WARSHAWSKY SELTZER PLLC

THE FRANCHISE LAW FIRM

IF YOU ARE A FRANCHISOR, YOU MAY NOW BE LIABLE FOR THE LABOR AND EMPLOYMENT LAW VIOLATIONS OF YOUR FRANCHISEES UNLESS YOU ACT SOON*

As a result of recent legal developments, many franchisors may now find themselves in the unenviable position of being considered a joint employer of their franchisees' employees. Joint employer status means the franchisor is jointly and severally liable for any labor or employment law violations committed by its franchisees (for example, missed overtime payments, miscalculated wages, minimum wage violations, unpaid benefits, anti-unionization activity, etc.). Because liability is joint and several, the franchisor can bear the full extent of the liability for a franchisee's violations, particularly if the franchisee does not have the financial resources to satisfy the liability.

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Now it seems that a franchisor can be deemed a joint employer even if it never exerts actual control over employment related matters. On January 20, 2016, the Department of Labor (DOL) issued an Interpretive Opinion laying the groundwork for future joint employer analysis. In the interpretive opinion, the DOL described a broadened "economic realities" test. The analysis focuses on the "economic realities" of the relationship between the franchisees' employees and the franchisor to determine whether the franchisees' employees are "economically dependent" on the franchisor. The DOL identified several factors, the presence of which could contribute to a finding of joint employer status. Unfortunately, some of these factors are common in the franchise relationship and have nothing to do with employment-related matters.

In addition to the broad economic realities test described in the previous paragraph, a franchisor may be found to be a joint employer under an "ostensible agency" theory, regardless of whether (i) the franchisor can directly or indirectly exert control over employment matters or (ii) the employees are economically dependent on the franchisor. Under this theory, a franchisor can be a joint employer where the franchisees' employees reasonably believe that they are employed by the franchisor.

We are hopeful that recent changes in the political landscape will put the joint employer approach announced by the DOL into remission. Without a change in policy, this joint employment approach announced by the DOL is nothing short of a crisis for franchisors. Unless and until a change of approach is announced, there are a number of practices franchisors should examine in order to mitigate the risk of being deemed a joint employer. One potential down-side to these changes is that the franchisor may harm the brand by eliminating critical support functions and controls that have traditionally been an integral part of the franchise relationship.

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Below is a non-exclusive list of items that franchisors should review, and when appropriate, modify:

Operational Changes

Supervision – Make sure the franchisee is responsible for supervising all work performed by employees (and make sure the franchisee and the franchisee's employees are aware of this fact). Do not dictate the manner in which the employees perform their tasks.

Employment Related Services and Advice – Do not get involved with any employment related practices, including: hiring, training, firing, disciplining, setting work hours, setting work conditions, specifying the manner in which work must be performed, etc. Do not specify minimum staffing levels. Refrain from providing any HR related services on behalf of franchisees, such as handling payroll, providing worker's compensation insurance, providing tools/equipment for employees, providing employee transportation, etc. Refrain from providing any feedback to franchisees who seek your advice on employment related issues. If job applications may be submitted through the corporate website, make clear that they will not be reviewed by the franchisor but will simply be passed along to the appropriate franchisee.

Field Visits – Instruct your field representatives to limit their interactions to the franchisee's owners and managers. Do not issue directives to lower level employees. Any concerns relating to these employees should be brought to the attention of the franchisee's owners / senior managers. Leave it to the franchisee to provide any required remedial action or otherwise take steps to fix the problem.

Training – Do not train the franchisee's lower level employees. Limit training to the franchise owners and key employees with managerial authority. Require these individuals to train lower level employees. If you have online training modules for lower level employees, license those modules to the franchisees, who in turn will provide the online training to their employees.

Scheduling Software – Never mandate the use of scheduling software. If you recommend or require that franchisees use a specific POS system, make sure any employee scheduling module that is included with the POS system is disabled by the licensor prior to delivery. The franchisee may then request that the licensor re-enable the scheduling software.

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Document Changes

Add Disclaimers – Make sure your FDD and Franchise Agreement include appropriate disclaimer language regarding employment matters. Please contact us for examples of language that should be added.

Remove Unnecessary Controls – Remove provisions in the FDD and Franchise Agreement that reserve or give you the right to exert employment related controls, even if you do not ever exert such control. Remove content regarding employment practices, policies and procedures, or at a minimum, make all such items optional (such as sample employee handbooks, applications, interview questions, etc.). Instead, refer franchisees to an appropriate labor relations/HR professional who can provide these services. Do not require use of one particular HR firm.

Broaden Indemnification – Broaden the indemnification provision within the Franchise Agreement to cover joint employer liability (whether such a provision is enforceable remains to be seen).

Change Manual – Use the title "Brand Standards Manual" rather than "Operations Manual." At the beginning of the manual, explain that the brand standards are necessary to ensure the uniform quality of products/services and customer experience and to protect the goodwill associated with the trademarks. Specify that all employment related forms, policies, etc. are just examples and the franchisee should have these items reviewed and modified by local counsel prior to use.

Modify Insurance Provisions – Modify the insurance provision in the Franchise Agreement to eliminate any requirement that the franchisor be named as an additional insured on employment liability insurance policies.

Minimize Ostensible Agency Risks – Add language in the FDD and Franchise Agreement requiring that franchisees have their employees sign an employment relationship acknowledgment form. This form should explain the relationship between the franchisor and franchisee, specify that the franchisee operates an independent business, and clarify that the franchisee alone is the employer and not the franchisor. The documents should also require that the franchisee exclusively uses its legal name (i.e., ABC, LLC) on all employee applications, paystubs, pay checks, employment agreements, time cards, etc. All references to the franchisor's trademarks on these documents should be removed. The Franchise Agreement and Manual should also require that the franchisees post a conspicuous notice in back-of-the-house areas to explain who the franchisee is and that the employees are employed by the franchisee and not the franchisor.

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ABOUT THE AUTHOR

Dan Warshawsky is a franchise, licensing and distribution attorney who represents clients in all aspects of franchise and distribution law. His practice focuses on franchise structuring and development, preparation of franchise disclosure documents and agreements, franchise registrations and exemptions, franchise relations, franchise compliance, franchise avoidance, international franchising, mergers and acquisitions of franchise systems, distributorships and licensing. Dan represents both franchisor and franchisee clients, although his practice predominantly involves the representation of franchisor clients. Prior to forming Warshawsky Seltzer, PLLC in 2013, Dan practiced franchise law at Greenberg Traurig (7 years) and Weiss Brown (2 years).

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