

# Franchise Regulation for the Fissured Economy

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## ABSTRACT

*Franchise stores employ nearly nine million people in the United States. Many franchisors, which own trademarks that they license to franchisees, are among the largest, most sophisticated corporations in the United States. Yet franchise store employees are often paid below the minimum wage and frequently report unsafe workplaces and workplace discrimination.*

*The thesis of this Article is that widespread employment law noncompliance in franchise stores is symptomatic of the failure of employment law to recognize the measures that franchisors use to protect their brand in franchise stores. Franchisors often develop intensive relationships with franchisees and franchise store employees as representatives of the brand, and provide franchisees with required or recommended personnel standards and business tools. These standards and tools can encourage employment law violations by triggering employment law obligations, which franchisees, who own and operate franchise stores, have little incentive to understand or follow. Yet the joint employer doctrine, which holds contractors that are joint employers jointly and severally liable for employment law violations by subcontractors, often does not recognize these measures as evidence of joint employment. Courts, accordingly, often reject joint employer claims against franchisors, even when the franchise relationship may mask or encourage employment law violations in franchise stores.*

*Although most scholarship focuses on the joint employer doctrine to deter subcontractor employment law violations, this Article argues that improving compliance in franchise stores will require liability standards that recognize these unique features of franchising and do not depend on a joint employer determination. It identifies apparent agency and misrepresentation theories in existing law that would hold franchisors liable for employment law violations based on their representations to franchisees and franchise store employees. It offers these standards as a conceptual framework to deter em-*

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*ployment law violations in franchise stores and evaluates potential over- and underdeterrence critiques. This analysis has important implications for the governance of contractual relationships in which a firm contracts out for employees who represent the firm's brand to the consumer.*

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## INTRODUCTION

Franchising<sup>1</sup> employs nearly nine million people in the United States.<sup>2</sup> It is a dominant business model in the service economy, particularly the fast food sector, and accounts for half of retail sales in the United States.<sup>3</sup> Franchising is a paradigmatic example of the “fissured workplace,”<sup>4</sup> in which firms contract out labor-intensive services in order to reduce management costs, the need for upfront capital, the risk of liability, and business failure. It is unique among contracting arrangements in permitting franchisors to maintain a strong brand identity through uniform products and services across thousands of units in geographically dispersed markets, while allowing franchisees, who are often first-time business owners, to own and operate a business without previous training or a business plan.

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<sup>1</sup> Franchising is a contractual relationship in which a firm—the franchisor—delegates store ownership and operation to a subcontractor—the franchisee—who purchases a limited license to use the franchisor’s trademark in a geographically defined area, usually in return for an upfront fee and royalties. See JEFFREY L. BRADACH, *FRANCHISE ORGANIZATIONS* 3 (1998); Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 *STAN. L. REV.* 927, 934 (1990); Paul H. Rubin, *The Theory of the Firm and the Structure of the Franchise Contract*, in *FRANCHISE CONTRACTING AND ORGANIZATION* 19 (Francine Lafontaine ed., 2005) [hereinafter *FRANCHISE CONTRACTING*].

<sup>2</sup> INT’L TRADE ADMIN., U.S. DEP’T OF COMMERCE, 2016 TOP MARKETS REPORT *FRANCHISING* 7 (2016).

<sup>3</sup> *Id.* The fast food sector had over 190,000 franchise stores in 2017, the largest number of any sector in the United States, followed by 110,236 personal services franchise establishments and 106,207 business services franchise establishments. IHS MARKIT ECON., *FRANCHISE BUSINESS ECONOMIC OUTLOOK FOR 2018*, at 17 (2018).

<sup>4</sup> David Weil describes franchising as a type of “fissuring,” in which firms contract out to preserve “the benefits of a strong brand while controlling labor costs (particularly important for service businesses, where labor represents a significant share of costs).” DAVID WEIL, *THE FISSURED WORKPLACE* 122 (2014).

Franchise store employees are often low wage.<sup>5</sup> The fast food sector, where a plurality of franchise store employees work,<sup>6</sup> pays among the lowest wages in the U.S. economy.<sup>7</sup> United States Department of Labor (“DOL”) investigations have found widespread violations of wage-and-hour law in franchise stores,<sup>8</sup> and franchise store employee surveys and litigation also suggest a high incidence of workplace injuries and employment discrimination as well.<sup>9</sup>

Employment law violations appear to be far more frequent in franchise stores than franchisor-owned stores. David Weil, comparing DOL investigations of fast food franchisee- and franchisor-owned stores, found that franchisee-owned stores are twenty-four percent more likely to violate wage-and-hour law than comparable franchisor-owned stores, and that where DOL found violations, franchise store employees were owed about fifty percent more back wages than employees in franchisor-owned stores.<sup>10</sup> Franchisees of large, sophisti-

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<sup>5</sup> See *Franchise Employment*, U.S. CENSUS BUREAU (Feb. 22, 2016), [https://www.census.gov/library/visualizations/2016/comm/cb16-tps17\\_franchise.html](https://www.census.gov/library/visualizations/2016/comm/cb16-tps17_franchise.html) [<https://perma.cc/BN6D-AMX3>] (finding that the majority of franchisee employees work in service sector, including fast food, hotels, and home health care); see also Drew Desilver, *Where Near-Minimum-Wage Workers Work, and How Much They Make*, PEW RES. CTR.: FACT TANK (Nov. 17, 2014), <http://www.pewresearch.org/fact-tank/2014/11/17/where-near-minimum-wage-workers-work-and-how-much-they-make/> [<https://perma.cc/BN8Z-T95D>].

<sup>6</sup> The fast food sector employs 3.6 million franchise store employees, the highest number of any sector, and with the million franchise store employees in full service restaurants, most franchise store employees in the United States work in food service. IHS MARKIT ECON., *supra* note 3, at 17.

<sup>7</sup> Fast food employees earn an average hourly minimum wage of \$9.73 per hour, which the U.S. Bureau of Labor Statistics recorded as the lowest average wage of all U.S. occupations except for gaming dealers. *May 2017 National Occupational Employment and Wage Estimates: United States*, U.S. BUREAU LAB. STAT. (Mar. 30, 2018), [https://www.bls.gov/oes/current/oes\\_nat.htm#00-0000](https://www.bls.gov/oes/current/oes_nat.htm#00-0000) [<https://perma.cc/XVY5-6HWK>].

<sup>8</sup> An analysis of DOL investigations from 2000 to 2013, for example, showed that DOL found 17,000 FLSA violations in Subway’s 26,000 chain stores, the worst record in the industry. See Annalyn Kurtz, *Subway Leads Fast Food Industry in Underpaying Workers*, CNN MONEY (May 1, 2014, 3:50 AM), <http://money.cnn.com/2014/05/01/news/economy/subway-labor-violations> [<https://perma.cc/5WXU-S93F>].

<sup>9</sup> See, e.g., HART RESEARCH ASSOCS., *KEY FINDINGS FROM A SURVEY ON FAST FOOD WORKER SAFETY* (2015), <https://hartresearch.com/wp-content/uploads/2016/10/Fast-Food-Worker-Survey-Memo-10-5-16.pdf> [<https://perma.cc/THL5-A39X>] (reporting that eighty-seven percent of 1,500 surveyed fast food workers report that they suffered a workplace injury in the previous year, and seventy-eight percent reported multiple injuries during the same period); Daniel Wiessner, *McDonald’s, Franchisees Hit with Sexual Harassment Complaints*, REUTERS (Oct. 5, 2016, 12:24 PM), <http://www.reuters.com/article/mcdonalds-complaint/mcdonalds-franchisees-hit-with-sexual-harassment-complaints-idUSL2N1CA1QB> [<https://perma.cc/QL8G-JK2A>] (highlighting complaints filed by fifteen employees alleging sexual harassment by managers in McDonald’s franchise stores).

<sup>10</sup> WEIL, *supra* note 4, at 131; see also MinWoong Ji & David Weil, *Does Ownership Struc-*

cated franchisors often violate wage-and-hour laws even as these franchisors overwhelmingly comply with them.<sup>11</sup> These investigations showed, for example, “that one-half of the top twenty brands had *no* violations and owed no back wages at *any* of their company-owned outlets even though the franchisees in those same companies often owed substantial back wages to employees.”<sup>12</sup>

Why, given that national franchisors are among the most profitable and sophisticated firms in the United States, have a reputational interest in legal compliance, and operate stores themselves in compliance with employment law standards, do violations in franchise stores seem to be widespread?

This Article argues that at the root of low workplace standards in franchise stores is the franchisor’s deep involvement in franchise store operations, which can mask and even encourage violations. Unlike many other types of contracting out arrangements, franchise store employees are the representatives of the franchisor’s brand to the consumer. To protect their brand, franchisors exercise indirect control over franchise stores through internal branding measures that implicitly promise that franchise store employees that champion the brand to the consumer will work in a stable, well-run workplace that complies with employment laws. However, franchisors do not monitor employment law compliance in franchise stores; on the contrary, franchisors often provide personnel practices and business tools to franchisees without informing franchisees that these policies trigger employment law obligations that franchisees are unaware of and have little incentive to follow. Employment law violations predictably ensue.

The joint employer doctrine, the primary employment law liability regime for subcontracting arrangements that holds all firms jointly and severally liable if they “codetermine”<sup>13</sup> terms and conditions of employment, often does not recognize these aspects of the franchise relationship. Courts in joint employer claims against franchisors adopt a narrow right to control test that excludes evidence of the indirect

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*ture Influence Regulatory Behavior? The Impact of Franchising on Labor Standards Compliance* 3 (Bos. Univ. Sch. of Mgmt., Working Paper No. 2010-21, 2009), [https://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1623387](https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1623387) [<https://perma.cc/W733-DL3S>]; Alan B. Kreuger, *Ownership, Agency, and Wages: An Examination of Franchising in the Fast Food Industry*, in *FRANCHISE CONTRACTING*, *supra* note 1, at 517, 540 (finding that employees in franchise stores are paid lower wages than in franchisor-owned stores).

<sup>11</sup> See WEIL, *supra* note 4, at 132.

<sup>12</sup> *Id.*

<sup>13</sup> *Salinas v. Commercial Interiors*, 848 F.3d 125, 141 (4th Cir. 2017).

and remote measures that franchisors use to control franchise stores. Even a broader version of the joint employer standard that considers these factors would not credit the franchise store employee's reasonable belief that franchisors are responsible for ensuring legal compliance in franchise stores and would not impose a specific duty on franchisors for personnel policies that trigger employment law obligations. The recent history, moreover, of potential widening of the joint employer standard, followed by legislative and administrative backlash, casts doubt on the joint employer doctrine as a broad, durable standard to regulate franchisor representations that may mask or encourage employment law violations.

This Article offers theories of franchisor liability, outside of the traditional joint employer doctrine but found in existing law, to improve employment law compliance in franchise stores. Emergent litigation shows how apparent agency and misrepresentation theories can ground this analysis by hinging on franchisor measures that mask or encourage employment law noncompliance in franchise stores. Apparent agency, under both common law and some state labor laws, would hold jointly liable those franchisors that use internal branding measures that create a reasonable belief among franchise store employees that the franchisor is responsible for ensuring legal compliance in franchise stores. State fraud and franchise laws, which regulate franchisor misrepresentations to franchisees, would hold franchisors liable for encouraging franchisee use of policies and business tools that trigger employment law obligations without taking reasonable efforts to ensure compliance with those legal requirements. Confining franchisor liability to representations to franchise store employees and franchisees can also address objections that a broad joint employer doctrine will create unpredictable franchisor obligations or harm franchising as a business model. Although already available under existing law, lawmaking can elaborate these doctrines to make them more effective in encouraging employment law compliance in franchise stores, particularly in jurisdictions in which these theories are limited by heightened reliance requirements.

