June 25, 2019

Ms. Melissa Smith
Division of Regulations, Legislation, and Interpretation
Wage and Hour Division
U.S. Department of Labor, Room S-3502
200 Constitution Avenue NW
Washington, D.C. 20210

By electronic submission: http://www.regulations.gov

RE: RIN 1235-AA26; Comments on Joint Employer Status Under the Fair Labor Standards Act; Notice of Proposed Rulemaking

Dear Ms. Smith:

The International Franchise Association ("IFA") hereby submits the following comments in response to the above referenced proposed rule published in the Federal Register on April 9, 2019, at 84 Fed. Reg. 14043.

About IFA

IFA is the world's oldest and largest organization representing franchising worldwide. Celebrating over 50 years of excellence, education and advocacy, IFA works through its government relations and public policy, media relations and educational programs to protect, enhance and promote franchising. Through its media awareness campaign highlighting the theme, Franchising: Building Local Businesses, One Opportunity at a Time, IFA promotes the economic impact of the more than 733,000 franchise establishments, which support nearly 7.6 million jobs and $674.3 billion of economic output for the U.S. economy. IFA members include franchise companies in over 300 different business format categories, individual franchisees, and companies that support the industry in marketing, law and business development.

For the reasons set forth below, IFA supports the rule proposed by the Department, which would clarify the standard for finding joint employer status under the Fair Labor Standards Act ("FLSA") and would modernize the Department's long outdated regulations on this important issue.

I. The Franchising Method

"Franchising is a method of marketing goods and services" that depends upon the existence of the franchisor's control over a trademark, other intellectual property or some other commercially desirable interest sufficient to induce franchisees to pay to participate in the franchisor's system by distributing goods or services under the franchisor's trademark or name.[1]

There are two principal explanations given for the popularity of franchising as a method of distribution. One is that it "was developed in response to the massive amounts of capital required to establish and operate a national or international network of uniform product or service vendors, as demanded by an increasingly mobile consuming public."[2] The other is that "franchising is usually undertaken in situations where the franchisee is physically removed from the franchisor, and thus where monitoring of the performance and behavior of the franchisee would be difficult."[3] These two motivations are consistent with a business model in which the licensing and protection of the trademark rests with the franchisor and the capital investment and direct management of day-to-day operations of the retail outlets are the responsibility of the franchisee, which owns, and receives the net profits from, its individually-owned franchise unit.

It is typical in franchising that a franchisor will license, among other things, the use of its name, its products or services, and its reputation to its franchisees. Consequently, it is commonplace for a franchisor to impose standards on its franchisees, necessary under the federal Lanham (Trademark) Act to protect the consumer. Such standards are essential for a franchisor that seeks to ensure socially desirable and economically beneficial oversight of operations throughout its network. These standards allow franchisors to maintain the uniformity and quality of product and service offerings and, in doing so, to protect their trade names, trademarks and service marks (collectively the "Marks"), the goodwill associated with those Marks, and most importantly, the protection of the consumer.

Because the essence of franchising is the collective use by franchisees and franchisors of Marks that represent the source and quality of their goods and services to the consuming public, action taken to control the uniformity and quality of product and service offerings under those Marks is not merely an essential element of franchising, it is an explicit requirement of federal trademark law. The Lanham Act, the federal law regulating trademarks, service marks, and unfair completion, mandates that owners of trademarks must "maintain[] sufficient control of the licensee's use of the mark to assure the nature and quality of goods or services that the licensee distributes under the mark."[4] Moreover, because the Lanham Act provides that a trademark can be deemed "abandoned" when "any course of conduct of the owner . . . causes the mark . . . to lose its significance,"[5] franchisors have a strong incentive to control the nature and quality of the good or

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[1] Joseph H. King, Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 Wash. & Lee L. Rev. 417, 420-21 (2005).

[2] Kevin M. Shelley & Susan H. Morton, *"Control" in Franchising and the Common Law*, 19 Fran. L. J. 119, 121 (1999-2000).

[3] Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, 21 J. Law & Econ. 223, 226 (1978).

[4] 15 U.S.C. § 1064(5)(A).

[5] 15 U.S.C. § 1127.

services sold by their franchisees.[6] As a result, franchisors are compelled to establish and monitor brand standards and provide global oversight with regard to their franchisees.

Likewise, it is imperative that franchisees protect their franchisors' brands, and the trademark value of those brands. A franchisee, functioning as an independent operator under a Brand License, is trusted and relied upon (by the franchisor) to protect the trademark value in implementing brand standards, and exercising day-to-day management over the operation, since the franchisor is not present at every individual franchise location. Because franchising requires the collective use by franchisees and franchisors of Marks, all stakeholders affiliated with a brand collectively share risks and rewards. For example, if a franchisee fails to take adequate steps to protect the brand or otherwise engages in an action that injures the brand's reputation, the damage inflicted on the brand impacts all of the brand's stakeholders, including all other franchisees and the consuming public. With that being the case, it is essential to franchising that all of the stakeholders understand the expectations for brand protection standards and take all necessary action to ensure that those standards are met. Furthermore, these rights and obligations are enunciated in well-drafted franchise agreements and reviewed in advance under a prescribed set of mandated disclosures.

