New York Law Journal

WWW.NYLJ.COM THURSDAY, OCTOBER 22, 2015 Serving the Bench and Bar Since 1888

FRANCHISING

NLRB's Misguided 'Joint Employer' Thrust Against Franchising

The "progressive" attack on alleged economic disparity—reflected in efforts to secure increases in the minimum wage and to bolster the fortunes of labor unions whose memberships are declining—has invaded the franchise arena and threatens to cripple franchising.

The thrust? Seek to have franchisors declared the employers or joint employers of their franchisees' employees. By doing so, supporters of this theory hope to make large franchisors the economic "bargaining unit" with which unions may negotiate the salaries and benefits to be accorded those franchisees' employees.

In this column and the one to follow, we will examine the philosophical roots behind this campaign; its impact if successful; and, how this NLRB approach is contradicted by the Lanham Act, all federal and state franchise laws, the business norms of franchising and 50 years of judicial precedent.

By **David J. Kaufmann**

Complaint

On Dec. 19, 2014, NLRB General Counsel Richard Griffin, Jr., following through on previously enunciated threats, issued complaints[1] against McDonald's Corporation and certain McDonald's franchisees. These complaints allege that those franchisees violated the rights of employees working at their franchised restaurants at various locations around the country—and asserted that McDonald's, as a "joint employer" of those franchisees' employees, was jointly liable with its franchisees for any violations of the National Labor Relations Act (NLRA[2]) that may have taken place.

Specifically, the NLRB in its complaints alleged that certain McDonald's franchisees—and, as a "joint employer," McDonald's itself—engaged in improper discriminatory discipline; reductions in hours; employee discharges; and, allegedly coercive conduct directed at employees in response to unionization activity. The McDonald's franchisees in question are located in New York; Philadelphia; Detroit; Atlanta; Chicago; St. Louis; Kansas City; New Orleans; Minneapolis; San Francisco; Indianapolis; Phoenix; and, Los Angeles. Consolidated hearings on these charges began in March, 2015.

> The NLRB approach is contradicted by the Lanham Act, federal and state franchise laws, business norms of franchising and 50 years of judicial precedent.

Griffin's Dec. 19, 2014, issuance of the complaints alleging that McDonald's is the joint employer of its franchisees' employees was not accompanied by any memorandum, report, or other writing detailing the rationale or logic behind it—merely the contention that McDonald's "controlled" its franchisees. And when McDonald's sought a "bill of particulars" from Griffin detailing the facts upon which he intended to rely in asserting that McDonald's was a joint employer, its motion was denied by an administrative law judge, whose denial was upheld by three of the five NLRB members themselves (who concluded that "the consolidated complaint was sufficient to put McDonald's on notice that the general counsel is alleging joint employer status based on McDonald's control over the labor relations practices of its franchisees"[3]).

If Griffin succeeds in having the National Labor Relations Board declare McDonald's to be the joint employer of its franchisees' employees (the NLRB general counsel brings charges while the NLRB itself adjudicates them), then unions would presumably be able to collectively bargain with McDonald's itself (as opposed to its thousands of franchisees) to determine what wages those franchisees must pay their employees. Of course, as a joint employer, McDonald's may also find itself jointly liable under the doctrine of respondeat superior for its franchisees' employees' acts, errors and omissions.

Also, under this theory, McDonald's could find itself responsible for its franchisees' employees' Workers Compensation, unemployment insurance, Affordable Care Act and other employer-related liabilities and obligations as well as wage-and-hour violations, sick leave obligations and all other duties, obligations and liabilities which are legally imposed upon employers.

Franchising and Trademark

Characterizing franchisors as the "joint employers" of their franchisees' employees directly clashes with the fundamental business principles, structures and norms of franchising—as well as with the Lanham Act,[4] every federal and state franchise law extant in the United States and 50 years of virtually unanimous judicial precedent.

The Business Realities of Franchising. From a business perspective, franchising's bedrock is the independent contractual relationship between a franchisor and its franchisees. It is the franchisor that develops a business unit model—what will be sold from each unit; where the unit should be located; how it should be built and equipped; what standards must be adhered to in the course of a franchisee's operation of the unit; and, what type of marketing or advertising will be accomplished. In turn, it is the franchisee that, in return for a fee, acquires the right and assumes the obliga-

» Page 9

DAVID J. KAUFMANN *is senior partner of Kaufmann Gildin & Robbins and wrote the New York Franchise Act while serving as Special Deputy Attorney General of New York.*

« Continued from page 3

tion to build out and operate a unit under the franchisor's brand name and in complete accord with the franchisor's standards of operation.

Accordingly, to achieve franchising's ultimate goal—the replication of units, each virtually identical in appearance and operation and operating under a common trademark and/or service mark—franchisors per force impose upon franchisees a series of standards that encompass virtually all elements of the operation of a franchised unit. But these are the very standards of operation which, as detailed above, the NLRB general counsel asserts render a franchisor the "joint employer" of its franchisees' employees.

Not to miss the obvious, but Griffin also ignores who actually hires a franchisee's employees—the franchisee itself, which similarly sets their pay rates; supervises them on a day-to-day basis; disciplines them when necessary; pays (in addition to their salaries) all taxes and contributions associated with their employment; fixes their schedules; and, terminates their employment when necessary. In every franchised network, it is always the franchisee that performs these functions and never the franchisor.

The Lanham Act Refutes the NLRB's 'Joint Employer' Position. It is not only business precepts which mandate that franchisors mandate standards of operation upon their franchisees. It is fundamental under the Lanham Act that such controlling standards are required by trademark law.