The effect of franchisor measures to protect the brand on employment law compliance in franchise stores is an underdiscussed topic.<sup>14</sup> Other scholars, notably David Weil, have previously argued

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<sup>14</sup> Economists and law scholars typically examine the problem of opportunism in franchising as a double-sided moral hazard, between the franchisors, which impose comprehensive standards on franchisees to protect their brand, and franchisees, which ignore standards that franchisors do not monitor in order to increase store profit. As Gillian Hadfield argues, this

that contracting out creates financial pressure for franchisees to lower costs in ways that can violate wage-and-hour law,<sup>15</sup> but this Article shows that franchisors can also directly encourage a broad range of employment law violations by recommending business policies and tools that trigger employment law obligations in franchise stores without monitoring compliance. Although previous scholarship critiquing the joint employer doctrine has recommended theoretical third-party liability standards to induce contractors to improve subcontractor employment law compliance,<sup>16</sup> this Article is the first to offer liability standards outside of the joint employer doctrine but found in existing law. This Article also builds on previous scholarship about the psychological contract—formed by mutual, implicit promises in the employment relationship<sup>17</sup>—by identifying internal branding practices that can create an implicit promise between franchisors and franchise store employees. These practices can create a reasonable expectation that, in return for effectively championing the franchisor’s brand to the consumer, franchise store employees will work in a well-run store that complies with employment laws.

Although franchising encompasses a variety of business models, this Article will focus on business format franchising, in which franchisors condition the franchise agreement on franchisee compliance with the franchisor’s business system and process.<sup>18</sup> This is the dominant form of franchising in the United States, particularly in the service sector where most franchising occurs.<sup>19</sup> The liability standards offered in this Article have less relevance in a distributorship model of

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creates incentives for opportunistic behavior by the franchisor even if they run counter to the reasonable expectations of franchisees. This includes the imposition of standards that improve the franchisor’s brand but cut deep into franchisees’ profits. Hadfield, *supra* note 1, at 951–53. This Article agrees with Professor Hadfield’s analysis that franchisors can structure the franchise relationship to control franchise store operations by conditioning franchise agreements on franchisee dependency on the franchisor. It also argues that, independent from this contractual relationship, franchisors can also protect their brands by bypassing franchisees and developing relationships directly with franchise store employees through internal branding practices.

<sup>15</sup> See WEIL, *supra* note 4, at 121–23.

<sup>16</sup> See Alan Hyde, *Nonemployer Responsibility for Labor Conditions*, in WHO IS AN EMPLOYEE AND WHO IS THE EMPLOYER? 409, 416–17 (Kati L. Griffith & Samuel Estreicher eds., 2015); Steven A. Carvell & David Sherwyn, *It Is Time for Something New: A 21st Century Joint-Employer Doctrine for 21st Century Franchising*, 5 AM. U. BUS. L. REV. 5, 11–12, 35–36 (2015); Brishen Rogers, *Toward Third-Party Liability for Wage Theft*, 31 BERKELEY J. EMP. & LAB. L. 1, 1–2 (2010).

<sup>17</sup> Katherine V.W. Stone, *The New Psychological Contract: Implications of the Changing Workplace for Labor and Employment Law*, 48 UCLA L. REV. 519, 550 (2001).

<sup>18</sup> BRADACH, *supra* note 1, at 3–5, 23, 85.

<sup>19</sup> *Id.*

franchising, in which the franchisor has a limited role in franchise store operations.<sup>20</sup> In contrast, this analysis has important implications for other business models that rely on third-party intermediaries to manage the employees who champion the brand to consumers.

This Article proceeds as follows: Part I charts the measures that franchisors use to protect their brand—delineated as dependency, control, and loyalty measures—and concludes that these measures (1) can cause franchise store employees to reasonably believe that they are employed by the franchisor and (2) can encourage employment law violations in franchise stores. Part II explains that the joint employer doctrine, which holds jointly and severally liable those entities with the right to control the workplace, can elide the dependency, control, and loyalty measures that franchisors take to protect the brand—requiring theories outside of the joint employer doctrine to improve employment law compliance. Part III offers an extension of franchisor liability, grounded in apparent agency and misrepresentation theories, to regulate franchisor representations to franchisees and franchise store employees, and suggests lawmaking to improve these standards in state employment, fraud, and franchise laws. It will also address the critique that increased franchisor regulation will cause overdeterrence and examine recent legislation in Australia that offers an alternative proposal of a negligence standard to improve the franchisor's standard of care. The Article concludes that a liability standard grounded in apparent agency and misrepresentation theories will improve employment law compliance in franchise stores, with less of a risk of over- or underdeterrence than alternative liability regimes.

## I. FRANCHISOR MEASURES TO PROTECT THE BRAND AND THEIR IMPLICATIONS FOR EMPLOYMENT LAW COMPLIANCE IN FRANCHISE STORES

The growth of franchising since the 1980s<sup>21</sup> is emblematic of the larger transformation of the production process, from firm-based to

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<sup>20</sup> Some businesses, such as soft-drink bottlers, automobile dealerships, and gasoline service stations, often use a distributorship model that does not require a business system or process, and simply provides franchisees with a limited license to use the franchisor's trademark, equipment, and materials in a regional market in return for franchisee fees. See Francine Lafontaine & Roger D. Blair, *The Evolution of Franchising and Franchise Contracts: Evidence from the United States*, 3 ENTREPRENEURIAL BUS. L.J. 381, 383–85 (2009) (describing traditional model of franchising); see also HENRY HANSMANN, *THE OWNERSHIP OF ENTERPRISE* 158–59 (1996) (describing franchisor-retailer cooperatives, in which the retailer members are the exclusive shareholders).

<sup>21</sup> See Lafontaine & Blair, *supra* note 20, at 395 (concluding that “franchising has grown



network-based, throughout the U.S. economy.<sup>22</sup> But while other forms of contracting seek to outsource services that are outside the firm's core competency, franchising permits firms to control their own production process by indirectly and remotely controlling franchise store operations while outsourcing the risk and liabilities of store ownership.<sup>23</sup> As business scholar Jeffrey Bradach shows, to do this, franchisors adopt a hybrid, or plural, model of franchisor and franchisee ownership of stores.<sup>24</sup> Retaining some stores for direct ownership allows franchisors to perfect their business systems and processes in the units they directly control before requiring franchisees to adopt those business systems and processes.<sup>25</sup> Franchising also provides flexibility in how, and to whom, to delegate store ownership. Franchisors may select new, single-unit franchisees, who may need more support to learn the franchisor's business process and system to supplement firm-owned stores in densely populated areas, while preferring multi-unit franchisees, which tend to be more sophisticated and independent, to operate in isolated regions where competition would otherwise prevent growth.<sup>26</sup> The result is a flexible mix of firm-owned and single- and multiunit franchisees to expand and contract ownership of chain stores based on operational costs and liabilities, and the firm's capital accumulation and brand value.<sup>27</sup>

These undeniable benefits of franchising to franchisors (and to franchisees, who may operate a profitable franchise store without previous business experience<sup>28</sup>), however, are contingent on the ability of

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somewhat faster than the overall economy," from "12.8% of GDP in the mid-1980s" to "14 to 14.5% of GDP" in the 2000s).

<sup>22</sup> See June Carbone & Nancy Levit, *The Death of the Firm*, 101 MINN. L. REV. 963, 1016 (2017).

<sup>23</sup> WEIL, *supra* note 4, at 122–26.

<sup>24</sup> In this model, franchisors may elect to directly own and operate chain stores where monitoring and operational costs are low and to delegate ownership to franchisees when the franchisors lack capital or when agency costs are high. BRADACH, *supra* note 1, at 63–75; Francine Lafontaine & Margaret E. Slade, *Retail Contracting and Costly Monitoring: Theory and Evidence*, in FRANCHISE CONTRACTING, *supra* note 1, at 367, 375 (noting that firms are more likely to franchise in sectors where store-level monitoring costs are high).

<sup>25</sup> See BRADACH, *supra* note 1, at 149–50.

<sup>26</sup> See *id.* at 68–75 (discussing the relative costs and benefits of unit growth through new franchisees and existing, multiunit franchisees). See generally Alanson P. Minkler, *Why Firms Franchise: A Search Cost Theory*, 148 J. INSTITUTIONAL & THEORETICAL ECON. 240, 240–59 (1992) (finding that franchisees primarily absorb the risk of franchisor expansion).

<sup>27</sup> This mix may change over time, with greater levels of franchising at the outset as a growth strategy, to a plural model of firm-owned and multiunit franchisees as the franchisor matures, achieves greater brand recognition, and faces fewer capital constraints.

<sup>28</sup> Economists Patrick Kaufmann and Francine Lafontaine estimate that McDonald's franchisees in the 1980s earned an annual profit of between five and six percent on a franchise store.

franchisors to control those aspects of store operations important to maintain their brand image. As in any network relationship, the risk for franchisors is a loss of control over operations to franchisees, who are responsible for day-to-day operations.<sup>29</sup> This is a particular risk in the service sector, in which franchisors must ensure that franchise store employees effectively represent the brand to the consumer.<sup>30</sup> New and single-unit franchisees are often unsophisticated and require supervision to operate effectively,<sup>31</sup> and all franchisees have a free-rider interest in maximizing profit by attracting customers with the franchisor's brand name while cutting costs by shirking on franchisor standards that reduce profit.<sup>32</sup> Franchisee failure may cause a loss of market share in a region, while franchisee shirking may associate the franchisor with an inferior product or service.<sup>33</sup> Franchisors, moreover, may be equally concerned with shirking by franchise store managers and employees as by franchisees because the franchisor's growth hinges on whether franchise store employees faithfully represent the brand to the consumer.<sup>34</sup> Nor does delegation of ownership to fran-

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Patrick J. Kaufmann & Francine Lafontaine, *Costs of Control: The Source of Economic Rents for McDonald's Franchisees*, in *FRANCHISE CONTRACTING*, *supra* note 1, at 276, 285 & tbl.2, cited in *WEIL*, *supra* note 4, at 127–29.

<sup>29</sup> Economists often study franchising through the lens of principal-agent theory, and refer to this risk as one side of a doubled-sided moral hazard. See Sugato Bhattacharyya & Francine Lafontaine, *Double-Sided Moral Hazard and the Nature of Share Contracts*, in *FRANCHISE CONTRACTING*, *supra* note 1, at 114, 114–34; Francine Lafontaine & Emmanuel Raynaud, *Residual Claims and Self-Enforcement as Incentive Mechanisms in Franchise Contracts: Substitutes or Complements?*, in *FRANCHISE CONTRACTING*, *supra* note 1, at 435, 435–36.

<sup>30</sup> Marion Crain, *Managing Identity: Buying into the Brand at Work*, 95 *IOWA L. REV.* 1179, 1183–84 (2010); Majken Schultz, Yun Mi Antorini & Fabian F. Csaba, *Corporate Branding—An Evolving Concept*, in *CORPORATE BRANDING* 9, 10–11, 18 (Majken Schultz et al. eds., 2005); see, e.g., Deven R. Desai, *From Trademarks to Brands*, 64 *FLA. L. REV.* 981, 983, 985–86 (2012); Ceridwyn King, Debra Grace & Scott Weaven, *Developing Brand Champions: A Franchisee Perspective*, 29 *J. MARKETING MGMT.* 1308, 1309–10 (2013).

<sup>31</sup> See, e.g., Timothy Bates, *Survival Patterns Among Newcomers to Franchising*, 13 *J. BUS. VENTURING* 113, 113–14 (1998) (finding that new franchisees face a high rate of failure compared with multiunit franchisees and cohort independent businesses).

<sup>32</sup> Economics literature discusses this phenomenon as a free-riding incentive for franchisees to use a national franchisor's reputation to entice customers while shirking on standards to increase profit. See generally Bhattacharyya & Lafontaine, *supra* note 29, at 114–34; Steven C. Michael, *The Effect of Organizational Form on Quality: The Case of Franchising*, in *FRANCHISE CONTRACTING*, *supra* note 1, at 582, 582–83 (arguing that free riding prevents franchise store from providing the same quality as other corporate forms).