A person need not be a franchise expert to recognize that the ability of a customer to identify a certain level of quality and uniformity in the products or services offered by disparate franchisees within a system has led to the explosive growth of franchising. A patron may enter a chain restaurant in New York, Mexico City, or Hong Kong and expect and receive virtually the same food. The uniformity and quality of products offered under a single brand is a prime factor in the success of the franchising concept. Without uniform standards, franchisees could build and operate units in whatever dissimilar fashions they chose, resulting in different buildings, uniforms, food, consumer service standards, and supply chain issues which could raise health concerns, ultimately causing the destruction of the franchisor's concept.[7]

A franchisor's exercise of controls are limited only to brand standards and should not be viewed as day-to-day management over the business operations of its franchisees. Further, this exercise of control is not merely reflective of the legal realities imposed by

[6] As explained further below, the Department's outdated current rule, and inconsistent judicial applications of it, deter franchisors from providing guidance, advice, or recommendations to their franchisees that are essential to the franchisors' protection of their brands. In doing so, the current standard conflicts with the Lanham Act's provisions mandating that franchisors maintain control over the use of their Marks. Absent statutory authorization, the Department may not override Congressional mandates contained in other statutes. *See Hoffman Plastic Compounds, Inc. v. NLRB*, 535 U.S. 137, 147 (2002) ("[W]here the Board's chosen remedy trenches upon a federal statute or policy outside the Board's competence to administer, the Board's remedy may be required to yield"); *Connell Constr. Co. v. Plumbers & Steamfitters Local Union No. 100*, 421 U.S. 616, 634-35 (1975) (rejecting claim that federal antitrust policy should defer to the NLRA).

[7] *See* Shelley & Morton, *supra* note 2, at 121.

trademark law, the FTC Franchise Rule,[8] and pervasive state and federal regulation. It is also a value-added proposition for franchisees and consumers, which is entirely consistent with the fact that franchisees are independent entrepreneurs who invest substantial capital in their businesses, control their labor relations, and dream to build equity in an independently-owned business for the benefit of themselves, their families, and their communities. For a franchisee, the purchase of a franchise means avoiding those costs of market entry that are ameliorated by the franchisor's extensive guidance and training in many aspects of the operation of the franchised business. It also means enjoying the goodwill generated by the use of the franchisor's Marks, brand and system collectively with other franchisees and company-operated outlets. Dependence by the franchisee on the detailed brand standards and methods of operation honed by franchisor experience is therefore a basic part of what a franchisee bargains for in acquiring a franchise. The use of Marks that project to members of the consuming public that they will enjoy a quality and predictable consumer experience at each outlet operated under those Marks—even though each is independently owned and operated—is the other principal part of the equation, which again benefits both franchisees and consumers.

Put simply, "[t]o comply with trademark standards, a franchisor must achieve uniformity among its company-owned and franchised units; to achieve that goal, elaborate and voluminous standards are developed, imposed, and policed."[9]

As one examination of the franchisor/franchisee model explained:

> Typically, a franchisor imposes systemwide standards by means of the franchise agreement between the parties that establishes uniform specifications with regard to: advertising and promotion; site selection; construction and design; furniture and fixtures; products and services; cash control; bookkeeping and reporting procedures; general operations; personnel; revenue reports; customer lists; accounting; display of signs and notices; authorized or required equipment, appliances, and appurtenances; required uses of trademark; insurance requirements; license requirements; standards for management and personnel; hours of operation; required uniforms; local advertising; required manner of offering or selling products or services; standards of maintenance and appearance; and training requirements. Other procedures, specifications, and standards may also be imposed. This list is not exhaustive,

[8] Published by the Federal Trade Commission, the Franchise Rule provides prospective purchasers of franchises information they may use to weigh the risks and benefits of a franchise investment, and requires franchisors to provide potential franchisees with specific items of information about the offered franchise, its officers, and other franchisees.

[9] David J. Kaufman, Felicia N. Soler, Breton H. Permesly, Dale A. Cohen, *A Franchisor is Not the Employer of Its Franchisees or Their Employees*, 34 Franchise L.J. 439, 461 (2015).

> but it touches upon many of the characteristics of the franchise relationship that courts have erroneously cited as examples of the franchisor's “control” over its franchisees in order to justify imposing direct or vicarious liability upon a franchisor.[10]

Indeed, most franchisee agreements will routinely include contractual provisions governing many aspects of business operation, some in great detail, but which have little to no bearing on a franchisor’s “control” of its franchisees’ employees. In *Drafting Franchise Agreements After Patterson v. Domino’s: Avoiding the Minefield of Vicarious Liability and Joint Employment*, the authors describe and analyze a series of such provisions commonly found in franchisor/franchisee agreements:

- Language expressly characterizing the relationship of both businesses, and setting forth which responsibilities each party assumes or retains;[11]
- Brand standards manuals and guidance, which give franchisees the benefit of the franchisor’s experience and expertise to assist them in running a successful franchise, while giving the franchisor an assurance that its brand standards are used consistently, and in a manner consonant with its policies and procedures for business operations;[12]
- Training requirements for franchisees and their franchises’ executive management on business operation;[13]
- The rights and responsibilities of the parties with respect to ongoing business guidance, recommendations, or advice for franchisees to use at their discretion, and obligations relating to periodic advice and communication;[14]
- Broad contours for the conduct of business administration, including required hours of operation, trade dress provisions ensuring the visual consistency of brand décor, design, color, and signage;[15]
- Staffing guidance, offering suggestions or sample documents for, *e.g.*, HR policies, employee discipline, training, and scheduling, to use (or not use) as the franchisee sees fit;[16]
- The use of proprietary software for business operation or payroll processing;[17]
- Safety and security requirements which franchisees must meet;[18] and

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[10] Shelley & Morton, *supra* note 2, at 121.

[11] Susan A. Grueneberg, Joshua Schneiderman, Lulu Y. Chiu, *Drafting Franchise Agreements After Patterson v. Domino’s: Avoiding the Minefield of Vicarious Liability and Joint Employment*, 36 Franchise L. J. No. 2 189, 195-97 (Fall 2016).

[12] *See id.* at 197-199.

[13] *See id.* at 199-201.

[14] *See id.* at 201-202.

[15] *See id.* at 203-207.

[16] *See id.* at 207-210.

[17] *See id.* at 210-211.

