PUBLICATION

Franchisor Liability for Franchisee Employment Decisions

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McDonald's and the Joint-Employer Standard

In July 2014, the National Labor Relations Board (NLRB) took the unexpected step of authorizing complaints against McDonald's USA, LLC and some of its franchisees for the franchisees' responses to employee protests. The Board took the position that McDonald's, as a franchisor, was a joint employer of the employees and could therefore be liable for the franchisees' employment decisions. The move riled many in Congress, several of whom wrote the NLRB's general counsel, Richard Griffin, demanding an explanation of the Board's position.

On November 4, Griffin responded to House Representatives John Kline (R-MN) and Phil Roe (R-TN) (here), and on November 10, he wrote Representative Todd Rokita (R-IN) (here), attempting to explain – and perhaps walk back – the Board's position. Both letters sent the same message: The Board asked whether it should continue to use the existing joint-employer standard or adopt a new one, and the general counsel's office responded with a proposed new test in an amicus brief. But there are currently no open cases in which Griffin's office is alleging "that an entity is a joint-employer solely under the test" proposed in the amicus brief. Griffin continued his attempt to placate the congressmen, assuring Kline and Roe that "my office is not seeking to have the Board overturn the line of cases that stand for the proposition that, where franchisors' indirect control over employee working conditions is merely related to the franchisors' legitimate interest in protecting the quality of their brand or product, such indirect control is insufficient to make the franchisors joint employers with their franchisees."

Griffin's description makes the Board's position seem more reasonable than its actions have indicated. But this could simply be lip service to calm a political storm. Only time will tell whether the Board will continue to follow established precedent or attempt to radically expand the joint-employer standard during the last two years of President Obama's second term in a way that implicates franchises across the country.

Patterson v. Domino's Pizza, LLC

The California Supreme Court recently had an opportunity in *Patterson v. Domino's Pizza, LLC* to follow the Board and expand the joint-employer standard in the franchisor/franchisee context. It instead reached a very different result, and issued an opinion that provides a logical response to the Board's position and guidance for franchisors to avoid liability — either vicariously or as a joint employer — for franchisees' employment decisions.

Man Behaving Badly (Allegedly)

In September 2008, Sui Juris, LLC signed an agreement with Domino's Pizza Franchising, LLC to operate a Domino's franchise in Southern California. A couple of months later, a young woman named Taylor Patterson was hired at the store. Soon after she started, she reported that a male assistant manager was sexually harassing her each time they worked together. Patterson reported the harassment to the franchise owner and her father, who called the police and a Domino's customer service line. Patterson resigned soon after because she felt that her hours had been cut in retaliation for complaining about the harassment.

Patterson then sued the assistant manager, the franchise and Domino's for sexual harassment, retaliation and constructive termination under California's Fair Employment and Housing Act (FEHA), along with other claims. She claimed that Domino's was both her and the assistant manager's employer, that each defendant was an agent of the other, and that they all acted with each other's permission and approval to commit these violations.

The Trial Court Says Not Enough Control to Hold Domino's Liable

The trial court didn't buy it. Domino's moved for summary judgment arguing that it did not have an agency or employment relationship with the franchisee and thus could not be held liable for the assistant manager's conduct. Domino's did not downplay its involvement in operations or brand management, but instead argued that it had no input into the selection, management or discipline of the franchise's employees. The trial court agreed and found that Domino's did not exercise sufficient control over the day-to-day operations of the franchise to establish an agency relationship or to be the offending assistant-manager's employer.

The Appeals Court Says, "Not So Fast, My Friend..."

Though the Court of Appeals applied the same legal principles as the trial court, it reached the opposite decision. It decided that the franchise agreement and guidance provided by Domino's showed that the franchise lacked sufficient "managerial independence" to dismiss Domino's without a trial. According to the appeals court, a reasonable jury could conclude that Domino's had liability because, in sum, its standards addressed far more than food preparation, and Domino's Area Leader (the liaison between the company and the store) told the franchise owner: "You've got [to] get rid of this guy."

The Supreme Court Provides Clarity: The Court's Holding

In a refreshingly direct and clear opinion, the California Supreme Court concluded that Domino's could not be held liable for the alleged harassment under either a joint employer or vicarious liability theory. The reason was this: "Domino's lacked the general control of an 'employer' or 'principal' over relevant day-to-day aspects of the employment and workplace behavior of [the franchisee's] employees."