<sup>33</sup> BRADACH, *supra* note 1, at 5, 10–11; WEIL, *supra* note 4, at 12; see also Hadfield, *supra* note 1, at 948–55; MinWoong Ji & David Weil, *The Impact of Franchising on Labor Standards Compliance*, 68 *INDUS. & LAB. REL. REV.* 977, 979–80 (2015).

<sup>34</sup> See Ceridwyn King & Debra Grace, *Examining the Antecedents of Positive Employee Brand-Related Attitudes and Behaviours*, 46 *EUR. J. MARKETING* 469, 470 (2012) (U.K.) (finding that “employees are considered particularly significant in the brand management of services . . .

chisees necessarily deter franchise store employee shirking. A franchisee may not have an incentive to control franchise store employee shirking that harms the franchisor's brand but does not cut into franchisee profits.<sup>35</sup> Moreover, unlike in a vertically integrated firm, the franchisor often has limited ability to terminate a franchisee under the franchise agreement,<sup>36</sup> and has no direct contractual relationship with franchise store managers and employees. Direct supervision of franchise stores (and the termination of franchise agreements) is costly for franchisors<sup>37</sup> and has only indirect impacts on franchise store managers and employees.

Properly understood, then, the central preoccupation for franchisors in a franchise relationship is how to ensure that franchisees *and* franchise store managers and employees faithfully represent the brand to the consumer. Lacking a hierarchical relationship with franchisees and franchise store employees as in a vertically integrated firm, to maintain high, uniform operational standards, franchisors use a mix of coercive and relational practices aimed at not only the franchisee, but franchise store managers and employees.

The next Section will first chart the measures that franchisors use to protect their brand, delineated as dependency, control, and loyalty. Its purpose is to show that unique features of franchising can create a set of mutual obligations between franchisors, franchisees, and franchise store employees, both express and implied, which can mask and encourage violations of employment law in franchise stores.

### A. *Dependency, Control, and Loyalty in the Franchise Relationship*

To protect their brand, franchisors manage the franchise store relationship with a mix of practices to ensure compliance with franchisor standards: (1) *dependency*, through the franchisee selection process and by extending franchisee dependence through required sunk costs,

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because the functional and emotional values of the service brand are delivered through personal interaction between consumers and employees”).

<sup>35</sup> This is particularly true of multiunit franchisees, which are less reliant on the franchisor's operational guidance and delegate store operations to managers. In these instances, the franchisor may rely on franchise store managers rather than franchisees to prevent shirking by franchise store employees.

<sup>36</sup> Robert W. Emerson, *Franchise Contract Interpretation: A Two-Standard Approach*, 2013 MICH. ST. L. REV. 641, 666 n.153 (noting that eighteen states impose good cause requirements for franchisors seeking to terminate franchisees).

<sup>37</sup> See James A. Brickley & Frederick H. Dark, *The Choice of Organizational Form: The Case of Franchising*, in FRANCHISE CONTRACTING, *supra* note 1, at 53, 53–72 (finding that high monitoring cost is an important factor in a firm's decision to franchise instead of operating a company-owned store).

broad grounds by which franchisors may terminate or refuse to renew—or to permit franchisees to purchase new units—in the franchise agreement; (2) *control*, by supervising store operations through comprehensive operational standards that franchisees, their managers, and employees must meet, and by monitoring those standards in franchise stores; and (3) *loyalty*, by internal branding or relational systems to instill brand loyalty in franchisees and franchise store managers through business consulting services, operational tools, and policy guidance to increase store profit, and in franchise store employees by developing a uniform brand image to represent to store customers.<sup>38</sup>

These dependency, control, and loyalty measures are effective in ensuring a uniform service in franchise stores, in part, because of internal branding measures that persuade franchisees and franchise store employees to champion the brand to the customer. As Marion Crain argues, firms use internal branding measures in addition to direct control to “engender the sort of loyalty necessary to gain a competitive advantage in the highly competitive service sector market.”<sup>39</sup>

Internal branding measures that instill franchisee and franchise store employee loyalty can create a psychological contract, entailing mutual obligations not reflected in the franchise agreement.<sup>40</sup> In franchising, in lieu of an internal labor market in a vertically integrated firm, franchisors can use internal branding measures to elicit an implicit promise that franchise stores will champion the brand to the consumer; in return, franchisees will own a profitable business with high consumer demand and low turnover, and franchise store employees will work in a stable, well-run store that complies with workplace laws. As we will see at the conclusion of this Part, this implicit promise to franchise store employees is often not borne out in reality.

The following account of franchisor dependency, control, and loyalty measures draws from franchise scholarship and recent franchise store employee litigation claiming that franchisors are joint employ-

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<sup>38</sup> See WEIL, *supra* note 4, at 123–25; Mark A.P. Davies et al., *A Model of Trust and Compliance in Franchise Relationships*, 26 J. BUS. VENTURING 321, 321–25 (2011); Hadfield, *supra* note 1, at 960–65 (1990).

<sup>39</sup> Crain, *supra* note 30, at 1186.

<sup>40</sup> “[O]rganizational scholars have recognized that employees tend to develop a set of expectations about their relationship with the employer that extends beyond any formal contract, but that is nonetheless perceived to entail genuine obligations.” David W. Hart & Jeffrey A. Thompson, *Untangling Employee Loyalty: A Psychological Contract Perspective*, 17 BUS. ETHICS Q. 297, 302 (2007) (describing the elements of a psychological contract between employer and employee). Katherine Stone has shown the value of the psychological contract for employers seeking to persuade employees who can no longer rely on job security to invest in the firm’s work for training and future employability. Stone, *supra* note 17, at 570–71.

ers.<sup>41</sup> To be sure, franchisors use a different mix of these practices, and some franchisors may use fewer coercive or relational practices than others. Nonetheless, they collectively represent the distinct yet inter-related ways that franchisors protect their brands in franchise stores.

### 1. *Dependency, Control, and Loyalty in the Franchisor-Franchisee Relationship*

Franchisors use dependency, control, and loyalty measures to create incentives for franchisees to adopt the franchisor's required and recommended practices, despite free-rider incentives to ignore them. Through dependency and control, franchisors ensure that franchisees experience negative consequences (termination and loss of sunk capital) for failing to offer a uniform brand to customers, while loyalty measures offer long-term career opportunities in return for adopting a vast set of costly operational practices that might otherwise cut against the franchisee's short-term interests.

Franchisees embed asymmetric dependence into the franchise relationship in the franchise selection and contract formation stages. Most franchisees at the outset of a franchise relationship are small, thinly capitalized, relatively inexperienced business owners.<sup>42</sup> This appears to be by design. Franchisors seek out franchise applicants who seem likely to follow franchisor standards without question.<sup>43</sup> Franchisors additionally generally require an initiation period for aspiring franchisees—from weeks to years—of working in a franchisor- or franchisee-owned store.<sup>44</sup>

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<sup>41</sup> See *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1230 (N.D. Cal. 2015); Verified Petition for New York para. 3, *People v. Domino's Pizza, Inc.*, No. 450627/2016 (N.Y. Sup. Ct. May 23, 2016) [hereinafter *V. Pet. for N.Y.*].

<sup>42</sup> See Affidavit of Yash Sharma para. 5, *People v. Domino's Pizza, Inc.*, No. 450627/2016 (N.Y. Sup. Ct. May 23, 2016) [hereinafter *Domino's Sharma Aff.*] (stating that Domino's Pizza franchisee had no prior relevant business training and no business degree); Robert W. Emerson & Uri Benoliel, *Are Franchisees Well-Informed? Revisiting the Debate over Franchise Relationship Laws*, 76 ALB. L. REV. 193, 206–09 (2013) (finding that the typical franchisees lack business experience); Kimberley A. Morrison, *An Empirical Test of a Model of Franchisee Job Satisfaction*, 34 J. SMALL BUS. MGMT. 27, 30 (1996) (finding that eighty percent of franchisees are first-time business owners); Elizabeth Garone, *The New Face of Franchisees*, WALL ST. J. (Aug. 19, 2013), <http://www.wsj.com/articles/SB10001424127887324021104578553580349491440> [<https://perma.cc/DZA6-SSEZ>] (noting that eighty-one percent of franchisees only own one unit).

<sup>43</sup> See BRADACH, *supra* note 1, at 69–70; John L. Hanks, *Franchisor Liability for the Torts of Its Franchisees: The Case for Substituting Liability as a Guarantor for the Current Vicarious Liability*, 24 OKLA. CITY U. L. REV. 1, 28 (1999) (“[F]ranchisors typically do not favor individuals with strong entrepreneurial leanings. . . . They are expected to toe the line when it comes to abiding by the prescribed operating procedures.”).

<sup>44</sup> See BRADACH, *supra* note 1, at 70–71; see, e.g., Affidavit of Robert Cookston paras. 8–11, *People v. Domino's Pizza, Inc.*, No. 450627/2016 (N.Y. Sup. Ct. May 23, 2016) [hereinafter

Asymmetric dependence is also woven into franchise relationships through the initial franchise fee and other sunk costs. These costs can range into the hundreds of thousands of dollars,<sup>45</sup> which can constitute the franchisee's entire life savings. Franchisors limit the ability of franchisees to diversify their risk by investing in other businesses in the sector and to act as a passive investor, effectively requiring franchisees to maximize their effort in order to recoup their investment.<sup>46</sup> Franchisors maintain asymmetric dependence by retaining ultimate authority to permit a franchisee to sell or close an unprofitable franchise store and conditioning growth from single- to multiunit franchisees on store profitability.<sup>47</sup> Because franchisors also operate their own stores, they have superior expertise in business practices that maximize store profit. Franchisees, accordingly, depend on franchisor expertise in store operations to recoup their initial investment.<sup>48</sup>

Franchisors extend the franchisee's initial dependence on the franchisor with contract specifications that condition store operation on compliance with the franchisor's business system and process, with the threat of franchise termination or nonrenewal and loss of sunk costs that entails, if franchisees fail to meet franchisor standards.<sup>49</sup> Franchisors integrate all operational standards into the franchise agreement, creating a standing and wide-ranging series of obligations that franchisors may enforce through increasingly coercive measures up to franchise termination.<sup>50</sup>

Although franchisors often cannot exert the same level of direct control over franchise store operations as in a vertically integrated firm, franchisors do use some forms of direct control, conditioning the

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Domino's Cookston Aff.] (explaining that franchisee began work with Domino's as a driver, working his way up to be a manager in training, manager, and supervisor position before applying to become a franchisee).

<sup>45</sup> Hadfield, *supra* note 1, at 934–35 & tbl.1.

<sup>46</sup> See, e.g., Domino's Cookston Aff., *supra* note 44, para. 13; Domino's Sharma Aff., *supra* note 42, para. 6 (alleging that franchisees are prohibited from owning outside businesses or being absent from franchise stores for more than thirty days without Domino's permission).

<sup>47</sup> See, e.g., Domino's Cookston Aff., *supra* note 44, para. 15 (alleging that before being able to sell a store, franchisees are required to show Domino's that the store is staffed properly, with a sufficiently high inspection score, and that before being allowed to close a store, Domino's required him to show an inability to earn a profit despite meeting Domino's operational and promotional requirements).

<sup>48</sup> Rajiv P. Dant et al., *An Introspective Examination of Single-Unit Versus Multi-Unit Franchisees*, 41 J. ACAD. MARKETING SCI. 473, 475 (2013).

<sup>49</sup> WEIL, *supra* note 4, at 66–69 (excerpting detailed standards required in franchise agreements).

