NLRB CONTENDS FRANCHISORS ARE JOINT EMPLOYERS; CASE LAW DEVELOPMENTS

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NLRB Charges McDonald's as the "Joint Employer"of its Franchisees' Employees

In a malevolent and noxious effort to bolster the politically correct attack on "income inequality", the efforts to secure an increase in the minimum wage and the fortunes of a labor union whose membership is dwindling according to certain reports - - and in complete and utter disregard of 50 years of legal precepts and business practices - - on July 29, 2014 Richard Griffin, the General Counsel of the National Labor Relations Board ("NLRB") determined that McDonald's Corporation could be deemed a "joint employer" of its franchisees' employees asserting claims of alleged violations of the National Labor Relations Act (NLRA).

As a consequence, Mr. Griffin announced om December 29, 2014 that the NLRB filed charges against McDonald's Corporation as a joint employer in 86 allegedly meritorious unfair labor practice complaints filed against McDonald's and its franchisees by those franchisees' employees over the past 24 months.

Mr. Griffin's determination comes against the background of labor unions pressuring fast food restaurants to adopt a $15 per hour wage floor (and against the larger political backdrop of claimed "income inequality" in America). Since 90% of McDonald's restaurants in the United States are franchised, McDonald's (and other franchisors) respond that they do not set employee wages, franchisees do. However, Mr. Griffin's charges (the NLRB General counsel brings charges, the NLRB adjudicates them), if adopted by the National Labor Relations Board, would give rise to McDonald's

Corporation being the joint employer of its franchisees' employees and, as a consequence, would enable unions to collectively bargain with McDonald's itself (as opposed to thousands of individual franchisees).

Mr. Griffin's charge that McDonald's Corporation is a "joint employer" of its franchisees' employees noxiously and entirely disregards 50 years of law and business principles. The very essence of the franchise model involves an arms-length, independent contractual relationship between a franchisor and its franchisees. It is the franchisor which develops the concept in question; the names, marks and logos by which its network will be identified; and, the various operational systems, procedures and protocols which franchisees must observe when operating under their franchisor's names, marks and logos. In this respect, a franchise is like any other license of intellectual property - - to be valid, that license must contain standards which licensees must adhere to when operating under the subject name/mark/logo or else, as a matter of law, intellectual property rights therein will be deemed abandoned (since a trademark and service mark, by law, stand for the elements and standards of quality and product/service attributes associated therewith).

In the franchise relationship, it is the franchisee (again, a licensee) which most typically alone is responsible for building the subject franchised unit; operating that unit; and, most critically, earning and retaining all of the profits therefrom. Typically, a franchisee only pays an initial franchisee fee to its franchisor (averaging $10 - $50,000 and, thereafter, a royalty on gross sales (averaging 5%.)

The franchise model has proven integral to the American economy. You cannot buy a car; have it serviced; fill it with gas; buy a house; eat at a restaurant; have your taxes prepared or lawn taken care of; shop at a convenience store; stay at a hotel; engage in disaster cleanup; shop at the mall; or, have your hair done without the odds being very high that you are transacting business with a franchised establishment. The latest numbers indicate that franchising today accounts for $840 billion in economic output; employs over 8.5 million individuals; and, features over 770,000 establishments[1].

But the economic realities of franchising and the fundamental business principles upon which it rests appear to matter little to the NLRB's Mr. Griffin. His mission in life appears to be aiding labor unions and fighting "income inequality." Never mind the devastating impact which his "joint employer" ruling against McDonald's may have on such a vital segment of the American economy as the franchise sector.

And toward what end? This column does not mean to suggest that the American economy is anything but sluggish; has been for the past 15 years; and, that the minimum wage should not be raised. However, perhaps instead of perverting one of our nation's most successful methods of distribution - - franchising - - Mr. Griffin and

[1] International Franchise Association, *Franchise Opportunities Guide*, Spring/Summer 2014, at 10-11 (citing IHS Global Insight).

others of his ilk should instead examine the devastating impact of the 1990's "free trade" agreements, which large American multinational companies used as cover to outsource manufacturing to countries whose employees earn a fraction of what American workers do, leaving the American economy in what seems like a permanent malaise but which resulted in the Dow Jones Industrial Average tripling in but a decade's time.