Every franchise agreement subsumes a trademark or service mark license agreement. Under Section 5 of the Lanham Act, a trademark licensor must exert control over its licensees' use of its mark in order to avoid public deception—that is, in order to avoid the mark not standing for the standards of quality, product/service and other attributes associated with the mark. In turn, Section 45 of the Lanham Act makes clear that franchisors are embraced by Section 5 of the act.

The courts universally uphold this precept, holding that quality control is an indispensable element of a trademark license and that if a franchisor fails to exert sufficient trademark controls over its franchisees, a petition to cancel the federal registration of that trademark under Section 14 of the Lanham Act may result. As well, hold the courts, franchisors that fail to enforce trademark controls over their franchisees can have their licensed marks declared abandoned by the judiciary.[5]

Accordingly, if a franchisor fails to establish, maintain and police standards associated with its marks and also fails to effectively compel its franchisees to follow those standards, that franchisor may find its marks judicially deemed abandoned.[6] Indeed, the courts routinely emphasize that franchisors must exert actual control, rather than mere reserved contractual control, over their franchisees in order for a trademark license to be declared valid.[7]

These well-established and judicially mandated requirements of trademark law mandate that franchisors promulgate and enforce standards of operation upon their franchisees. But these are the very standards that the NLRB general counsel asserts give rise to a franchisor being the "joint employer" of its franchisees' employees, in complete derogation of a century of judicial decisions recognizing a franchisor's obligation to protect its trademark and service marks (and achieve the uniformity which consumers demand and expect) through such standards and controls.

Federal and State Franchise Laws Negate the NLRB 'Joint Employer' Thesis. As well, the NLRB general counsel's thrust against McDonald's (and conceivably all other franchisors) flies in the face of the very definition of the term "franchise" found in every federal and state franchise registration/disclosure law. Each of them features a definitional element that—reflecting the structures and economic realities of franchising—requires that a franchisor impose standards and controls on its franchisees.

Representative of these federal and state franchise law definitions of the term "franchise" is the definition afforded by Section 681(3) of the New York Franchise Act, which provides:

> "Franchise" means a contract or agreement...by which: (a) A franchisee is granted the right to engage in the business of offering, selling, or distributing goods or services under a marketing plan or system prescribed in substantial part by a franchisor, and the franchisee is required to pay, directly or indirectly, a franchise fee...

Embedded in state franchise law definitions of the term "franchise" is the franchisor's "prescription" of a "marketing plan or system." The Merriam-Webster Dictionary defines the term "prescribed" as meaning "to lay down a rule; to lay down as a guide, direction, or rule of action."[8] It is thus clear that a franchisor's "prescribing" a "marketing plan or system" has a compulsory element to it.

As to what a "marketing plan or system" is, it consists of those very "controls" which Griffin now asserts render a franchisor the joint employer of its franchisees' employees but which, under state franchise laws, must be present for a "franchise" to exist as a matter of law. Various states define what constitutes a "prescribed marketing plan or system" as including a franchisor furnishing to franchisees detailed directions and advice concerning operating techniques; assigning exclusive territories; providing for uniformity or distinctiveness of appearance; requiring approval of advertising and signs; providing training sessions; and, requiring adherence to an operations manual.[9]

Yet not once in the 45 years since the first of these federal and state franchise laws was enacted has any authority or agency administering them on either the federal or state level ever determined, suggested, stated or even implied that such franchisor standards and controls yield the result that a franchisor is the joint employer of its franchisees' employees. In other words, not a single utterance in accord with the position asserted by the NLRB general counsel—that the very standards and controls imposed by franchisors upon their franchisees that are a bedrock of franchising, required by the Lanham Act and which form a critical definitional element of the very term "franchise" in every federal and state law—somehow render franchisors the joint employers of their franchisees' employees.

Not once in the 45 years since the first of these federal and state franchise laws was enacted has any authority or agency administering them on either the federal or state level ever determined or suggested that franchisor standards and controls yield the result that a franchisor is the joint employer of its franchisees' employees.

In a future column, I will examine how the NLRB's "joint employer" thrust against franchisors is contravened by virtually unanimous judicial decisions over the past 50 years.

1. See http://www.nlrb.gov/news-outreach/fact-sheet, last accessed on September 17, 2015.
2. National Labor Relations Act of 1935, 29 U.S.C.A. §§151-169 (2000).
3. Janet Sparks, NLRB Denies McDonald's Appeal on Joint Employer Order, Blue Mau-Mau, http://www.bluemaumau.org/14648/nlrb_denies_mcdonalds%E2%80%99s_appeal_joint_employer_order.
4. 15 U.S.C.A. §1051-1172.
5. *Taco Cabana International v. Two Pesos*, 932 F.2d 1113 (5th Cir. 1991); *Kentucky Fried Chicken Corp. v. Diversified Packaging Corp.*, 549 F.2d 368 (5th Cir. 1977); and, *Dawn Donut Co. v. Hart's Food Stores*, 267 F.2d 358 (2d Cir. 1959).
6. *Barcamerica International U.S.A. Trust v. Tyfield Importers*, 289 F.3d 589 (9th Cir. 2002).
7. *Dawn Donut Co.*, supra. See, also, *Transgo v. Ajac Transmission Parts Corp.*, 768 F.2d 1001 (9th Cir. 1985).
8. Merriam-Webster Online Dictionary 2014, available at http://www.merriam-webster.com.
9. See, for example, Release No. 3-F Revised (June 22, 1994) of the California Department of Business Oversight, §I(B)(2)(1974), Bus. Franchise Guide (CCH) ¶5050.45. See, also, Ill Administrative Code §200.102; Code of Maryland Regulations, §02.02.08.02B; and, Wisconsin Administrative Code §31.01(6).