<sup>50</sup> *Id.* at 71–72.

franchise agreement on exacting business specifications and a rigorous inspection and monitoring system.<sup>51</sup> Franchising, according to a KFC division director, permits the franchisor to “run[] thousands of identical factories.”<sup>52</sup> Franchisors impose comprehensive operational standards on franchisees—breaking down each element of a production process into hundreds of steps, from placing an order, to preparing a food item, to packaging or delivering to the customer—and assign specific metrics that each store must meet for each step.<sup>53</sup> Franchisors require new franchisees to obtain extensive training regarding these standards, which can include personnel topics, such as “recruiting, management selection, compensation and benefits, protecting your business, and industry relations.”<sup>54</sup>

Third, franchisors monitor these standards. Franchisors often deploy a redundant, intensive monitoring system.<sup>55</sup> Field auditors conduct random inspections to ensure that franchisees only use approved products and equipment and evaluate performance on each of the hundreds of standards; franchisors hire temporary “mystery shoppers” to conduct the same inspections surreptitiously by role-playing a customer; and franchisors require franchisees to install and use software that tracks all of these steps and provides continuous reports about the franchisees’ operation.<sup>56</sup>

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<sup>51</sup> See BRADACH, *supra* note 1, at 23 (explaining that operating manuals “specify virtually every aspect of a unit’s operation,” breaking down all activities “into minute parts and prescribing procedures for performing each part”).

<sup>52</sup> BRADACH, *supra* note 1, at 85. A Domino’s Pizza franchisee, for example, alleges that the franchisor’s required computer tracking system requires his employees to log “each step of the order preparation and dispatch process,” in the system, “including placing the uncooked pizza in the oven and the cooked pizza on the routing stand to await delivery,” and that the system records each of these times for the franchisor. *Domino’s Cookston Aff.*, *supra* note 44, para. 16.

<sup>53</sup> BRADACH, *supra* note 1, at 85–86.

<sup>54</sup> Susan J. Wells, *Franchisors Walk a Fine Line*, SOC’Y HUM. RESOURCE MGMT. (Aug. 1, 2004), <https://www.shrm.org/hr-today/news/hr-magazine/pages/0804covstory.aspx#exposure> [<https://perma.cc/JKJ7-39SL>] (quoting Mari Fellrath, then–Senior Vice President of Franchise Services and Human Resources at Great Clips) (franchising consultant stating that “[t]raining is the vehicle for franchises to maintain their culture and brand” and describing one franchisor’s week-long franchisee training program).

<sup>55</sup> See Second Amended Class & Collective Action Complaint para. 178, *Ocampo v. 455 Hosp. LLC*, 2016 WL 4926204 (S.D.N.Y. Sept. 15, 2016) (No. 7:14-cv-9614), [hereinafter *Ocampo 2d Am. Class & Collective Action Compl.*] (“By the regular QA inspections and audits, the Franchisor Defendants enforced their control over Hotel employees by mandating the manner and quality of their work.”).

<sup>56</sup> See BRADACH, *supra* note 1, at 83; WEIL, *supra* note 4, at 70–71; see, e.g., *Ocampo 2d Am. Class & Collective Action Compl.*, *supra* note 55, para. 175 (“Franchise Defendants regularly perform both scheduled and unannounced audits and inspections of the Hotel, often multi-

Advances in information technology have enabled forms of low-cost, remote monitoring that have transformed the franchise relationship.<sup>57</sup> Franchisors increasingly require franchisees to install and use information technology in stores that franchisors access and use as a management information system (“MIS”).<sup>58</sup> Through MIS, franchisors may provide daily and weekly reports to franchisees about store performance, audit franchise store data against their established benchmarks, and require franchisees to develop action plans if the operational data do not meet the franchisor’s standards.<sup>59</sup> One franchisor reports using data to track turnover rates at franchise stores, “which is a great indicator . . . of HR practices.”<sup>60</sup>

These dependency and control measures collectively permit the franchisor to ensure that franchisees adopt its required and recommended policies without exerting direct control. Franchisor selection of unsophisticated and thinly capitalized franchisees can ensure franchisee compliance with franchisor standards and recommendations in order to recover sunk costs and avoid business failure.<sup>61</sup> Franchisees with little business experience are also more likely to associate business success with following franchisor standards and recommendations because they lack previous business models as a comparison. Termination of opportunistic or unprofitable franchisees can serve as an example to compliant franchisees of the potential consequences of noncompliance.

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ple times in a year, to review 455 Hospitality’s compliance . . . .”); *Domino’s Cookston Aff.*, *supra* note 44, paras. 16, 47.

<sup>57</sup> Although no recent study has compared franchisor monitoring of firm- and franchisee-owned stores, some of these systems—including mystery shoppers and MIS—are relatively recent additions to monitor franchise stores. In the 1990s, franchisors “rarely” used mystery shoppers for franchisors and did not use information systems to monitor franchise store operations. See BRADACH, *supra* note 1, at 43, 83. Low-cost and real-time franchisor digital monitoring of franchise stores, which requires franchisees to provide franchisors with access to franchise store operational data, has eroded the prevailing assumption among franchisors and franchisees that “a franchisee’s operation [should be] opaque to” the franchisor because “[i]nformation played a role in defining what it meant to be an independent businessperson.” *Id.* at 43.

<sup>58</sup> See *Ocampo 2d Am. Class & Collective Action Compl.*, *supra* note 55, para. 173.

<sup>59</sup> See, e.g., *Cordova v. SCCF, Inc.*, No. 13CIV5665-LTS-HP, 2014 WL 3512838, at \*2 (S.D.N.Y. July 16, 2014) (explaining how corporate defendant maintained functional control by providing programs to track performance of employees); *Domino’s Cookston Aff.*, *supra* note 44, paras. 16, 48.

<sup>60</sup> Wells, *supra* note 54.

<sup>61</sup> *Emerson & Benoliel*, *supra* note 42, at 209–12 (explaining that typical franchisees lack business experience and fail to read or understand the terms of a franchise agreement); *Morrison*, *supra* note 42, at 30 (noting that that eighty percent of franchisees are first-time business owners); *Garone*, *supra* note 42 (noting that eighty-one percent of franchisees only own one unit).



The coercive power of franchisors to enforce standards through control and dependency, however, has its limits and can be counterproductive. It runs up against the fact that franchisees operate legally distinct entities which—unlike franchisor-owned chain store managers—cannot be terminated without cause.<sup>62</sup> Even were this not the case, franchise termination imposes costs on franchisors as well as franchisees, including disruption to store operation and litigation costs. Coercion can also undermine morale and engender disloyalty, reducing customer satisfaction.<sup>63</sup> Franchisors therefore have an incentive to ensure the compliance of franchisees through internal branding measures to promote brand loyalty.<sup>64</sup>

To engender loyalty to the brand, franchisors use relational systems, or internal branding systems of support and inclusion of franchisees in the brand identity.<sup>65</sup> These internal branding measures are distinct from external branding measures that franchisors use to build customer affiliation with the brand. For franchisees, franchisors create an information flow and provide tools and recommendations to improve store profitability, including job descriptions for franchise store employees and brand-specific interview and performance review guides.<sup>66</sup> Domino's Pizza, for example, provides franchisees with employment forms, applications, and interview guides, and Intercontinental Hotels Group, which owns franchisor Holiday Inns, provides franchisees with template recruitment advertisements, employee engagement surveys, recognition programs, and job postings on IHG's career site.<sup>67</sup>

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<sup>62</sup> Robert W. Emerson, *Franchise Contract Clauses and the Franchisor's Duty of Care Toward Its Franchisees*, 72 N.C. L. REV. 905, 930 (1994).

<sup>63</sup> See Davies et al., *supra* note 38, at 325; Lynne Zappone, *How to Engage Franchise Employees*, SOC'Y FOR HUM. RESOURCE MGMT. (June 1, 2011), <https://www.shrm.org/hr-today/news/hr-magazine/pages/0611zappone.aspx> [<https://perma.cc/FS85-62ZD>] (arguing that franchisor human resources tools for franchisees can decrease turnover and improve customer satisfaction).

<sup>64</sup> See King et al., *supra* note 30, at 1311 (arguing that “a communicative and trusting relationship with franchisees . . . makes control much less of a problem and . . . avoids the need to exert coercive power”).

<sup>65</sup> See *id.* at 1310. Brand literature refers to internal branding as “living the brand,” or strategies for firms to deepen employees' commitment to the values of the firm. See generally Esben Karmark, *Living the Brand*, in CORPORATE BRANDING, *supra* note 30, at 103, 127.

<sup>66</sup> See Zappone, *supra* note 63 (describing these tools, provided by Intercontinental Hotels Group to its subsidiary franchisors' franchisees); Len Strazewski, *Managing the Franchise*, HUM. RESOURCES EXECUTIVE ONLINE (Dec. 1, 2006), <http://www.hreonline.com/HRE/view/story.jhtml?id=8485517> [<https://perma.cc/C7VJ-7NFR>] (describing Domino's policies and business tools).

<sup>67</sup> See Zappone, *supra* note 63.

For franchisees that follow franchisor standards and recommendations, franchisors make an implied promise of long-term profit and growth. Jeffrey Bradach describes the “cross-cutting career paths” available to individuals in plural model of franchising as one of the means by which franchisors can “exercise control over the franchise arrangement.”<sup>68</sup> The single-unit franchisee complies with franchisor standards with the expectation that this will enable the franchisee to make a profit and to become a desirable candidate for new store offerings. The multiunit franchisee complies with franchisee standards to become an even larger multiunit enterprise across multiple regional markets. Franchisees who internalize the myriad franchisor rules and recommendations may reasonably expect that adhering to these standards will permit them to continue to operate and potentially grow through the franchisor’s network.<sup>69</sup>

## 2. *Control and Loyalty in the Franchisor-Franchise Store Employee Relationship*

The franchisor depends on franchise store employees to effectively champion the brand to the consumer. Franchisors have increasingly recognized that high consumer satisfaction and low employee turnover in franchise stores require measures that foster a direct relationship with franchise store employees. Unlike vertically integrated firms, however, franchisors cannot control franchise store employee behavior directly by contract because the franchise agreement is only between franchisors and franchisees. Franchise agreements, moreover, disclaim any direct relationship between franchisors and franchise store employees. Recognizing the centrality of the franchise store employee to the customer’s experience and their limited ability to directly control franchise store employees, franchisors use control and loyalty measures to foster a direct relationship with franchise store employees both through and outside of the franchisee–franchise store employee relationship.

First, many control measures that, in theory, franchisors impose on franchisees are equally felt by franchise store employees.<sup>70</sup> Many

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<sup>68</sup> BRADACH, *supra* note 1, at 55.

<sup>69</sup> The psychological contract between franchisor and franchisee can also extend to the franchise store manager, who may adhere to these standards in order to one day become a franchisee or to transfer to the franchisor’s employment as a franchise consultant.

<sup>70</sup> In a recent, striking example of this, until widespread media attention led to the discontinuance of the practice, franchisors often required franchisees to sign a “no-hire” agreement prohibiting them from hiring other franchisees’ employees, effectively forbidding franchise store employees from profiting from their training through lateral transfers. See Rachel Abrams, *Why*

franchisor standards control employee selection, appearance, demeanor, and job responsibilities, including precise service time requirements, of franchise store employees.<sup>71</sup> McDonald's "brand 'bible,' [for example,] specifies to employees how the brand values 'Quality', 'Service' and 'Cleanliness' [are] to be practiced in the day-to-day work situation."<sup>72</sup> Domino's Pizza markets its "brand image and consistency of product quality, customer service and management procedure" as "The Power of One," training franchise store employees in the same uniform standards as franchisor-owned store employees,<sup>73</sup> and Domino's allegedly requires franchise store employees to greet customers within nine seconds, to report to work clean shaven with no visible tattoos or jewelry, and to address customer complaints using the franchisor's uniform, structured method.<sup>74</sup> The franchisor's redundant management systems directly monitor franchise store employee activity, informing franchisees and franchise store managers if franchise store employees do not meet the franchisor's required or preferred performance metrics.<sup>75</sup> Franchisors' own evaluations suggest the effectiveness of these measures. Yum! Brands, which owns franchisors including KFC, Pizza Hut, and Taco Bell, attributes a drop in customer complaints and reduction in turnover rates in its chain stores to 113%—the average in the quick-service industry is 200%—to setting and monitoring employment standards in franchise stores.<sup>76</sup>

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*Aren't Paychecks Growing? A Burger-Joint Clause Offers a Clue*, N.Y. TIMES (Sept. 27, 2017), <https://www.nytimes.com/2017/09/27/business/pay-growth-fast-food-hiring.html> [<https://perma.cc/HNC4-Q7ZV>] (citing study showing that majority of franchisors, and nearly all fast food franchisors, imposed some restriction limiting franchisee ability to hire employees from other franchise stores).

