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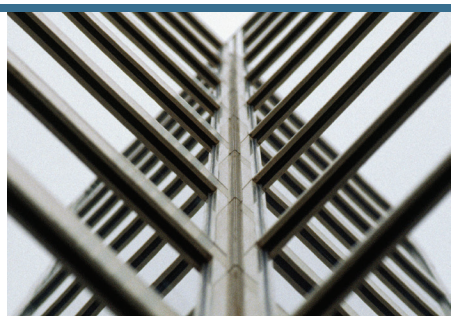

"Would You Like Joint-Employer Liability With That?" McDonald's Serves as a Cautionary Tale for Franchisors and Other Potential Joint Employers

The National Labor Relations Board Office of the General Counsel has investigated charges alleging McDonald's franchisees and their franchisor, McDonald's, USA, LLC, violated the rights of employees as a result of activities surrounding employee protests…. If the parties cannot reach settlement in these cases, complaints will issue and McDonald's, USA, LLC will be named as a joint employer respondent.

—NLRB Press Release

Carolyn Vardi
Partner, New York
+ 1 212 819 8584
cvardi@whitecase.com

Tal Marnin
Counsel, New York
+ 1 212 819 8916
tmarnin@whitecase.com

Background

The risk that franchisors and other entities may be held liable as "joint employers" for the employment-related liabilities of their affiliated companies has become more stark and warrants their increased attention to respecting corporate formalities in dealing with affiliated companies.

Joint-employer liability may arise when one entity controls the terms and conditions of employment of the employees of an affiliated company (sometimes referred to as the primary employer), such as hiring, firing, discipline, supervision and direction. The typical example is where a company engages workers through an employee leasing firm or temporary staffing agency but exercises sufficient control over the leasing firm's or staffing agency's employees to be held responsible for employment-related claims. However, franchisors, controlling equity holders (potentially including private equity sponsors), parent companies, secured lenders and other companies that exercise too much control over the employment relations of their affiliated companies may also be at risk of being "joint employers."[1]

1 *See, e.g., Guippone v. BH S&B Holdings LLC, et al.*, 737 F.3d 221 (2d Cir. 2013) (holding that fact issue existed as to whether parent exercised de facto control over its subsidiary so as to be held liable under the WARN Act as a single employer with its subsidiary, but affirming dismissal of the WARN Act claims against the equity investors in the parent company because there were not sufficient allegations regarding control by such equity investors); *Coppola v. Bear, Stearns & Co. Inc.*, 499 F.3d 144 (2d Cir. 2007) (finding that creditor did not exercise sufficient control over debtor to make it liable under the WARN Act with respect to employees of the debtor); *In Re: Enterprise Rent-A-Car Wage & Hour Practices Litigation*, 683 F.3d 462 (3d Cir. 2012) (holding that parent is not liable under the federal Fair Labor Standards Act as a joint employer because it did not exercise sufficient control over subsidiaries' employees); *Myers v. Garfield & Johnson Enterprises, Inc.*, 679 F. Supp. 2d 598 (E.D. Pa. Jan. 14, 2010) (denying motion to dismiss by franchisor Jackson Hewitt because sufficient facts alleged for franchisor's potential liability as joint employer for sexual harassment of franchisee employee). Although many of the decisions regarding single or joint-employer liability have been resolved in favor of the non-employer defendants, the courts have generally focused on the level of control exercised by such non-employer defendants, among other factors.

White & Case LLP
1155 Avenue of the Americas
New York, NY 10036
United States
+ 1 212 819 8200

Companies found to be joint employers can be held responsible, together with the primary employer, for violations of employment laws affecting the employees of the primary employer. Indeed, joint employers have been held to be liable for violations of laws dealing with, among others, (i) employment discrimination, (ii) wage and hour issues, including minimum wage and overtime pay, and (iii) WARN Act notice for plant closings and mass layoffs, and also have been subject to union organizing and claims of unfair labor practices. Each of these laws generally has its own test for determining whether an entity is a "joint employer," but "direction and control" over the employees or the employment decision at issue is usually a critical component of the analysis.

NLRB General Counsel Authorizes Claims Against McDonald's, as Joint Employer, and Seeks to Expand "Joint-Employer" Test

Since 1984, the National Labor Relations Board (NLRB), which enforces the federal National Labor Relations Act, has determined whether a joint-employer relationship exists by examining if an entity has and, in fact, exercises "direct and immediate control" over employment matters affecting another entity's employees and whether such control is "substantial" rather than "limited and routine."[2] Applying this test, franchisors that generally observed corporate formalities had not traditionally been found to be joint employers of the employees of their franchisees. The announcement by the Office of the General Counsel of the NLRB (the "General Counsel") authorizing the filing of complaints against McDonald's, USA, LLC ("McDonald's") for unfair labor practices involving employees of McDonald's franchisee restaurants illustrates a new-found interest by the NLRB in expanding the "joint employer" test.