Fortunately, the courts continue to respect the economic realities of franchising and legal precedent reflecting same. That legal precedent may be simply stated: if a franchisor does not control the day-to-day operation of its franchisees' businesses, does not set the pay of its franchisees' employees, has no power to hire or fire its franchisees' employees and does not maintain employment records for them, then that franchisor will not be deemed the joint employer or co-employer of its franchisees' employees. See, for example, *Patterson v. Domino's Pizza, LLC,* 333 P.3d 723 (Cal. 2014); *Singh v. 7-Eleven Inc.*, 2007 WL 715488 (N.D.Cal. 2007); *Reese v. Coastal Restoration and Cleaning Services, Inc.*, 2010 WL 5184841 (S.D.Miss. 2010); and, *Hatcher v. Augustus*, 956 F.Supp. 387 (E.D.N.Y. 1997).

On the other hand, generally speaking courts will refuse to dismiss at the pleading stage a complaint asserting that a franchisor is a joint employer or co-employer of its franchisees' employees. Instead, while the courts almost never reach this conclusion, they wait for discovery to be conducted and a record established before doing so. As long as the subject judicial complaint sufficiently alleges a joint employment scenario, the judiciary will customarily permit that complaint to proceed, deny a motion to dismiss and instead await a post-discovery motion for summary judgment.

This occurred twice in the past year. In *Cordova et al. v. SCCF, Inc. et al.*, 2014 WL 3512838 (S.D.N.Y. 2014), the franchisor of Sophie's Cuban Cuisine Restaurants was alleged to be the joint employer or a single integrated employer of its franchisees' employees in a putative class action alleging Fair Labor Standards Act and New York State Labor Law violations. Sophie's moved to dismiss the complaint. However, as observed, the court denied Sophie's motion as being premature:

> The Second Circuit has not yet considered whether a franchisor can qualify as a joint employer, but (Sophie's) cites decisions from other circuits in which courts, using versions of the economic reality test established by the Supreme Court, have generally concluded that franchisors are not employers within the meaning of the FLSA (citations omitted)… The decisions that (Sophie's) cite, however, were all issued on motions for summary judgment after the parties had completed discovery… Here, however, there has not been any discovery and the question on this motion practice is whether the allegations pleaded in the (complaint) are sufficient plausibly to state a claim for relief… While it is not far from this juncture that Plaintiffs will need to show that (Sophie's) qualifies as a joint employer, taking the facts in the light most favorable to Plaintiffs, the Court finds that Plaintiffs have plausibly pleaded facts

suggestive of joint employment (citation omitted).

Accordingly, Sophie's motion to dismiss the complaint was denied.

The same result pertained in *Olvera et al. v. Bareburger Group LLC et al.*, 2014 WL 3388649 (S.D.N.Y. 2014), a putative class action alleging that the franchisor of Bareburger restaurants, as a joint employer, violated the rights of its franchisees' employees under the Fair Labor Standards Act and New York Labor Law. Franchisor Bareburger moved to dismiss but, again, the franchisor's motion was denied as being premature:

> Taking these pled facts as true, as the Court must at this stage, they state a plausible claim that the franchisor defendants were plaintiffs' joint employers under the FLSA and NYLL. The cases on which the franchisor defendants rely are not to the contrary. In these cases, franchisors were held not to be employers but, in all but one, this determination was made not on the pleadings but at summary judgment… These cases may signal the challenge plaintiffs may face in establishing their claims after discovery but, at this stage, plaintiffs need only plead enough facts to "state a claim to relief that is plausible on its face" (citation omitted)…
>
> Although plaintiffs may ultimately fail to prove that the franchisor defendants were joint employers under the FLSA and NYLL, they have pled enough facts to survive a motion to dismiss, and are thus entitled to test their claims in discovery.

In other words, while the facts adduced in discovery will generally support a franchisor's claim that it in no fashion serves as the joint employer or co-employer of its franchisees' employees, at the pleading stage it is enough for franchisees to adequately allege franchisor co-employment to survive an initial motion to dismiss.

Required Advertising Spend Deemed Indirect Franchise Fee

Under the New York Franchise Act (and virtually all other state franchise registration/disclosure statutes), for a "franchise" legally to exist, the putative franchisee must be "required to pay, directly or indirectly, a franchise fee" (see *Act*, §681(3)).

In turn, Section 681(7) of the Act defines "franchise fee" as "any fee or charge that a franchisee…is required to pay or agrees to pay directly or indirectly for the right to enter into a business under a franchise agreement…".