<sup>71</sup> See Plaintiffs' Corrected Reply in Support of Their Motion for Class Certification at 10, *Myers v. Jani-King of Philadelphia, Inc.*, 2015 WL 1055700 (E.D. Pa. Mar. 11, 2015) (No. 2:09-cv-01738-RBS), *aff'd sub nom.* *Williams v. Jani-King of Philadelphia Inc.*, 837 F.3d 314 (3d Cir. 2016) [hereinafter *Jani-King Pls.' Corrected Reply Supp. Mot. Class Certification*] ("Jani-King maintains the right to direct the methods workers use to . . . contact and communicate with Jani-King's customers, set cleaning schedules, and present themselves.").

<sup>72</sup> Karmark, *supra* note 64, at 110. One state appellate court also referred to the Domino's 800-page manual "a veritable bible for overseeing a Domino's operation . . . [that] literally leaves nothing to chance." *Parker v. Domino's Pizza, Inc.*, 629 So. 2d 1026, 1029 (Fla. Dist. Ct. App. 1993).

<sup>73</sup> Strazewski, *supra* note 66.

<sup>74</sup> Domino's Cookston Aff., *supra* note 44, para. 50 (describing the franchisor's "LEADS" method—"Listen, . . . Empathize," "Apologize, . . . Do Whatever it Takes, Stand by Your Promise"—for addressing customer complaints).

<sup>75</sup> According to Professor Bradach, who observed these systems in operation in company-owned stores, they can be "panoptical," instilling a fear of "being constantly watched and judged without knowing when or by whom." BRADACH, *supra* note 1, at 89.

<sup>76</sup> Wells, *supra* note 54.

Second, franchisors also use loyalty measures, emphasizing the franchise store employee's inclusion as a team member of the brand, to enlist franchise store employees to positively represent the brand to franchise store customers, often making little distinction between employees in firm-owned and franchisee-owned stores. Franchise store employees often apply to work for the franchise store through the franchisor's hiring portal;<sup>77</sup> greet customers using the franchisor's name;<sup>78</sup> wear the same uniforms, undergo the same training, and perform the same jobs as firm-owned store employees;<sup>79</sup> receive orientation materials, personnel forms, and paystubs that use only the franchisor's name and trademark, and are referred to in those materials as members of the franchisor's team.<sup>80</sup>

These control and loyalty measures can encourage franchise store employees to identify with the franchisor, championing the franchisor's brand to the consumer and lending the impression that the employee ultimately works for the brand.<sup>81</sup> In return for brand loyalty, franchise store employees may expect "a steady job in a safe environment," and that the franchisor "would make sure [they were] paid and treated correctly, because it is a large corporation with standardized systems."<sup>82</sup>

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<sup>77</sup> See Second Declaration of Ernestina Sandoval para. 2, *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228 (N.D. Cal. 2015) (No. 3:14-cv-02098-JD) [hereinafter *McDonald's 2d Sandoval Decl.*] (*McDonald's* hiring portal); Wells, *supra* note 54 (*Yum! Brands*); Zappone, *supra* note 63 (*Intercontinental Hotel Group*).

<sup>78</sup> See, e.g., *McDonald's 2d Sandoval Decl.*, *supra* note 77 (alleging that franchise store employees trained to greet customers with "Welcome to McDonald's").

<sup>79</sup> See *Jani-King Pls.' Corrected Reply Supp. Mot. Class Certification*, *supra* note 71, at 4 ("Jani-King maintains the right to direct the methods workers use to . . . contact and communicate with Jani-King's customers, set cleaning schedules, and present themselves."); Wells, *supra* note 54.

<sup>80</sup> See *Ochoa*, 133 F. Supp. 3d at 1240.

<sup>81</sup> See, e.g., Declaration of Joseph Ayala para. 2, *Salazar v. McDonald's Corp.*, 2017 WL 88999 (N.D. Cal. Jan. 5, 2017) (No. 3:14-cv-02096-RS) ("I thought of myself as representing McDonald's."); Declaration of Juvetta Brown para. 2, *Salazar*, 2017 WL 88999 (No. 3:14-cv-02096-RS) ("I identified with the mission of McDonald's."); Declaration of Plaintiff Judith Zarate in Opposition to McDonald's Motion for Summary Judgment para. 3, *Salazar v. McDonald's Corp.*, 2016 WL 4394165 (N.D. Cal. Aug. 16, 2016) (No. 3:14-cv-02096-RS), [hereinafter *McDonald's Zarate Decl. Opp'n Mot. Summ. J.*] ("I believed I was employed by McDonald's at both stores. Both restaurants looked the same and were run and managed in the same way. There was nothing in my job at either store that suggested that McDonald's was not my employer at both stores.").

<sup>82</sup> Declaration of Plaintiff Guadalupe Salazar in Opposition to McDonald's Motion for Summary Judgment at 3, *Salazar*, 2016 WL 4394165 (No. 3:14-cv-02096-RS); see also *McDonald's Zarate Decl. Opp'n Mot. Summ. J.*, *supra* note 81, para. 4 (alleging that franchise store employee applied to franchisors on belief that they "would have more steady jobs and better working conditions than smaller individual restaurants").

## *B. Franchisor Personnel Standards and Recommendations May Encourage Employment Law Violations*

Franchisor control, dependency, and loyalty measures can also trigger employment law obligations in ways that ultimately harm franchise store employees. As David Weil argues, franchisor opportunism can create indirect incentives for franchisees to violate wage-and-hour law. Because franchisors have an incentive to impose onerous operational standards, and aggressively police nearly all cost variables except for employee wages, franchisees may rationally conclude that suppressing employee wages is one of the few ways that franchise stores can boost profit by cutting costs.<sup>83</sup>

Franchisor imposition of personnel requirements, recommendations, and business tools can also directly encourage employment law violations, by triggering legal obligations that franchisees have little incentive to understand or follow.<sup>84</sup> To begin, it is impossible to separate employment practices from other business requirements required of franchisees to operate within the franchisor's required operational standards. Franchise store employees represent the brand to the consumer and are ultimately responsible for meeting all franchisor guarantees to the customer. To meet these guarantees, franchisors suggest and require franchise store employee hiring and appearance standards, pay policies, and job functions that trigger employment law obligations. Although a comprehensive list is beyond the scope of this Article, the following examples demonstrate the impossibility of separating these standards from their corresponding legal requirements. These business practices are also employment policies, and each of these standards implicate a raft of federal, state, and local employment laws that impose various legal obligations on the employer.

### *1. Hiring/Appearance Standards*

Franchisor hiring and appearance restrictions may implicate Title VII<sup>85</sup> and Americans with Disability Act ("ADA")<sup>86</sup> regulation of prehire inquiries. Franchisor requirements, for example, that franchisees conduct criminal background checks when hiring franchise store

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<sup>83</sup> WEIL, *supra* note 4, at 9.

<sup>84</sup> See, e.g., Josh Kosman, *Schneiderman Wins \$800K in Back Wages, Eyes Parent Suit*, N.Y. POST (Feb. 1, 2015), <https://nypost.com/2015/02/01/schneiderman-wins-800k-in-back-wages-eyes-parent-suit/> [<https://perma.cc/625U-YVTN>] (quoting franchisee subject to wage-and-hour judgment that he was unaware of the overtime requirements of wage-and-hour law).

<sup>85</sup> 42 U.S.C. § 2000e to 2000e-17 (2012).

<sup>86</sup> Americans with Disabilities Act of 1990, Pub. L. No. 101-336, 104 Stat. 327 (codified as amended in scattered sections of 42 and 47 U.S.C.).

employees<sup>87</sup> implicate the Title VII prohibition on employment practices that have an adverse impact on a protected class unless the practice is justified by business necessity.<sup>88</sup> Courts have found that the blanket rejection of applications based on arrests without convictions or a single previous conviction may violate Title VII.<sup>89</sup> Many state and local jurisdictions go further and ban pre-interview criminal record inquiries and require consideration of a variety of factors before rejecting an applicant because of a past criminal conviction.<sup>90</sup>

Franchisors also often impose appearance standards on franchise store employees that implicate antidiscrimination law. Franchisor grooming requirements restricting employee hair or facial hair may violate Title VII because of a disparate impact on African-American men, who disproportionately cannot shave because of a skin condition,<sup>91</sup> or may violate Title VII's prohibition of religious discrimination<sup>92</sup> if the employer fails to grant a reasonable accommodation to employees who wear beards as a religious practice.<sup>93</sup>

## 2. *Pay Policies and Job Functions*

Franchisor MIS systems that provide payroll systems to franchisees may facilitate violations of the Fair Labor Standards Act ("FLSA") and many state wage-and-hour laws. Franchisors often require franchisees to purchase computer equipment and software to track the hours worked by store employees that contain payroll pro-

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<sup>87</sup> See, e.g., *Reese v. Coastal Restoration & Cleaning Servs., Inc.*, No. 1:10cv36-RHW, 2010 WL 5184841, at \*4 (S.D. Miss. Dec. 15, 2010) (discussing franchisor requirement that franchisee conduct criminal background checks for all employees every two years and "not to employ anyone with a conviction for a felony or any type of assault").

<sup>88</sup> See 42 U.S.C. § 2000e-2(a), (k) (2012).

<sup>89</sup> See *Green v. Mo. Pac. R.R. Co.*, 523 F.2d 1290, 1293, 1298-99 (8th Cir. 1975) (finding employer's policy of denying employment to applicants who have been convicted of "any offense, except a minor traffic offense" violated Title VII); *Gregory v. Litton Sys., Inc.*, 316 F. Supp. 401, 403 (C.D. Cal. 1970) (finding discharge based on arrest records was unlawful).

<sup>90</sup> See Andrew Elmore, *Civil Disabilities in an Era of Diminishing Privacy: A Disability Approach for the Use of Criminal Records in Hiring*, 64 DEPAUL L. REV. 991, 995, 1014-15 (2015).

<sup>91</sup> See *Bradley v. Pizzaco of Neb., Inc.*, 7 F.3d 795, 799 (8th Cir. 1993) (ordering injunction requiring that franchisor's no-beard policy recognize an exception for African-American males with pseudofolliculitis barbae).

<sup>92</sup> Title VII requires that employers grant reasonable religious accommodations that do not cause an undue hardship. 42 U.S.C. § 2000e(j) (2012).