- Language requiring the franchisee to operate the franchise in compliance with all applicable laws and regulations.[19]

Some or all of these are likely to be found in common franchisor/franchisee agreements, and on their face can suggest a far greater involvement of the franchisor in day-to-day operations than is actually the case, or which in no way bear on the relationship of the franchisor to the franchisee's employees. While, as one commentator noted, these "[t]ypical franchisor controls can look pervasive to judges, lawyers, and jurors who are not schooled in modern franchising,"[20] they are nevertheless the very types of standards that many courts have found to be: (1) consistent with a franchisor's right to control its trademarks and the quality of products and services distributed under those Marks; and (2) insufficient to justify the imposition of vicarious liability. Establishing and monitoring brand standards performance merely constitutes the global oversight necessitated by the Lanham Act to ensure that franchisors protect and preserve their Marks and brands. Indeed, global oversight, unlike the exercise of control over the essential terms and conditions of employees' work lives, is a "routine feature of independent contracts."[21] Likewise, it is essential to all Brand Licenses, whether in franchising or not.

The Department's final rule must avoid disrupting commonplace and necessary reservations of rights wholly unrelated to the direct control of the terms and conditions of franchisee employees' employment, but which are rather in place to ensure brand consistency and uniformity or protection of Marks. The final rule should make clear that such provisions are not indicia of a joint employer relationship. As discussed further below, it is critical that the Department use this rulemaking as an opportunity to clarify that those exercises of "control" which are vital to the franchise model, but may in no way touch directly on the terms and conditions of franchisee employees' employment, are *not* indicia of joint employment.

Several real-life examples illustrate the uncertainty that results because of the expanding joint employer standard. Consider the following common examples of franchisor-franchisee interactions:

1. The franchisor's franchise agreement sets forth specific requirements for franchisees, such as operating hours, required uniforms, and required pre-employment screenings.
2. The franchisor provides training to franchisees regarding best practices for operations, which include suggestions for general staffing, scheduling, hiring, and disciplinary practices that are common to the business environment.
3. The franchisor provides employee handbooks or other personnel policies to its franchisees that may be used with respect to the franchisee's employees.

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18 *See id.* at 212-213.

19 *See id.* at 213-214.

20 William L. Killion, *Franchisor Vicarious Liability—The Proverbial Assault on the Citadel*, 24 Franchise L. J. 162, 165 (2005).

21 *Id.*

4. The franchisor provides its franchisees with sample policies or best practices regarding workplace civil rights issues, such as anti-discrimination policies, anti-harassment policies, statements promoting diversity and inclusion, or guidance regarding affinity groups at the worksite.
5. The franchisor conducts on-site inspections of its franchisees to ensure brand standards are being maintained.
6. The franchisor’s audit of the of a franchise location to ensure brand standards are being met causes the franchisee to correct behavior of employee(s) to ensure brand standards and quality control standards are being met.
7. The franchisor issues to a franchisee’s employee an award recognizing the employee’s quality service, which results in the franchisee rewarding the honored employee with a pay raise or promotion.
8. The franchisee requests input from its franchisor regarding desired skill sets of a store general manager, which the franchisee references but is not required to adopt to hire its store manager—or, alternatively, a franchisor recommends an individual to a franchisee as a potential general manager and the franchisee elects to hire the recommended individual for that position.
9. The franchisor provides its franchisees with regular newsletter updates advising the franchisees of recent developments in the law that could impact the franchisees.
10. In light of negative publicity resulting from an allegation that a franchisee's employee has harassed customers, the franchisor contacts the franchisee to gather further information on the allegations and the status of any investigation into such allegations.
11. In light of negative publicity resulting from an allegation that a franchisee's employee has harassed customers, the franchisee contacts the franchisor and asks for advice on options for how best to respond publicly, and the franchisor obliges.
12. In light of negative publicity resulting from an allegation that a franchisee's employee has harassed customers, the franchisor contacts the franchisee and recommends that the franchisee investigate the allegations, which the franchisee does.
13. In light of negative publicity resulting from an allegation that a franchisee's employee has harassed customers, the franchisor provides non-mandatory guidance to the franchisee regarding disciplinary action that could be pursued.
14. The franchisor refers a franchisee to the franchisor’s employment counsel for the purpose of providing advice on legal or litigation matters.
15. The franchisor provides its franchisees with point of sale (“POS”) software or other business management software including tools that assist franchisees with various operational tasks, including scheduling and inventory.
16. The franchisor requires that its franchisees maintain drug-free workplaces, which causes the franchisee to terminate an employee’s employment in light of the employee’s violation of a drug-free workplace policy.
17. The franchisor provides recommendations to franchisees regarding best practices involving personnel matters, such as hiring and discipline that is not specific to any individual employee.

18. The franchisor offers a hotline through which its franchisees can seek advice regarding operational matters.
19. The franchisor provides its franchisees with model staffing and compensation suggestions based on the franchisor's and its other franchisees' experiences—such as typical peak customer hours, the number of supervisors to staff during peak hours versus slower hours, ranges of salaries franchisees have offered to general managers at other stores, etc.

In the past, these types of interactions were deemed to be essential to maintaining a brand's reputation and were insufficient to support a joint employer finding, because they presented no direct and immediate control over the terms and conditions of employment of the franchisee's employees. As further explained below, however, the Department's current joint employer standard, and recent court holdings applying it, potentially permits joint liability to be mistakenly imposed under some or all of these hypothetical facts, and at a minimum leaves the outcome unclear. That lack of clarity needs to be rectified by way of a final rule that restores the long-standing requirement of direct and immediate control, and makes clear that the examples set forth above are *not* indicia of joint employer status.

