's options open.

—By Joel R. Buckberg, Baker Donelson Bearman Caldwell & Berkowitz PC

Joel Buckberg is a shareholder in Baker Donelson Bearman Caldwell & Berkowitz's Nashville, Tennessee. Prior to joining the firm, Buckberg was executive vice president and deputy general counsel of Cendant Corp.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.