<sup>93</sup> Consent Decree at 2, *EEOC v. Family Foods, Inc.*, 2012 WL 3060635 (E.D.N.C. April 30, 2012) (No. 5:11-cv-00394) (stating Taco Bell franchisee must pay \$27,000 to resolve religious discrimination complaint by employee for refusal to accommodate his religion in franchisee's policy).

grams to calculate gross wages owed to these employees.<sup>94</sup> Using franchisor software as a payroll system, however, requires franchisees to independently account not only for overtime but also for any wage premiums owed for single-day shifts, such as required meal and rest breaks, and split shifts or shifts spread over long periods of time, and combine all hours worked in different franchise stores in a single week to correctly report these wage premiums.<sup>95</sup>

Business systems that require franchise store employees to perform delivery services create additional payroll and safety and health obligations. The use of a tip credit, or an employer deduction of the employee's base wage by a certain amount that the employee earns in tips, is lawful under federal and most state wage-and-hour laws and is common in delivery systems. For tipped employees whose franchisees claim a tip credit, however, the payroll system would need to account for the lawful minimum and overtime wage in applying the tip credit, and could not apply the tip credit to nontipped responsibilities.<sup>96</sup> Business models that require employees to own and use their own vehicles to perform deliveries additionally require employers to provide safety equipment to employees and to correctly calculate and reimburse employees for delivery expenses.<sup>97</sup>

To observe that required franchisor personnel standards inevitably bump up against employment laws is not to suggest that the franchisor has no legitimate interest in these terms. To the contrary, customer satisfaction in the service sector depends on customer ser-

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<sup>94</sup> See, e.g., *Domino's Cookston Aff.*, *supra* note 44, paras. 16, 20–25; *Domino's Sharma Aff.*, *supra* note 42, paras. 7, 24 (alleging that franchisor required franchisees to use a payroll report to calculate wages for their employees).

<sup>95</sup> See CAL. LAB. CODE §§ 226.7, 512, 1198 (West 2011) (explaining required meal and rest breaks under California law).

<sup>96</sup> 29 C.F.R. § 531.59(b) (2017) (“[T]he tip credit may be taken only for hours worked by the employee in an occupation in which the employee qualifies as a ‘tipped employee.’”).

<sup>97</sup> FLSA, in particular, requires that employers pay employees “free and clear,” and prohibits employers from requiring employees to “kick-back” wages in the form of paying for tools or equipment for work if they result in payments less than the legally entitled minimum or overtime wages. 29 C.F.R. § 531.35 (2017). Although courts have permitted employers to use a reasonable approximation of these expenses, *Morangelli v. Chemed Corp.*, 922 F. Supp. 2d 278, 301, 316 (E.D.N.Y. 2013), reimbursement for automobile usage should include gas, wear and tear, the proportional cost of repairs and replacements, and depreciation. See *Perrin v. Papa John's Int'l, Inc.*, 818 F. Supp. 2d 1146, 1152 (E.D. Mo. 2011). Franchisor requirements that franchise store employees engage in potentially dangerous work, particularly under timed conditions, also implicate federal and state occupational safety and health requirements. New York City, for example, requires employers to provide bicycle delivery personnel with adequate helmets, lights, bell or other sound device, brakes, reflective tires, reflective jacket or vest, and employers must ensure that all delivery personnel complete a bicycle safety course. N.Y.C., N.Y., ADMIN. CODE 10-157(a), (b), (e), (i) (2017) (citing 16 C.F.R. pt. 1203).

vice, and franchise store employees ultimately provide the goods and services that customers associate with the franchisor. Imposing these requirements without ensuring compliance with the associated legal requirements can result in their violation, even assuming the franchisee's good faith intention to comply.

Litigation against franchisors claiming their joint responsibility for employment law violations in franchise stores suggest that the franchisor's required business process, including hiring, appearance, and pay standards and recommendations, may encourage violations of employment law. In *Bradley v. Pizzaco of Nebraska*,<sup>98</sup> the Eighth Circuit enjoined Domino's Pizza's no-beard requirement for franchise store employees because of its disparate impact on African-American men, half of whom suffer from pseudofolliculitis barbae, a skin condition that will not permit them to shave.<sup>99</sup> In *EEOC v. Papin Enterprises, Inc.*,<sup>100</sup> a trial court denied summary judgment to Subway and its franchisee, finding that refusal to exempt a franchise store employee from a franchisor-required appearance standard could constitute a failure to accommodate her religious beliefs under Title VII.<sup>101</sup> Delivery employees have successfully sued franchisees of Pizza Hut, Papa John's, and Domino's Pizza for failure to appropriately apply the tip credit or to reimburse them for employer-required delivery expenses.<sup>102</sup> Recent litigation against three different franchisors claim that the MIS systems they require their franchisees to use to track franchise store employees' hours worked included flaws that underreport wages owed to franchise store employees.<sup>103</sup>

Setting aside the merits of those complaints and their joint employer arguments, which will be addressed in the next Part, these cases

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<sup>98</sup> 7 F.3d 795 (8th Cir. 1993).

<sup>99</sup> *Id.* at 799.

<sup>100</sup> No. 6:07-cv-01548-Orl-28GJK, 2009 WL 961108 (M.D. Fla. Apr. 7, 2009).

<sup>101</sup> *Id.* at \*1.

<sup>102</sup> *See* *Smith v. Pizza Hut, Inc.*, No. 09-CV-01632-CMA-BNB, 2013 WL 1751850 (D. Colo. Apr. 23, 2013); *Kirtright v. Holiday Delta, Inc.*, No. 7:09-CV-184-BO, 2010 BL 311330 (E.D.N.C. Dec. 30, 2010) (approving settlement with Domino's franchisees); *Bass v. PJCOMN Acquisition Corp.*, No. 09-cv-01614-REB-MEH, 2010 WL 3767132 (D. Colo. Sept. 15, 2010).

<sup>103</sup> *See* *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1237 (N.D. Cal. 2015) (noting that McDonald's payroll program failed to calculate owed wages for required meal and rest breaks required under California law); *Aleksick v. 7-Eleven, Inc.*, 205 Cal. App. 4th 1176, 1180 (Cal. Ct. App. 2012) (noting that 7-Eleven payroll program allegedly shaved minute portions of shifts from daily payroll calculations); *Affirmation of Terri Gerstein in Support of Verified Petition paras. 91-118, People v. Domino's Pizza, Inc.*, No. 450627/2016 (N.Y. Sup. Ct. May 23, 2016) [hereinafter *Domino's Gerstein Aff. Supp. V. Pet.*] (noting Domino's payroll program under calculated owed wages for employees whose employers claimed a "tip credit," and also failed to calculate shift premiums under New York law).



show how the franchisor's dependency, control, and loyalty measures can encourage employment law violations in franchise stores.

The risk of reputational harm to the franchisor created by franchisee employment law violations, particularly for legal obligations triggered by franchisor required and recommended standards and tools, would seem to create an incentive for franchisors to monitor employment law compliance and to cure violations. Franchisors, which are often sophisticated and operate their own stores, have expertise in using their own business systems and processes in a way that complies with employment law. It is in the reputational interests of firms, particularly in the service sector, that customers associate their brands with stores that operate in a legally compliant manner. It is also unsurprising that franchisees, particularly those that are judgment proof, would be unable or unwilling to comply with the technical employment law requirements triggered by a franchisor's required or recommended personnel policy or tool. Yet, although some franchisors provide franchisees with access to generic information about employment law compliance, they typically withhold legal compliance support related to specific required and recommended personnel policies and tools, and they do not monitor employment law compliance.<sup>104</sup>

Understanding why it is that franchisors do not monitor franchise stores for employment law compliance requires an exploration of the joint employer doctrine, the legal doctrine that holds multiple entities in a production process jointly and severally liable as joint employers if they codetermine the terms and conditions of employees in a workplace. The next Part argues that the lack of franchisor legal compliance measures in franchise stores reflects a judicial failure to consider the ways that franchisors protect their brand in the joint employer analysis. It will show that courts often limit the joint employer doctrine in franchising to only hold franchisors liable if they exert direct control over the workplace. Perversely, a control-based joint employer doctrine may permit franchisors to impose standards that encourage employment law violations but discourage franchisors from taking control-based measures to monitor employment law compliance and cure violations. Even a broader test that accounts for the franchisee's dependency on and loyalty to the franchisor would not consider the franchisor–franchise store employee relationship or provide a liability standard for policies and business tools that can encourage employment law violations. This suggests the need, explored

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<sup>104</sup> Ji & Weil, *supra* note 10, at 34–36

in Part III, for new liability standards to deter franchisor practices that may mask or encourage employment law violations.

## II. THE FAILURE OF THE JOINT EMPLOYER DOCTRINE TO TAKE ACCOUNT OF THE IMPLICIT PROMISES IN FRANCHISING THAT CAN MASK AND ENCOURAGE EMPLOYMENT LAW VIOLATIONS

Employment law traditionally deters violations by subcontractors by extending joint employer, or joint and several, liability to all entities that control the workplace.<sup>105</sup> But historically, borrowing from common law vicarious liability standards, courts have limited joint employer liability to franchisors that exercise day-to-day supervision over franchise stores or that control the policy or business tool that causes the harm.<sup>106</sup> Because franchisees must directly supervise store operations and have final authority to implement policies under the franchise agreement, this narrow interpretation of the joint employer doctrine has effectively created a presumption in franchising that franchisees are independent contractors, and that franchisors are not joint employers. In response, courts have faced increasing calls to broaden the joint employer doctrine to account for franchisor measures to control franchise store operations other than direct control of franchise store employees.

This Part introduces and critiques the current, narrow joint employer rule for franchising. By only considering direct franchisor control over the workplace as evidence of joint employment, the right to control test fails to account for the franchisee's dependency on and loyalty to the franchisor in adopting optional, franchisor-recommended policies and business tools. Even a broader version of the joint employer test, while recognizing the franchisor measures that make these standards and tools effectively mandatory for franchisees,

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<sup>105</sup> See, e.g., *Salinas v. Commercial Interiors, Inc.*, 848 F.3d 125, 134 (4th Cir. 2017).

<sup>106</sup> These courts often adopt a narrow interpretation of joint employer liability, requiring a showing that franchisors exercise day-to-day supervision of the workplace. See, e.g., *Ochoa*, 133 F. Supp. 3d at 1235–39 (disregarding “the welter of . . . facts” showing McDonald’s “strength as a franchisor,” including its power to unilaterally sanction the franchisee and terminate the franchise agreement, “recommendations” about crew scheduling and staffing, extensive monitoring, required training and use of scheduling and payroll programs, as evidence of an employment relationship); *Reese v. Coastal Restoration & Cleaning Servs., Inc.*, No. 1:10cv36-RHW, 2010 WL 5184841, at \*4 (S.D. Miss. Dec. 15, 2010) (noting that a contractual provision in the franchise agreement “is simply one of the quality control standards” imposed by the franchisor and that it “does not show that [the franchisor] has power to control hiring/firing of [franchisee] employees”); *Patterson v. Domino’s Pizza, LLC*, 333 P.3d 723, 743 (Cal. 2014) (granting summary judgment against plaintiff in a state sex harassment case on the issue of Domino’s joint liability).

would not address the ways that franchising can create a psychological contract between franchisors and franchise store employees, and has yet to define an outer boundary of franchisor liability for policies that trigger employment law obligations. This Part will conclude that recognizing the implicit promises in franchising—that franchisees may grow their business, and franchise store employees may work in a stable, well-run workplace if they champion the brand to the consumer—will require emergent apparent agency and misrepresentation theories of franchisor liability that do not depend on a joint employer determination.<sup>107</sup>

#### A. *The Right to Control Limitation to Joint Employment for Franchisors*

Courts historically evaluate joint employer claims against franchisors by using a narrow right to control standard developed from the common law vicarious liability doctrine.<sup>108</sup> Under this doctrine, a franchisor may be vicariously liable for the harms caused in franchise stores if the franchisor “has control or the right to control the physical conduct of the agent such that a master/servant relationship can be said to exist.”<sup>109</sup> Most courts narrowly construe this right to control test in franchising, requiring plaintiffs to produce evidence that the franchisor exerts “control over a franchisee’s performance of its day-to-day operations,”<sup>110</sup> in order to establish the franchisor’s vicarious liability. Under this narrow right to control test, courts exclude evidence of control designed to ensure “uniformity and standardiza-

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<sup>107</sup> See Stone, *supra* note 17, at 590–92 (arguing that recognizing the implicit promise by employers of training and future employability in return for employee loyalty would require courts to reassess doctrines that permit employers to restrict future employment).

