Labor and Employment Alert: Slouching Toward Joint Employment with the U.S. Department of Labor and California Litigation Involving Franchises

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Things fall apart; the centre cannot hold; Mere anarchy is loosed upon the world.
~ W.B. Yeats, *The Second Coming*

Under the basic franchise model, the franchisor gives the franchisee a license to use its name, trademark, and business practices and benefit from established methods of operating the business. The business plan and the operations remain solely under the control of the franchisee. Thus, the central premise of the franchisor-franchisee relationship has been that the franchisee is an independent contractor and that the franchisor and franchisee are not joint employers. This model has been under attack by the Department of Labor (DOL), the National Labor Relations Board, the Occupational Safety and Health Administration, and the Equal Employment Opportunity Commission. A new initiative between the DOL and Doctor's Associates (the franchisor for Subway restaurants) and California litigation involving McDonald's further seek to fundamentally alter the franchise paradigm.

In August 2016, the DOL announced a voluntary agreement between itself and Subway as part of Subway's efforts "to make its franchised restaurants and overall business operations socially responsible" and "encourage FLSA compliance by its franchisees." For its part, the DOL seeks to collaborate with businesses "to promote compliance on a broader scale." This collaboration is notable for the level of involvement Subway agrees to take in monitoring and ensuring its franchisees' wage-hour compliance.

First, Subway will assist the DOL in creating compliance assistance materials for the franchise restaurant industry, which Subway will disseminate to its development agents, franchisees, and managers. Subway and the DOL will meet quarterly to discuss ways to improve franchisee compliance – such as identifying "opportunities for corporate [i.e, Subway] and agency leadership to emphasize the importance of FLSA compliance" and engage in "creative problem-solving" to ensure widespread compliance.

Second, the DOL will "help Subway understand and use" the publicly available enforcement data "so that Subway can make informed business decisions that reflect existing and potential franchisees' history of FLSA violations." The agreement notes that Subway may exercise its business judgment to terminate an existing franchise, deny a franchisee the opportunity to purchase additional franchises, or otherwise discipline a franchisee based on a history of FLSA violations.

Third, Subway and the DOL will "analyze and discuss" Subway's disclosures to other governmental agencies in order to "generate new ideas for promoting compliance with the FLSA." Subway and the DOL will also explore ways to use technology to support its franchisees' wage-hour compliance, "such as building alerts into the payroll and scheduling platform that Subway offers as a service to its franchisees."

Finally, "when circumstances warrant," Subway agrees to "inform" its franchisees that the DOL has the authority to investigate and inspect their premises for potential FLSA violations.

The agreement does not disclose whether the DOL considers Subway to be a joint employer with its franchisees. Nor does the agreement absolve Subway of liability for FLSA violations (the agreement expressly states the DOL "retains its prosecutorial discretion to investigation and seek remedies"). But it is foreseeable that this agreement will be cited by a franchisee's employees when attempting to show that Subway has direct or indirect control over their terms and conditions of employment. Subway's agreement to undertake ongoing monitoring and compliance of its franchisees' wage-hour issues may weigh in favor of finding joint employment.

Meanwhile, in California, a federal judge recently denied summary judgment for McDonald's Corp and McDonald's USA LLC in a class action alleging off-the-clock work, unpaid overtime, and meal and rest period violations. In *Salazar v. McDonald's Corp*., the plaintiffs sued both McDonald's and its franchisee, which was the plaintiffs' immediate employer, asserting claims of actual and ostensible agency to show that McDonald's and the franchisee were joint employers. The court found no actual agency because McDonald's did not control the hiring, firing, wages, hours, or day-to-day aspects of the plaintiffs' workplace.

But the court found sufficient evidence, "albeit subject to dispute," of McDonald's ostensible agency (under ostensible agency, the plaintiffs must prove McDonald's intentionally or negligently caused them to believe that the franchisee was its agent). According to the plaintiffs, they believed they and the franchisee worked for McDonald's because they wore McDonald's uniforms, prepared and served McDonald's food, had managers who were trained by McDonald's and who referred to themselves as "working for McDonald's," and completed applications that bore the McDonald's logo. While McDonald's presented countervailing evidence that questioned the reasonableness of plaintiffs' beliefs, the court found the plaintiffs have provided enough evidence to assert an ostensible agency claim under California law.

It remains to be seen how the DOL will press for similar "voluntary" agreements with other franchisors or whether the plaintiffs' ostensibly agency theory will ultimately win out. Other courts have rejected that argument in the franchisor-franchisee context. Regardless, the DOL's initiative and this litigation illustrate increasing efforts to treat franchisors and their franchisees as joint employers. Contact your Vorys lawyer if you have questions about the franchisor-franchisee relationship.