II. The Department's Current Joint Employer Standard Has Confused the Regulated Community and the Courts, Calling for the Department's Overdue Corrective Rewrite of the Outdated Regulations

As the proposed rule correctly recognizes, courts around the country have issued divergent and inconsistent rulings on the joint employer issue, most of which purport to apply the Department's current, outdated regulation. The number of different standards, and the number of factors employed in each different test by the courts, has bewildered and frustrated employers seeking to operate franchise businesses efficiently and profitably, without inadvertently creating joint employment. By way of examples only, the Second Circuit has applied a six-factor test in *Zheng v. Liberty Apparel Co.*,[22] while the Third Circuit applied four different factors in *Enterprise Rent-A-Car Wage & Hour Employment Practices Litigation*,[23] the Fourth Circuit has come up with yet a different

[22] 355 F.3d 61 (2d Cir. 2003). The Second Circuit's list of six factors, viewed in light of "economic reality," included (1) whether Liberty's premises and equipment were used for the plaintiffs' work; (2) whether the Contractor Corporations had a business that could or did shift as a unit from one putative joint employer to another; (3) the extent to which plaintiffs performed a discrete line-job that was integral to Liberty's process of production; (4) whether responsibility under the contracts could pass from one subcontractor to another without material changes; (5) the degree to which the Liberty Defendants or their agents supervised plaintiffs' work; and (6) whether plaintiffs worked exclusively or predominantly for the Liberty Defendants.

[23] 683 F.3d 462 (3d Cir. 2012). The Third Circuit's "non-exhaustive" factors included: (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. *Id*. at 469-70.

six-factor test in *Salinas v. Commercial Interiors, Inc.*,[24] while various cases in the Seventh Circuit have applied "economic realities" tests that are indeterminate in nature,[25] and the Eleventh Circuit recently applied an eight-factor test in *Freeman v. Key Largo Volunteer Fire and Rescue Dept., Inc*.[26]

It is worth noting that the Department's current, outdated rule has played a significant role in creating the judicial confusion described above on the joint employment issue. In particular, many of the courts have cited the Department's regulatory statement that joint employers can include any two business entities which are "not completely disassociated" from each other.[27] Other courts have wrongly conflated the FLSA's statutory definition of "employ," *i.e*., to "suffer or permit" to work, [28] with the separate statutory test for "employer," *i.e*., a person "acting directly or indirectly in the interest of an employer in relation to an employee."[29]

As the Department's proposed rule correctly points out, the judicial test that has gained the greatest following among multiple circuits was set forth by the Ninth Circuit in the 1983 case of *Bonnette v. California Health and Welfare Agency,*[30] and was subsequently adopted by courts of appeals in the First Circuit,[31] Fifth Circuit,[32] Sixth Circuit,[33] some

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[24] 848 F.3d 125 (4th Cir. 2017). The Fourth Circuit's extremely broad test included the following factors: (1) whether formally, or as a matter of practice, the putative joint employers jointly determine, share or allocate the power to direct, control, or supervise the worker, whether by direct or indirect means; (2) whether formally, or as a matter of practice, the putative joint employers jointly determine, share or allocate the power to, directly or indirectly, hire or fire or modify the terms or conditions of the employee's employment; (3) the degree of permanency or duration of the relationship between the putative joint employers; (4) whether, through shared management or a direct or indirect ownership interest, one putative joint employer controls, or is controlled by or is under common control with the other putative joint employer; (5) whether the work is performed on a premises owned or controlled by one or more of the putative joint employers, independently, or in connection with one another; and (6) whether formally, or as a matter of practice, the putative joint employers jointly determine, share, or allocate responsibility over functions ordinarily carried out by an employer.

[25] *See, e.g., Moldenhauer v. Tazewell-Pekin Consol.Comm. Center*, 536 F.3d 640 (7th Cir. 2008).

[26] 494 Fed. Appx. 940 (11th Cir. 2012).

[27] 29 C.F.R. 791.2(b). *See Salinas v. Commercial Interiors, Inc*., 848 F.3d125 (4th Cir. 2017), directing lower courts in that circuit not to apply the *Bonnette* test, in part, because it did not conform to the Department's "not completely disassociated" regulation.

[28] 29 U.S.C. 203(g).

[29] 29 U.S.C. 203(d).

[30] 704 F.2d 1465 (9th Cir. 1983).

[31] *See Baystate Alternative Staffing, Inc. v. Herman*, 163 F.3d 668 (1st Cir. 1998).

[32] *See Watson v. Graves*, 909 F.2d 1549 (5th Cir. 1990).

[33] *See Skills Dev. Servs., Inc. v Donovan*, 728 F.2d 294, 300-01 (6th Cir. 1984).

Seventh Circuit cases, and the Tenth Circuit,[34] with minor variations. The *Bonnette* test considers whether the alleged employer (1) has the power to hire and fire the employees in question; (2) supervises and controls employee work schedules or conditions of payment; (3) determines the rate and method of payment; and (4) maintains employment records. These factors are not applied "blindly" but are viewed within the context of the whole relationship between and among multiple employers. In the *Bonnette* case itself, a public social service agency was found to be a joint employer of domestic in-home workers in California.

While the *Bonnette* test is not perfect, IFA agrees with the Department's proposal to re-focus the joint employer regulations on the core principles expressed by the Ninth Circuit and a plurality of other courts. IFA therefore supports the Department's decision to codify the *Bonnette* test, while at the same clarifying both the regulatory and statutory basis for its joint employer standard, including deletion of the overbroad "not completely disassociated" language from the rule, and clearly separating the statutory concepts defining "employee" and "employer." The *Bonnette* test has stood the test of time and provides the clearest guidance to employers and employees attempting to determine which business entities are or are not joint employers under specific circumstances.