But what if a distributor of goods is required to expend a certain amount of money advertising those goods - - does this required advertising "spend", standing alone, constitute a "franchise fee"? Yes, held the court in *Nature's Plus Nordic A/S et al. v. Natural Organics, Inc. et al.*, 980 F.Supp. 2d 400 (E.D.N.Y. 2013). Echoing a line of judicial decisions first encountered in the California case of *Boat & Motor Mart v. Sea*

Ray Boats, Inc., 825 F.2d 1285 (9th Cir. 1987), the court in *Nature's Plus* held that a manufacturer's requirement that its distributor expend 5% of its net purchases on advertising the manufacturer's line of products constituted an indirect "franchise fee" under the New York Franchise Act. Held the court:

> In the Court's view, nothing in the (New York Franchise Act) requires that a "franchise fee" be paid directly from a franchisee to a franchisor. Indeed, the (New York Franchise Act) specifically provides that a "franchise fee" may be paid "directly or indirectly." This interpretation is consistent with the "New York's definition of a franchise [as] among the broadest in the country (citation omitted)."

That said, the court nevertheless held that the manufacturer's cause of action failed as a matter of law because the distributor did not make the foregoing advertising payments solely "for the right to enter into a business under a franchise agreement but, rather, to obtain goods at a discount." Further, observed the court, the distributor's 5% advertising expenditure did not result in that distributor cumulatively paying more than the wholesale price for the manufacturer's goods (and the sale of goods at a *bona fide* wholesale price is explicitly carved out from the definition of "franchise fee" in Section 681(7)(a) of the Act).

No Automatic Liability for Failing to Register/Disclose

That a mere failure to register and furnish a Franchise Disclosure Document does not lead to automatic liability under the New York Franchise Act was the principle espoused in *Mister Softee, Inc. et al. v. Amanollahi*, 2014 WL 3110000 (D.N.J. 2014) (construing and applying the New York Franchise Act).

In *Mister Softee*, plaintiff-franchisor sought a preliminary injunction against a terminated franchisee who continued to sell soft ice cream from trucks bearing the confusingly similar name "Master Softee" and other names/marks. In response, defendant-franchisee sought a judicial declaration that his Mister Softee Franchise Agreement should be rescinded - - and its covenant not to compete thus rendered nil - - as a consequence of the franchisee's assertion that Mister Softee failed to furnish him with a Franchise Disclosure Document.

After noting that there was disagreement as to whether or not Mister Softee had, in fact, furnished an FDD to defendant-franchisee, the court proceeded to hold the issue irrelevant since no causal relationship had been established by the defendant-franchisee between Mister Softee's alleged failure to disclose and any damages which the franchisee suffered. Held the court:

> Furthermore, I do not find any evidence to indicate that the alleged violation was material to either damages sustained by (the franchisee) or to its decision to enter into the Franchise Agreement. (The franchisee) summarily argues that it was, but his contentions are generic. Thus he

> argues that *all* information in a prospectus is, by its very nature, material. To find that a prospectus is always and everywhere material would render the materiality requirement (of the New York Franchise Act's rescission provision) meaningless, or at least superfluous. Indeed, Courts have required a showing that the non-disclosure was material to the franchisee's decision to invest or that it caused some ascertainable damage (citations omitted).
>
> The underlying purpose of the Franchise Act is to prohibit "the sale of franchises where such sale would lead to fraud or likelihood that the franchisor's promises would not be fulfilled" (citation omitted). There is no evidence of any materiality or willfulness - - *i.e.,* no evidence that any alleged non-disclosure in this case is connected to any unfulfilled promise or to fraud by (Mister Softee). The Franchise Act's rescission provision was not intended to shield a franchisee from complying with the terms and obligations he willingly agreed to undertake.

Accordingly, the court proceeded to hold that Mister Softee was likely to defeat its franchisee's claim for rescission and granted Mister Softee's request for a preliminary injunction (though the court narrowed its geographic scope to accord with New York reasonableness standards).

For a case involving the same franchisor resulting in a similar decision, see *Mister Softee, Inc. et al. v. Turkos*, 2014 WL 2535114 (S.D.N.Y. 2014).

For other routine cases in which franchisors sought and obtained preliminary injunctive relief against terminated franchisees, barring those franchisees from continuing to operate under the franchisor's names and marks and otherwise compelling those franchisees to comply with the post-termination duties and obligations set forth in their franchise agreements (including covenants not to compete), see: *Sunni, LLC et al. v. Edible Arrangements, Inc.*, 2014 WL 1226210 (S.D.N.Y. 2014); *7-Eleven, Inc. v. Kahn et al.*, 977 F.Supp. 2d 214 (E.D.N.Y. 2013); and, *Golden Krust Patties, Inc. et al. v. Bullock et al.*, 957 F.Supp. 2d 186 (E.D.N.Y. 2013).