<sup>108</sup> E.g., *Rainey v. Langen*, 998 A.2d 342, 347 (Me. 2010). The traditional rule for determining whether an economic relationship is legally sufficient to impose liability on a principal in a contracting arrangement derives from the master-servant doctrine. See RESTATEMENT (SECOND) OF AGENCY § 220 (AM. LAW INST. 1958) (listing ten factors to determine whether there is a master-servant agency relationship, including (1) the employer’s right to control the details of the work, (2) whether the putative agent is employed in a distinct business or occupation, (3) the method of payment used, and (4) whether the employer supplies the instrumentalities needed for the job). Courts have integrated this common law test into restrictive versions of the joint employer test in statutes. The best known of these versions is from *Bonnette v. California Health and Welfare Agency*, 704 F.2d 1465 (9th Cir. 1983), which considered “whether the alleged employer (1) had the power to hire and fire the employees, (2) supervised and controlled employee work schedules or conditions of employment, (3) determined the rate and method of payment, and (4) maintained employment records.” *Id.* at 1470.

<sup>109</sup> *Kerl v. Dennis Rasmussen, Inc.*, 682 N.W.2d 328, 331 (Wis. 2004).

<sup>110</sup> *Rainey*, 998 A.2d at 347–49.

tion of products and services”<sup>111</sup> as inherent in the franchise relationship. As an even narrower version of this rule, some courts additionally impose an “instrumentality” element. This requires plaintiffs to show “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 before vicarious liability may be imposed on the franchisor for the franchisee’s tortious conduct.”<sup>112</sup>

Courts routinely incorporate the right to control requirements into the joint employer standards of employment statutes. This has led the majority of courts to find that franchisors are not joint employers because they do not exercise day-to-day supervision over franchise stores.<sup>113</sup> Where franchisors have been found to be joint employers, courts have generally limited liability to instances in which the franchisor directly controls franchise store employees or directs the franchisee to adopt a policy that facially violates an employment law standard. As an example of the first, in *Miller v. D.F. Zee’s, Inc.*,<sup>114</sup> an

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<sup>111</sup> *Little v. Howard Johnson Co.*, 455 N.W.2d 390, 394 (Mich. Ct. App. 1990).

<sup>112</sup> *Kerl*, 682 N.W.2d at 340. In *Kerl*, the Wisconsin Supreme Court relied on the instrumentality theory to affirm dismissal of a vicarious liability claim against a franchisor for negligent supervision of an employee who shot and killed two individuals in a parking lot across the street from the franchise store. *Id.* at 332–33, 342. In that case, the court affirmed judgment for the franchisor because the plaintiff could not show that the franchisor “controlled or had the right to control [the franchisee’s] hiring and supervision of employees, which is the aspect of [franchisee’s] business that is alleged to have caused the plaintiff’s harm.” *Id.* at 342.

<sup>113</sup> See, e.g., *Lockard v. Pizza Hut*, 162 F.3d 1062, 1071 (10th Cir. 1998) (reversing judgment against franchisor as a joint employer because of no evidence of control over day-to-day employment decisions); *Evans v. McDonald’s Corp.*, 936 F.2d 1087, 1090 (10th Cir. 1991) (dismissing Title VII joint employer claim because “McDonald’s did not have control over [franchisee’s] labor relations with his franchise employees”); *McFarland v. Breads of the World, LLC*, No. 1:09-cv-929, 2011 WL 801815, at \*12 (S.D. Ohio Feb. 1, 2011) (rejecting joint employer claim where the franchisor played no role in the franchisee’s “employee relations issues, including but not limited to the day-to-day supervision of [the franchisee’s] employees”); *McLaurin v. Fusco*, 629 F. Supp. 2d 657, 663 (S.D. Miss. 2009) (same); *Matthews v. Int’l House of Pancakes*, 597 F. Supp. 2d 663, 671 (E.D. La. 2009) (dismissing Title VII claim because franchisee “has always been solely responsible for . . . day-to-day operations”); *Singh v. 7-Eleven, Inc.*, No. C-05-04534 RMW, 2007 WL 715488, at \*6 (N.D. Cal. Mar. 8, 2007) (holding that franchisor was not a joint employer under the FLSA because “7-Eleven was not responsible for setting plaintiffs’ wages, using its funds to pay plaintiffs, or providing any employment benefits,” and did not establish an employment relationship); *Baetzel v. Home Instead Senior Care*, 370 F. Supp. 2d 631, 641–42 (N.D. Ohio 2005) (dismissing a Title VII claim against a franchisor as a joint employer because the franchisor lacked “day-to-day” operational control); *Alberter v. McDonald’s Corp.*, 70 F. Supp. 2d 1138, 1143–44 (D. Nev. 1999) (dismissing Title VII joint employer claim on ground that franchisee was responsible for day-to-day operation and had final authority over employment matters); *Froedtert Mem’l Lutheran Hosp., Inc.*, 20 BNA OSHC 1500 (No. 97-1839, 2004) (applying “common-law agency doctrine to determine whether a conventional master-servant relationship exists” in a joint employer test under OSH Act).

<sup>114</sup> 31 F. Supp. 2d 792 (D. Or. 1998).

Oregon trial court denied summary judgment for a franchisor in a joint employer claim of sex discrimination and harassment under Title VII.<sup>115</sup> In *D.F. Zee's*, the court found evidence of a right to control in the franchisor's detailed, mandatory standards that it monitored and policed, which required store employee training and the right to discipline employees, including based on claims of discrimination.<sup>116</sup> As an example of the second, in *EEOC v. Papin Enterprises, Inc.*,<sup>117</sup> a trial court found the "instrumentality" element met by Subway's requirement that franchise store employees refrain from wearing facial jewelry, which required the franchisee to deny the plaintiff's requested religious accommodation.<sup>118</sup> The court held that the required appearance policy was "evidence that the franchisor had some power over, and became involved in, a specific dispute regarding terms and conditions of employment" central to the Equal Employment Opportunity Commission's ("EEOC") claim that the franchise store failed to accommodate the store employee's religion.<sup>119</sup>

The right to control test focus on the franchisor's day-to-day supervision of the franchise store employee and practices that cause the complained-of violations,<sup>120</sup> however, fails to account for the dependency, control, and loyalty measures that franchisors use to ensure brand uniformity, including those that may mask or encourage employment law violations. In *Patterson v. Domino's Pizza, LLC*,<sup>121</sup> for example, considering a state antidiscrimination law with the same joint employer standard as Title VII, the California Supreme Court rejected a joint employer claim on the ground that the franchisor did not have the "right to control" the franchise store employees, despite evidence suggesting the franchisor's deep involvement in the franchise store's operation.<sup>122</sup> In that instance, the court found that the franchise

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<sup>115</sup> *Id.* at 797.

<sup>116</sup> *Id.* at 802, 807.

<sup>117</sup> No. 6:07-cv-01548-Orl-28GJK, 2009 WL 961108 (M.D. Fla. Apr. 7, 2009).

<sup>118</sup> *Id.* at \*6.

<sup>119</sup> *Id.* at \*9; see also *Myers v. Garfield & Johnson Enters.*, 679 F. Supp. 2d 598, 609–10 (E.D. Pa. 2010) (holding that franchisor's "Code of Conduct" prohibiting harassment and alleged right to promulgate work rules, train franchisee managers, and terminate employees for violating code of conduct sufficed to defeat a motion to dismiss the Title VII claim against the franchisor as a joint employer).

<sup>120</sup> See, e.g., *Wu v. Dunkin' Donuts, Inc.*, 105 F. Supp. 2d 83, 94 (E.D.N.Y. 2000) (rejecting franchise store employee's vicarious liability claim against franchisor for workplace injuries based on failure of franchisor-mandated security system to protect employee from injury because franchisor was not at fault for the specific lapse that led to plaintiff's injury).

<sup>121</sup> 333 P.3d 723 (Cal. 2014).

<sup>122</sup> *Id.* at 726, 739 (holding that the joint employer standard requires a showing that the franchisor "has retained or assumed a general right of control over factors such as hiring, direc-

agreement, which stated that the franchisee is an independent contractor, and the franchisor's lack of day-to-day supervision and "hands-off" approach to sexual harassment allowed no reasonable inference of a joint employer relationship.<sup>123</sup> Notably, the court ignored evidence of the franchisee's dependency on and loyalty to the franchisor's recommendations, rejecting evidence that the franchisor representative told the franchisee to "get rid" of the plaintiff in retaliation for her complaint of sexual harassment because "no reasonable inference can be drawn that it was intended or interpreted to mean that [the franchisee] had no choice in the matter, that [the franchisor] was in charge, or that consequences would ensue if [the franchisee] did not follow [the franchisor's] advice."<sup>124</sup>

*Patterson's* disregard of franchisee dependency on and loyalty to the franchisor is reflected in other cases that adopt the right to control limitation in franchise joint employer cases. In *Orozco v. Plackis*,<sup>125</sup> the Fifth Circuit relied on the right to control test to reverse a jury determination that a franchisor was a joint employer in a wage-and-hour suit.<sup>126</sup> The Fifth Circuit, in finding dispositive the lack of day-to-day supervision by the franchisor, discounted evidence of franchisor meetings with the franchisee to recommend staffing and other operational changes that the franchisee adopted as mere "advice" and "suggested improvements" rather than evidence of control.<sup>127</sup> It found that required training and policies and personnel recommendations could not, as a matter of law, create a joint employment relationship in light of terms in the franchise agreement disclaiming franchisor authority over franchisee stores.<sup>128</sup> Similarly, in *Alberter v. McDonald's Corp.*,<sup>129</sup> a Nevada district court relied on the right to control test to reject the argument that the McDonald's franchise agreement, which required the franchisee to adopt the franchisor's policies and business tools, showed the right to control sufficient to establish a joint employer relationship.<sup>130</sup> That court reasoned that the franchisee's uncontested

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tion, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees").

<sup>123</sup> See *id.* at 739.

<sup>124</sup> *Id.* at 730, 742.

<sup>125</sup> 757 F.3d 445 (5th Cir. 2014).

<sup>126</sup> See *id.* at 452.

<sup>127</sup> *Id.* at 450.

<sup>128</sup> See *id.* at 449–52.

<sup>129</sup> 70 F. Supp. 2d 1138 (D. Nev. 1999).

<sup>130</sup> See *id.* at 1144–45 (dismissing Title VII sexual harassment action against McDonald's, finding that the franchise agreement, which required that the franchisee "promptly adopt and use exclusively the formulas, methods and policies contained in the business manuals, now and

day-to-day supervision over the workplace and ability to set employment policies notwithstanding the franchise agreement evidenced the franchisee's sole employment of franchise store employees.<sup>131</sup> Lack of day-to-day supervision also required dismissal of a joint employer claim in *Ochoa v. McDonald's Corp.*,<sup>132</sup> a California trial court found, despite evidence of the franchisor's "considerable pressure" on franchisees to adopt personnel scheduling and staffing policies, required training, monitoring, equipment, materials and uniforms, status as landlord of the store premises, and required management information software.<sup>133</sup>

Other courts have relied on the instrumentality rationale to reject franchisor general policies that trigger legal obligations as indicia of control absent evidence that the policies themselves caused employment law violations. In *Reese v. Coastal Restoration and Cleaning Services*,<sup>134</sup> a Mississippi district court rejected as evidence of control a background check requirement in which the franchisor required the franchisee to conduct a background check every two years and "not to employ anyone with a conviction for a felony or any type of assault."<sup>135</sup> That court held that the franchisor's background check policy was a "quality control standard" rather than the kind of policy that shows "power to control hiring/firing" of franchise store employees.<sup>136</sup> Lack of control over the instrumentality in *Singh v. 7-Eleven, Inc.*<sup>137</sup> led the court to disregard the franchisor's payroll services as "merely a convenience" to franchisees and not evidence of joint employment in a claim that paychecks to franchise store employees did not include owed overtime and meal-break compensation.<sup>138</sup>

These cases show how the right to control test fails to reflect the relationships between franchisors and franchisees and franchise store employees. Discounting franchisor-required operational policies as

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as they may be modified by" McDonald's, did not "establish control by McDonald's over employment matters at" the franchise store).