IFA further supports the Department's emphasis on actual, as opposed to reserved but unexercised, control by one employer over another's employees, as being more consistent with the word "acting" in the statutory definition of Section 3(d). IFA recommends going one step further, by analyzing specific allegations of joint employment under the common law "instrumentality" test. Such a test, as further discussed below in IFA's specific comments on the proposed rule, rejects an overbroad approach that looks at control generally, and rather more closely focuses the vicarious liability analysis on the "specific aspect of the franchisee's business that is alleged to have caused the harm."[35]

III. The Adverse Impact of the Current Regulation and Inconsistent Court Rulings on <u>Franchisors</u>.

IFA's members, both franchisors and franchisees, have conveyed to the association their experiences dealing with the proliferation of class action lawsuits claiming joint employer status, and their frustration in being unable to obtain clarity in the application of the Department's current outdated regulations. The following comments highlight the ways in which the current regulations, and the inconsistent applications of the current joint employer standard under the FLSA, jeopardizes the ability of franchisors to maintain their brands and preserve the franchise relationship:

A. The Outdated Standard Makes It Harder To Resolve Crises That Jeopardize Franchisor Brands.

Franchising businesses are in a severe predicament because the unclear and unreasonable standards adopted by some courts and regulators impose on them in

[34] *See Johnson v. Unified Government of Wyandotte County*, 371 F.3d 723 (10th Cir. 2004).

[35] *Kerl v. Dennis Rasmussen, Inc.*, 682 N.W.2d 328, 332 (Wis. 2004).

circumstances in which the actions of a franchisee's employee could adversely affect the brand. In the franchising world, many customers and members of the general public cannot distinguish between a franchisor and a franchisee. Franchisors and franchisees are commonly confused as being part of the same enterprise in light of the fact that they use common Marks and rely on the same branding. As a result, it is often public perception that the actions of a franchisee are imputed to the franchisor.

This creates a significant problem when a franchisee's employee engages in public misconduct. For example, one IFA franchisor member was alerted to a video in which an employee of a franchisee mistreated a customer's pet. In today's digital age, such video footage of an employee committing misdeeds can be easily disseminated and broadcast to the entire world within a matter of seconds. Consequently, the franchisor was left with the difficult choice of either: (a) doing nothing and hoping that the franchisee would address and resolve the situation in a manner that was satisfactory to the franchisor; or (b) communicating with the franchisee to ensure that the situation would be resolved without damage to the brand.

Under the current regulations and the overbroad court rulings, if the franchisor recommends any particular disciplinary action against a franchisee's employee who has engaged in misconduct, the franchisor exposes itself to joint employment liability. However, the option of doing nothing is untenable. A franchisor cannot reasonably be expected to sit idly by when its name becomes associated with scandals or negative publicity. To do so risks the brand. The amorphous standards of the current joint employer rule jeopardize the brand.

Several franchisors have relayed instances where they received reports of franchisee employees using offensive or derogatory language in the presence of customers. Again, in such instances, the franchisor is forced to decide between doing nothing, potentially experiencing repeat scenarios where customers suffer similar unacceptable experiences, thereby risking public backlash and damage to the brand, or communicating with the franchisee about a potential strategy moving forward to resolve the situation and thereby risking a joint employer finding. A further risk is created to other franchisees in the system who rely on each other's performance under the brand standards, and trust that the franchisor will exercise the necessary controls over those standards to protect their individual investments in the system.

The Department's current regulations, as unpredictably interpreted by some courts, effectively handcuff franchisors in situations in which actions have been taken by franchisee employees that can damage the franchisor's brand.

B. The Expanded Joint Employer Standard Forces Franchisors to Eliminate or Curtail Vital Training and Support to Franchisees

Many franchisors have reported to IFA that they have been forced to implement defensive distancing behaviors under the current Department regulations and adverse court rulings. A recent survey by IFA ("IFA Franchise Survey") revealed that almost 90% of the franchisor respondents have changed the way they interact with franchisees because of potential joint-employer liability. (The IFA Franchise Survey was conducted in May and June of 2019 and included 116 respondents in the franchise industry.) This is reflected in the dwindling amount of services franchisors are offering to their franchisees in light of the expansion of the joint employment standard. A loss of franchisor services and guidance has weakened the ability of franchisees to protect and grow the equity they count on to support their families and their communities, and to ensure that consumers are receiving a safe and positive experience.

Franchisors have drastically altered their training practices for franchisees following the expansion of the joint employer doctrine. Franchisors have elected to leave franchisees to their own devices to seek whatever training the franchisees believe would assist the franchisees' employees. Other franchisors have elected to cease providing training on Human Resources-related subjects, such as anti-harassment, unconscious bias, or employee leadership. IFA's Franchise Survey indicated that the increased threat of a joint employer finding led over 84% of the respondent franchisors to change its interactions with franchisees around training and compliance (including anti-harassment, anti-discrimination, and safety and health training). Over 85% have changed the way they offer advice or guidance to franchisees regarding personnel policies (such as model handbooks or templates). Over 80% of franchisors surveyed indicated they changed the way they interact with franchisees regarding staffing and scheduling issues, and over 71% changed the way they offered advice or guidance to franchisees regarding franchise employee standards.

Franchisors rightly believe that providing less training places their brand at risk, even if it reduces joint employment liability. One franchisor stated the downside of this approach is that it impedes consistency because franchisees receive advice from a number of different sources without any input or advice from the franchisor (who likely knows the best practices of the system and is most invested in the brand's success). The same franchisor stated that some franchisees are receiving insufficient training and different styles of training from diverse parties. The consequence of this cessation and lack of uniformity of training is that it increases the risk that franchisees or their employees engage in some activity that damages the brand.

Other franchisors have elected to offer training through third parties, which provide such training without any input or direction from the franchisors. However, doing so comes at a needless cost for the franchisors. One franchisor estimated that its training costs increased 300-400% due to its decision to outsource the training because of joint employer concerns.

Similarly, many franchisors have stopped providing advice or guidance to franchisees that request assistance with regard to personnel matters—such as compensation or disciplinary actions. Instead, some franchisors resort to providing franchisees with options for consideration, but without making any recommendations to rely on. Others refrain entirely from responding and instead refer franchisees to other resources, such as an attorney which creates an added expenditure for franchisees.