Specifically, the General Counsel authorized the filing of at least 43 separate complaints against the McDonald's franchisee restaurants and/or McDonald's as joint employer if such cases do not otherwise settle. These cases generally involve accusations that McDonald's franchisees illegally fired, threatened or otherwise penalized workers for their pro-labor activities, including employee protests over wage and hour issues. If the NLRB ultimately finds McDonald's, as franchisor, to be a joint employer of some or all of the 19,000 employees of its franchisee restaurants, McDonald's could be responsible for any unfair labor practices of its franchisees and also be required to bargain on a franchisor level with unions. McDonald's has stated that it will oppose the decision for it to be named a joint employer and has stressed that its franchisees control all decisions regarding wages, hours and other working conditions for their employees.

The decision by the General Counsel to authorize complaints against McDonald's is consistent with its previous request to expand the test used to determine joint-employer relationships. If the NLRB adopts the position advocated by the General Counsel, the NLRB will apply a more expansive "totality of circumstances" test rather than the more limited "direct and immediate control" test. The "totality of circumstances" test would look at whether one entity wields "sufficient influence over the working conditions of the other entity's employees" so that both entities should be required to participate in meaningful bargaining with a labor union.[3]

The General Counsel has proposed that the NLRB return to its pre-1984 joint-employer test that would find an entity to be a joint employer "where it exercised direct or indirect control over significant terms and conditions of employment of another entity's employees; where it possessed the unexercised potential to control such terms and conditions of employment; or where 'industrial realities' otherwise made it an essential party to meaningful collective bargaining."[4] The General Counsel noted that potential control includes both "the unexercised ability to control employment conditions reserved in … commercial agreements," as well as potential control "based not on specific contractual privileges but rather on the 'industrial realities' of certain business relationships."[5] The General Counsel also believes that joint-employer status is a factual issue regardless of which standard is to be applied.[6]

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2 *See, e.g.*, Amicus Brief of the General Counsel in *Browning-Ferris Industries of California, Inc.*, No. 32-RC-109684.

3 Id.

4 Id.

5 Id. The NLRB General Counsel recently confirmed, however, that "[his] office is not seeking to have the [NLRB] 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." Letter from Richard F. Griffin, Jr., General Counsel, NLRB, to Hon. John Kline and Hon. Phil Roe, M.D., dated November 4, 2014.

6 Id. In contrast to the NLRB's announcement, the California Supreme Court recently held (in P*atterson v. Domino's Pizza, LLC*, No. S204543, decided August 28, 2014) that Domino's Pizza LLC ("Domino's") was not a joint employer in connection with sexual harassment claims brought by an employee of one of its franchisees, regardless of the fact that Domino's implemented a "comprehensive operating system" with a "uniform marketing and operational plan" for its franchisees. The Court held instead that the franchisor "becomes potentially liable for actions of the franchisee's employees only if it has retained or assumed a general right to control other factors such as hiring, direction, supervision, discipline, discharge and relevant day-to-day aspects of the workplace behavior of the franchisee's employees. Any other guiding principle would disrupt the franchise relationship." The California decision applies only to claims under California law, and not to federal claims under the jurisdiction of the NLRB or other federal agencies, and illustrates that this area of the law continues to be in flux and that different legal rules may apply to different types of claims even within the general area of employee relations.

Recommendations for Minimizing the Risk of Being Joint Employers

Franchisors should be careful to observe corporate formalities to minimize their risk of being deemed joint employers under the various employment laws regardless of whether the NLRB ultimately expands its application of the joint-employer test or not. These steps should include the following, among others:

- Franchise agreements should contain statements confirming that the franchisor and/or non-employing entity does not have the authority to direct, control or supervise, or otherwise influence, employment decisions, and any contrary statements contained in franchise agreements should be deleted. Franchisors should also consider including indemnification provisions in the franchise agreement pursuant to which the franchisees indemnify the franchisors with respect to employment matters.
- Franchisors should avoid exercising control over their franchisees, other than through the ordinary incidents of the franchise relationship (e.g., controlling brand management).
  - A franchisee's own management team should be responsible for day-to-day operations as well as major employment decisions (e.g., terminations and layoffs, plant closings). Franchisors should not dictate such decisions for their franchisees.
  - Franchisees should develop and maintain their own labor and personnel policies and practices, and handle their own human resources issues. A franchisor should still be able to provide sample policies that it considers to be best practices for its franchisees.

Though not specifically affected by the General Counsel's decision regarding McDonald's, as stated above, equity holders (including private equity sponsors), parent companies, secured lenders and other companies are subject to potential claims that they too are joint employers with respect to employment discrimination, wage and hour issues, WARN Act obligations and unfair labor practices, and should take care to observe many of the same corporate formalities listed above in order to avoid joint-employer status. For example, controlling equity holders, such as private equity sponsors, should avoid exercising control, or reserving the right to exercise control, over their portfolio companies and limit their activities to oversight of the Board of Directors through their appointed directors. Such controlling equity holders should also refrain from providing input in employment decisions, other than through their appointed directors.

- In the mergers and acquisitions context, when conducting due diligence in connection with the potential acquisition of a franchisor, in addition to customary diligence review of the franchise system, would-be acquirors should pay special attention as to whether relevant franchise agreements contain appropriate protections for joint-employer issues and whether and how much the target franchisors exercise control over the labor and employment relations of their franchisees.