Before conducting its analysis, the court defended the franchise business model and its economic and societal benefits, providing a historical context that framed the decision well. (The opinion is well worth reading.) The court explained that appellate courts have historically focused on "the degree to which a particular franchisor exercised general 'control' over the means and manner of the franchisee's operations." It then defined those boundaries, recognizing that a franchisor may impose "comprehensive and meticulous standards for marketing its trademarked brand and operating its franchises in a uniform way," so that, "[to] this extent, [it] controls the enterprise." But the court made the important distinction that, at the same time, the "franchisee retains autonomy as a manager and employer...It is the franchisee who implements the operational standards on a day-to-day basis, hires and fires store employees, and regulates workplace behavior." Thus, strict control over operations and brand management does not necessarily result in vicarious liability. It is the implementation and application of the franchisor's standards on a day-to-day basis that counts.

The Franchise Agreement

With the groundwork laid, the court looked to the franchise agreement. The agreement, as it should, disclaimed any agency relationship between Domino's and the franchisee. In fact, the franchisee had agreed to act as an "independent contractor," regardless of the training, support or oversight Domino's provided. The agreement also disclaimed any employment relationship between Domino's and the franchisee's employees. All employee-related responsibilities and duties were allocated to the franchisee. And, the court noted, "[N]othing in the contract granted Domino's any of the functions commonly performed by employers." Domino's had no right or duty to operate the store or manage the employees.

The Parties' Conduct

The court then turned to the parties' conduct to see just how involved Domino's was in operating the franchise. Though the evidence indicated that the parties had not followed the franchise agreement to the letter (Domino's had provided training materials on store operations, safety, driving and even orientation materials), the court found that the franchisee had sole control over hiring decisions and training regarding how employees should "treat each other at work." In fact, the franchisee had implemented his own sexual harassment policy and training, and he alone had "the authority to impose discipline for any violations."

Domino's, on the other hand, did not have a procedure for monitoring or reporting sexual harassment complaints, and was not involved in addressing Patterson's allegations of harassment. The court also did not put as much stock as the appeals court did in the Domino's Area Leader's remark that the franchisee should get rid of the assistant manager. The court reasoned that the timing of the statement was not clear and that there was no accompanying threat if the franchisee did not do as the Area Leader suggested.

The Dissent

The court's opinion was only the majority opinion by one vote, with three of the seven justices disagreeing. The dissent focused on the position of strength held by Domino's over the franchisee, explaining that the "retention of control by the franchisor, enforced by regular inspections and the threat that a noncompliant franchisee will be placed in default, presents occasions for the franchisor to act as an employer by forcing the termination of problematic employees." They argued that this power, in effect, results in the franchisor having control over day-to-day personnel decisions, and a jury should have been allowed to determine whether Domino's exercised such power through its Area Leader.

***Patterson*'s Practical Guidance**

Patterson provides several reminders that will help franchisors avoid unnecessary exposure:

- First, critically review the franchise agreement.
  - Ensure that the franchisee retains the right to hire, fire, discipline and otherwise manage the store's employees.
  - Ensure that the agreement disclaims any employment relationship with the franchisee's employees.
  - Ensure that the agreement disclaims any agency relationship with the franchisee and its employees.
- Second, remember that control is everything.
  - Train franchisor employees who interact with the franchisee to stay out of personnel decisions. They should avoid any comments or correspondence related to a specific employee's performance, discipline or complaints.
  - Take a hard look at any training that the franchisor is providing directly to the franchisee's employees. Does it go beyond the brand promise of product uniformity and customer experience? Is the extension absolutely necessary? If not, consider modifying the training to limit its scope.
  - Critically consider all training provided to the franchise owner. Does it stray into managing employees? Are you imposing employment practices or policies that the franchisee must follow at

the peril of the franchise, or are you creating an atmosphere where the franchisee subjectively believes they must be followed at the peril of the franchise?

- Third, it may be better to terminate a franchise agreement or buy it out rather than to attempt to exercise more control of the franchise.

  - Carefully consider whether any documentation provided to the franchisee could be construed as imposing control over employment decisions. Careful management of a brand and business model does not make a franchisor liable; but demanding certain employment practices in the franchised workplace could open the door to liability exposure.
  - Train franchisor employees, particularly field representatives, to focus on compliance with standards related to performance and representation of the brand instead of getting involved in managing the franchisor's employees. Find an exemplary franchisee for workplace management and employment practices, and use them at franchisee events or on-line as a resource for other franchisees.