Finally, it bears note that the threat of joint employer liability has directly impacted franchisor costs, revenues, and profits. Almost three-quarters of franchisors surveyed (74%) indicated that changes in behaviors around guidance, training, performance standards, and other policies impacted their bottom line. Perhaps more troubling, over three out of four franchisors (77%) indicated that the threat of joint employer liability had directly increased their legal costs, including defending joint employer claims and adapting policies and operations to minimize the risk of joint employer liability. Indeed, as one survey respondent noted, the transactional costs of litigation and discovery alone have forced the franchisor to consider raising its royalty rates for franchisees solely to cover increased legal costs.

C. The Outdated Regulations Force Franchisors to Compromise or Restrict Their Relationships with New, Disadvantaged Franchisees

Franchisors are less inclined to work with newer franchisees or economically disadvantaged franchisees given the heightened risk of joint employer liability.[36] Specifically, if a prospective franchisee does not have a background in the type of service that a franchise system offers, those franchisors who have curtailed their services were less likely to offer the franchise opportunity out of fear that the prospective franchisee will need more guidance and coaching than the franchisor is able to offer under the current joint employer standard. Those franchisors reported strong reluctance to offering franchise opportunities to inexperienced franchisees, who might otherwise be quality and qualified candidates for a specific system, because the inexperienced franchisee would not have adequate access to the franchisor's support necessary for success in the system, nor the business experience to rely upon when those services and guidance are not provided. One franchisor compared this to sending a new franchisee into a boxing match with his hands tied behind his back.

Another franchisor, with over 20% of franchisees from economically disadvantaged backgrounds, has ceased expanding relationships with such franchisees unless those franchisees demonstrate greater economic long-term stability. Yet another franchisor, because of joint employer concerns, is considering eliminating a program in which it provides an opportunity for successful general managers at franchisor-owned stores to rent the store property and equipment, hire their own staff, and share in the profits of the store. Some franchisors have alternatively opted to stop expanding their franchisee base and instead open franchisor-owned stores.

This development is especially harmful to diverse and marginalized franchisees. As explained by the Southern Christian Leadership Conference (SCLC), "franchises are a

[36] As explained by the Progressive Policy Institute, "Faced with the new incentive structure of the expanded joint employer doctrine, franchisors . . . have a clear preference against smaller franchisees in favor of the larger organizations. This [makes] it much harder for new entrepreneurs to enter business through franchising, further raising barriers of entry for business creation." Dane Stangler, *Expansion of the Joint Employer Doctrine Fails to Strike the Right Balance*, PPI RADICALLY PRAGMATIC, Oct. 5, 2017, https://www.progressivepolicy.org/blog/expansion-joint-employer-doctrine-fails-strike-right-balance/ (last visited Dec. 3, 2018).

true symbol of economic opportunity with over 20% of franchises being owned by minorities" (Exhibit A). There is a higher minority ownership rate among franchised businesses than in non-franchised businesses. Indeed, IFA's recent study showed that in 2012, 30.8% of franchises were owned by minorities, compared to 18.8% of non-franchised businesses.[37] Between 2007 and 2012, the minority ownership rate for franchised businesses increased by 50% and female ownership increased by 49%.[38] During that time period, Black ownership of franchises increased by 66% and Hispanic ownership of franchises more than doubled.[39]

The SCLC emphasized, however, that "the expanded policy over what it means to be a joint employer has centralized the franchise systems, providing fewer opportunities for [minorities] to take control of their destiny and build wealth for their families."[40] This view is shared by the National LGBT Chamber of Commerce, which explained that the expanded joint employment standard "impede[s] upon the crucial business opportunities afforded to diverse and marginalized business communities, and in turn, reduce[s] their opportunities to build and sustain generational wealth" (Exhibit C). Historically disadvantaged populations that did not have the same opportunities and resources to gain the necessary business, managerial, or industry experience that franchisors are seeking in prospective franchisees are indirectly impacted when franchisors consider that lack of experience in deciding whether to offer a franchise opportunity. Reasonably so, franchisors must choose prospective franchisees who have compatible experience with the system, or risk mistakes that could damage the brand, consumer safety and experience, or result in litigation.

IV. The Adverse Impact of the Current Regulation and Inconsistent Court Rulings on Franchisees.

As explained above, expansion of the joint employer standard has caused franchisors to curtail the services and support they provide to their franchisees, to the detriment of franchisees.

A. Less Access to Advice and Training

The curtailment of franchisor training, in-store observations, and willingness to provide general advice has harmed franchisees. In light of franchisors no longer providing such services, franchisees have been forced to either invest in obtaining or offering such training for themselves or to act without receiving the benefit of any such training. Finding adequate training is not easy for every franchisee. Not all training is available on the internet or other remote resources, and some franchisees based in rural

[37] IFA Foundation, *Franchise Business Ownership by Minority and Gender Groups – 2018, available at* https://www.franchisefoundation.org/franchise-business-ownership-minority-and-gender-groups-2018 (last visited Dec. 3, 2018).

[38] *Id*.

[39] *Id*., Exhibit B.

[40] *Id.*

parts of the United States have difficulty obtaining affordable training that can be provided locally.

Given the curtailment of franchisor support, franchisees have been forced to incur new expenses. Several franchisees have retained attorneys to assist them with drafting employee handbook and personnel policies—which typically cost several thousand dollars at a minimum. In the IFA Franchise Survey, 60% of franchisee respondents reported that they'd seen their interactions with franchisors regarding training affected, and close to half of the respondents witnessed changes in the advice and guidance around personnel policies and suggested templates offered them by their franchisors. Such costs are especially burdensome on economically disadvantaged franchisees and rural franchisees that lack access to experienced employment law counsel. Aside from the economic burden and lack of access to experienced counsel, another hurdle to franchisees are the additional hours spent figuring out and completing tasks the franchisor had historically aided with, rather than spending those crucial hours enhancing the operation and growth of the business.

B. Loss of Collaboration

For many franchisees, expansion of the joint employer standard has effectively resulted in the elimination of collaboration between franchisees and franchisors. Previously, many franchisors provided recruiting materials, online job banks, applicant tracking software and other resources intended to help connect franchisees to a larger talent pool of potential employees. These franchisor-provided resources are an important part of the franchise value proposition because nearly all franchisees are challenged in attracting experienced applicants, and if they fail it can leave their business understaffed. What's more, many new franchisees struggle to identify what qualities and traits to look for in a potential employee, and end up hiring people who are not a good fit for the business. Poorly staffed or understaffed franchisees are often less efficient, increasing the operational workload of the business owner and depriving them of maximum potential growth. When franchisors are required to take away resources that help franchisees identify talented and experienced employees, those franchisees also see an increase in unfamiliar administrative work, adding yet another hindrance to the franchisee's growth and success.

Furthermore, many franchisors provided in-store observations in order to provide advice intended to assist franchisees with their operations. Franchisors often used such observations, as well as store training and sample personnel materials (such as model employee handbooks, payroll platforms, or personnel policies), to guide franchisees in training and maintaining talented and experience employees. As a result, franchisors offered advice on best practices—obtained through many years of experience working with multiple franchisors—through myriad channels. Beyond that, franchisor training sessions and meetings with franchisees often resulted in franchisees creating a network among themselves through which they could communicate with one another to share operational ideas. Many franchisors also rewarded successful franchisees with recognition awards designed to encourage compliance with the franchisor's branding expectations, but have stopped doing so due to joint employer concerns.

As franchisors have rolled back on providing such services, franchisees have been left to their own devices to develop successful recruiting and operational practices. Many of these franchisees, without the benefit of certain "model materials," applicant software and recruiting materials, and in-store observations, are left wondering whether they are competently performing basic operational tasks, such as scheduling, marketing, identifying and hiring the right employees, or even Human Resources tasks. Many franchisees do not know whether they are operating in a manner that is satisfactory with their franchisors' branding expectations. Franchisees are then forced to spend additional time or resources figuring it out, hindering the business, the brand, and potentially consumers' experiences.

As a consequence, franchisees are forced to rely on their own experiences. This is especially difficult and challenging for newer franchisees that have had little experience owning or managing a business. They have effectively been tasked with operating their stores, complying with their franchisors' expectations, complying with the law, and trying to run a profitable operation all on their own.

C. The Severe Economic Impact of Joint Employer Expansion on Franchisees

According to a recent study of joint employment conducted by Dr. Ron Bird, "the 'distancing' behavior by franchisors from franchisees has resulted in franchisees experiencing lost sales or increased costs equivalent to yearly lost potential output between [2.55% and 4.93%]."[41] He concluded that the output loss for franchisees in the United States as a result of the National Labor Relations Board's expansion of its joint employer standard in the *Browning-Ferris* case is in the range of $17.2 billion to $33.3 billion per year. He further determined that *Browning-Ferris* has resulted in anywhere from 142,000 to 376,000 lost job opportunities. Dr. Bird's findings have equal relevance to the expansion of joint employer status under the FLSA and fully support the Department's NPRM.

Dr. Bird concluded that "[f]or the 233,000 small business franchisees nationwide, [assuming a 4.93% loss in output], the average franchisee [has] experience[d] an annual revenue loss of $142,000 per year" since 2015. Dr. Bird noted that, "These amounts [have] significant impacts on small franchise businesses in which average annual revenue is only $2.9 million and average profit including return on the entrepreneur's own labor is $433,000."

Dr. Bird opined that the expanded joint employment standard "will have a significant adverse impact on the U.S. economy, equivalent to a loss of output of $17.2 billion to $33.3 billion annually for the franchise business sector and likely multiple times that for all sectors affected." These lost revenues do not take into consideration other increased costs that have incurred as a result of the expansion of the joint employer doctrine. As with franchisors, the threat of joint employer liability has had a direct

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[41] See Attachment L to comments filed by IFA in response to the NLRB's proposed rule on joint employer standards. RIN 3142-AA13 (Jan. 5, 2019).

impact on franchisees' bottom lines. Almost two-thirds (63%) of franchisees reported that changes in their behaviors related to potential joint employer liability had impacted their revenues, costs, and profits, and more than two-thirds (68%) reported increased in internal costs and changes in staff allocation in response to this threat.

D. The Department's Proposed Path Forward: IFA's Specific Comments on the Proposed Rule

As noted above, IFA supports the Department's proposal to codify the four-part *Bonnette* test in order to produce a rule that is clear and more predictable than the other divergent tests adopted by different courts. Beyond that, IFA supports the proposed rule's emphasis on the actual exercise of control prior to making any finding of joint employer status. This principle is essential to conforming the joint employment standard to Section 3(d) of the Act's definition of employer as a person "acting" directly or indirectly in the interest of another employer.

IFA strongly agrees with the Department's rejection of previous Administrator's Interpretations of the joint employment standard stating or implying that anyone who is "economically dependent" on another employer somehow becomes that employer's employee.[42] Such interpretations wrongly conflate the statutory definition of "employment" (the "suffer and permit" language in Section 203(g)) with the statutory definition of "employer" in Section 203(d). For the same reason, the "not completely disassociated" language in the current regulation is confusing, harmful, and contrary to the statute as interpreted by some courts, and must be eliminated.

Of particular importance is the Department's express disclaimer of applying joint employer status based on business models alone, including franchising. As the Department correctly states the use of the franchising (or any other) business model "does not make joint employer status more or less likely."

IFA also supports the Department's attempt to list certain excluded practices in Part (d)(4), so that they will not be deemed "additional factors" leading to a finding of joint employer status under Part (b)(1). The Department's list thus excludes mere setting of wage floors, instituting sexual harassment policies, establishing workplace safety practices, morality clauses, and similar generalized business practices. In the franchising field, however, this list does not go far enough to exclude business practices, as described in the first section of these comments, that are legitimate brand protection standards and that should not result in any joint employer finding. IFA specifically urges the Department to expand its list of practices excluded from being considered as evidencing joint employer status, so as to also exclude:

- Requiring standardized operating hours and uniforms;
- Providing franchisees with point of sale ("POS") software including tools that assist franchisees with scheduling.

[42] *See* Administrator's Interpretation No. 2015-1 (2015); Administrator's Interpretation No. 2016-1 (2016).

- Providing training regarding best practices for operations, which include suggestions for general guidance regarding staffing, scheduling, hiring, disciplinary practices, and dealing with outside third parties;
- Recommending standardized employee handbooks or other personnel policies;
- Providing sample policies or suggested best practices regarding workplace civil rights issues, such as anti-discrimination policies, anti-harassment policies, statements promoting diversity and inclusion, drug-free workplaces or guidance regarding affinity groups at the worksite;
- Conducting on-site inspections and offering negative or positive feedback to preserve franchise standards;

Some, but not all, of the foregoing list of common franchising brand-protection activities are referred to in the proposed rule or in the list of examples attached to the rule. However, IFA submits that <u>all</u> of the franchisor activities listed above should be recognized by the Department as legitimate franchising business practices, necessary to maintaining franchise brand standards, which should not be deemed to be evidence of joint employer status.[43]

As noted above, IFA further recommends the Department adopt the common law "instrumentality" test for analyzing specific joint employer allegations, at least in connection with franchising. The "instrumentality test … focuses the vicarious liability analysis more narrowly on whether a franchiser controls, or has the right to control, 'the daily conduct or operation of the particular 'instrumentality' or aspect of the franchisee's business that is alleged to have caused the harm.'"[44] Put more simply, and as made clear by way of example, the instrumentality test asks if the putative joint employer had control over the <u>specific behavior or term of employment</u> relevant in a given case. Such an approach ensures that the many common features of franchise contracts—most of which have little if anything to do with a specific employee's day-to-day conduct—are not misused as evidence in some "joint employment" tapestry.

As an example of this mode of analysis, in *Wendy Hong Wu v. Dunkin Donuts, Inc.*, the District Court for the Eastern District of New York observed that in assessing joint employer liability, "courts determine whether the franchisor controls the day-to-day operations of the franchisee, and more specifically whether the franchisor exercises a considerable degree of control of the instrumentality at issue in a given case."[45] Applying this standard, the court addressed the vicarious liability of a franchisor in a case where the franchisee's employee was brutally assaulted. The court focused its

[43] IFA also supports the comments submitted by the Coalition for a Democratic Workplace seeking additional exclusionary language in Part (d)(4), relating to industries other than franchising which are most affected by the proposed rule.

[44] Grueneberg, Schneiderman & Chiu, *supra* note 11, at 192 (citing *Kerl v. Dennis Rasmussen, Inc.*, 682 N.W.2d 328, 394 (Wis. 2004)).

[45] 105 F. Supp. 2d 83, 87 (E.D.N.Y. 2000).

examination on the specific term and condition of employment relevant to the harm suffered, specifically, the extent of the franchisor's control over the store's security, the failure of which was alleged to have caused the attack in question. The court readily concluded that because the franchisor did not require any specific security or equipment, but rather merely suggested that security was important and offered equipment for franchisees, it could not be held vicariously liable.[46]

Similarly, in *Patterson v. Domino's Pizza, LLC,*[47] the California Supreme Court, in determining whether franchisor Domino's could be held vicariously liable for the harassing behavior by a franchisee's employee, declined to find a joint employment or agency relationship relating to the particular facts in issue (*i.e.*, Domino's control over the franchisee's harassment policy and its enforcement). Rather, the court found persuasive the facts that Domino's had no right to establish a sexual harassment policy or training for the franchisee's employees; that there was no means by which franchise employees could report harassment to Domino's; and that the franchisee had implemented its own anti-harassment training and policies.[48] In light of such facts, the court concluded, no public policy would be served by holding liable a party that "could not have prevented the misconduct and corrected its effects."[49]

In adopting this functional approach, courts applying the instrumentality test—or something similar to it—appropriately ensure that the focus of the joint employment inquiry is on control of the specific terms and conditions of employment relevant to the question of vicarious liability in a given case, rather than a broad and overly-generalized "catch-all" of factors whose ostensible "control" bears little on the day-to-day activities of franchisee employees.

CONCLUSION

For the reasons set forth above, IFA supports the Department's proposed rule, with relatively minor improvements, because it portends greater clarity and recognition that long accepted business practices in the franchising industry should not be evidence of joint employment. The final rule should make as clear as possible that an employer may be considered a joint employer of a separate employer's employees only if the two employers share or codetermine the employees' essential terms and conditions of

[46] *Id.* at 93. *See also Helmchen v. White Hen Pantry,* 685 N.E.2d 180, 182 (Ind. Ct. App. 1997) (ruling that franchisor did not incur liability for the security of its franchisees' employees even though it required that its franchisees follow the franchisor's plans for fixtures, equipment, signs, and other display-related materials; it required franchisees that chose to adopt video security systems to employ certain kinds of equipment; required that the franchisees comply with the standards included in the franchisor's operating manual, which included a section on robbery; and employed a "director of loss prevention" who, in correspondence to franchisees, discussed loss prevention strategies, including video surveillance systems).

[47] 333 P.3d 723 (Cal. 2014).

[48] *See id.* at 739-42.

[49] *Id.*

employment, such as hiring, firing, discipline, and supervision. Such a rule is essential to franchising – a model that promotes small business and creates a pathway for individuals who wish to start their own businesses, create jobs, and participate in the American dream.

Respectfully submitted,

Matthew A. Haller
Senior Vice President
Government Relations & Public Affairs