<sup>131</sup> See *id.* at 1143–45.

<sup>132</sup> 133 F. Supp. 3d 1228 (N.D. Cal. 2015).

<sup>133</sup> *Id.* at 1235–37.

<sup>134</sup> No. 1:10cv36-RHW, 2010 WL 5184841 (S.D. Miss. Dec. 15, 2010).

<sup>135</sup> *Id.* at \*4.

<sup>136</sup> *Id.* (rejecting additionally as evidence of control a provision in the franchise license agreement requiring "vehicles, equipment, supplies, cleaning products, uniforms, computer hardware and software" to meet the franchisor's standards).

<sup>137</sup> No. C-05-04534 RMW, 2007 WL 715488 (N.D. Cal. Mar. 8, 2007).

<sup>138</sup> *Id.* at \*6 (holding that franchisor was not a joint employer under the FLSA because "7-Eleven was not responsible for setting plaintiffs' wages, using its funds to pay plaintiffs, or providing any employment benefits").

evidence of control because the franchisor is not present in the work-site to implement them ignores the franchisee's heavy incentives to implement them because of its dependency on and loyalty to the franchisor.<sup>139</sup> Rejecting evidence of a franchisor's policies that trigger employment law obligations as mere "recommendations" ignores the franchisee's loyalty to the franchisor that leads the franchisee to adopt recommendations in order to protect the franchisee's survival and future growth within the franchisor's network.<sup>140</sup> The restrictive causation requirement in the "instrumentality" test ignores the sophistication of franchisors, who are aware of the legal obligations triggered by a policy because they comply with them in their own units, and the comparable lack of franchisee sophistication.<sup>141</sup>

The right to control test also fails to address—and can magnify—the franchisor's incentives to impose standards that can encourage employment law violations in franchise stores. It imposes no sanction on franchisors for imposing policies that encourage employment law violations or taking no action to deter violations, yet does sanction franchisors for taking control-based actions to induce precaution in the form of strict liability for any harm that ensues.<sup>142</sup> Under these rules, as in *D.F. Zee's* and *Papin Enterprises*, in which franchisor liability hinged on direct franchisor supervision, the most cost-effective solution is for the franchisor to require the same policy but disclaim ultimate authority and take *fewer* precautions to deter employment law liabilities.<sup>143</sup> It, moreover, removes the reputational harm of employment law violations in franchise stores because franchisors may claim, with judicial approval, that franchisees are independent contractors responsible for their own employment practices.<sup>144</sup> This market failure can occur even if franchisors are best positioned to take

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<sup>139</sup> The dependency of franchisees on franchisors to recoup upfront fees and maintain their store ownership permits franchisors to impose standards even if they are in conflict with the franchisee's interests, with few corresponding franchisor obligations to the franchisee in return. See Hadfield, *supra* note 1, at 929–30, 933–37.

<sup>140</sup> BRADACH, *supra* note 1, at 69–70; see also Hanks, *supra* note 43, at 28.

<sup>141</sup> The fifty largest franchisors account for ninety-eight percent "of the market capitalization of all U.S. public companies engaged in business format franchising." Jeff Feingold, *Krispy Kreme Rebounds in UNH Franchise Index*, N.H. BUS. REV. (June 8, 2006), <http://www.nhbr.com/May-26-2006/Krispy-Kreme-rebounds-in-UNH-franchise-index/> [<https://perma.cc/CDW6-K7LH>]; see *supra* note 61.

<sup>142</sup> See Jennifer H. Arlen & W. Bentley MacLeod, *Beyond Master-Servant: A Critique of Vicarious Liability*, in *EXPLORING TORT LAW* 111, 113–12 (M. Stuart Madden ed., 2005).

<sup>143</sup> See *supra* notes 114–19.

<sup>144</sup> See Emerson, *supra* note 36, at 675, 682 (seventy-four of one hundred franchise agreements sampled by author stated that the franchisee was an independent contractor and not an agent).



appropriate action to prevent employment law violations themselves and to induce franchisees to take precautionary care.<sup>145</sup> It also does not address the incentive for franchisors to select franchisees who violate employment laws and who are judgment proof.<sup>146</sup>

In short, the current restrictive right to control test in the joint employer doctrine fails to account for the franchisor's relationships with franchisees and franchise store employees and can have the perverse effect of encouraging employment law violations in franchise stores.

### *B. Improving the Franchisor's Standard of Care by Broadening the Joint Employer Definition of Control*

The recent surge in joint employer litigation in franchising fueled by the Fight for Fifteen movement<sup>147</sup> has led courts to reexamine whether franchisors are joint employers under a broader joint employer test that would consider forms of remote and indirect control common in franchising. This Section finds that although a broader joint employer claim would recognize the dependency and control measures in the franchisor-franchisee relationship, it would not recognize the loyalty measures that create implicit promises between

<sup>145</sup> See Arlen & MacLeod, *supra* note 142, at 112–13 (explaining that because firms have access to a number of tools to regulate agents, they are often better equipped than courts to regulate the precautions of agents).

<sup>146</sup> Competitive forces benefit judgment-proof agents because they bear no costs for any harm they cause and thus can perform tasks at more competitive prices than agents that must internalize the cost of liability. See *id.* at 113.

<sup>147</sup> William Finnegan, *Dignity: Fast-Food Workers and a New Form of Labor Activism*, NEW YORKER (Sep. 15, 2014), <https://www.newyorker.com/magazine/2014/09/15/dignity-4> [<https://perma.cc/QAP9-2JTJ>]; see Andrew Elmore, *The Future of Fast Food Governance*, 165 U. PA. L. REV. ONLINE 73, 73 (2017). In response to complaints received by the Fight for Fifteen movement, the NLRB announced that it would consider McDonald's to be a joint employer with its franchisees subject to unfair labor practice complaints, and the New York Attorney General filed suit against Domino's Pizza, now pending, claiming that it is a joint employer under wage-and-hour law. See Press Release, Nat'l Labor Relations Bd., NLRB Office of the General Counsel Authorizes Complaints Against McDonald's Franchisees and Determines McDonald's, USA, LLC is a Joint Employer (July 29, 2014), <https://www.nlr.gov/news-outreach/news-story/nlr-office-general-counsel-authorizes-complaints-against-mcdonalds> [<https://perma.cc/NB44-F354>]; see also *V. Pet. for N.Y.*, *supra* note 41. The McDonald's dispute is pending before an NLRB administrative law judge and may be resolved by a proposed settlement, brokered by the new NLRB General Counsel, without reaching a decision on whether McDonald's is a joint employer. See Press Release, Nat'l Labor Relations Bd., Proposed Settlement Agreements Presented in McDonald's USA, LLC, et al. (March 20, 2018), <https://www.nlr.gov/news-outreach/news-story/proposed-settlement-agreements-presented-mcdonald%E2%80%99s-usa-llc-et-al> [<https://perma.cc/5YSJ-F24D>]; Noam Scheiber, *Push to Settle McDonald's Case, a Threat to Franchise Model*, N.Y. TIMES (March 19, 2018), <https://www.nytimes.com/2018/03/19/business/economy/mcdonalds-labor.html> [<https://perma.cc/JQ9P-TX8F>].

franchisors, franchisees, and franchise store employees to protect the franchisor's brand. To account for these measures, third-party liability claims will be necessary to regulate the specific representations by franchisors that may mask or encourage employment law violations in franchise stores.

Under a broad interpretation of the joint employer standard, as the Fourth Circuit explained in *Salinas v. Commercial Interiors, Inc.*,<sup>148</sup> the question is whether the putative joint employer “codetermine[s]—formally or informally, directly or indirectly—the essential terms and conditions of the worker’s employment.”<sup>149</sup> Perhaps the most recent famous articulation of this standard comes from the National Labor Relations Board (“NLRB”) decision *Browning-Ferris Industries of California, Inc.*,<sup>150</sup> in which firms are joint employers “if they share or codetermine those matters governing the essential terms and conditions of employment.”<sup>151</sup> Unlike the standard commonly used in franchising, which restrictively defines “control” as day-to-day supervision, this standard would consider indirect and remote forms of control. As in *Carrillo v. Schneider Logistics Trans-Loading and Distribution, Inc.*<sup>152</sup>—in which a court held that Wal-Mart could be a joint employer of its warehousing subcontractor’s employees—when presented with evidence of franchisor policy suggestions, a broader rule would inquire whether the franchisor’s expectation was that the franchisee “would follow these suggestions.”<sup>153</sup> Instead of the strict causation requirement of the instrumentality rule, in a broader test, allegations that a franchisor policy encouraged employment law violations are a factor that may weigh in favor of a joint employer determination.<sup>154</sup>

As a seminal example of this emerging, broader standard, in *Cano v. DPNY, Inc.*,<sup>155</sup> a federal court rejected a narrow interpretation of the joint employer doctrine and expressly considered required

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<sup>148</sup> 848 F.3d 125 (4th Cir. 2017).

<sup>149</sup> *Id.* at 141. This standard has been used by courts considering contractual arrangements in a variety of industries. *See, e.g.*, *Zheng v. Liberty Apparel Co.*, 355 F.3d 61, 69–72, 77 (2d Cir. 2003) (garment); *Torres-Lopez v. May*, 111 F.3d 633, 642–44 (9th Cir. 1997) (agriculture).

<sup>150</sup> 362 N.L.R.B. No. 186 (2015).

<sup>151</sup> *Id.* at 15.

<sup>152</sup> No. 2:11-cv-8557-CAS (DTBx), 2014 WL 183956 (C.D. Cal. Jan. 14, 2014).

<sup>153</sup> *Id.* at \*8.

<sup>154</sup> *See* *Flemming v. REM Connecticut Cmty. Servs.*, No. 3:11cv689 (JBA), 2012 WL 6681862, at \*6 (D. Conn. Nov. 13, 2014) (holding a contractor’s alleged incorrect designation of managers as exempt from overtime requirements was sufficient, along with other factors, to defeat the contractor’s motion to dismiss a joint employer claim).

<sup>155</sup> 287 F.R.D. 251 (S.D.N.Y. 2012).

but indirect and remote franchisor policies as evidence of control.<sup>156</sup> Specifically, it held that allegations that a franchisor, Domino's Pizza, promulgates compensation policies and implements them through a required payroll system—which the franchisor uses to track franchise store payroll and store personnel performance as well as required management, operation, hiring, and inspection policies—are sufficient to state a claim that the franchisor is jointly liable for wage-and-hour law violations as a joint employer.<sup>157</sup> Many courts have followed the reasoning in *Cano* and have denied franchisor motions to dismiss on similar allegations.<sup>158</sup>

*Cano* and later cases have shown how a broader standard would account for the franchisor's control measures, which are indirect and remote, and the franchisee's dependency on and loyalty to the franchisor, which may effectively require a seemingly discretionary recommendation or business tool. Extending joint and several liability to large, sophisticated franchisors that indirectly and remotely control franchise store operations is likely to improve employment law compliance in those franchise stores by providing an incentive for these franchisors to monitor their franchise stores to prevent and cure employment law violations.

But in restricting its analysis to the franchisor-franchisee relationship,<sup>159</sup> a broad joint employer standard still tends to disregard the franchisor's relationship with franchise store employees. It also does not draw an outer boundary of franchisor liability for its policies that may trigger employment law violations.<sup>160</sup> Thus, a broader joint employer test is likely to improve legal compliance in some instances but

<sup>156</sup> See *id.* at 260.

<sup>157</sup> *Id.*

<sup>158</sup> See, e.g., *Lora v. Ledo Pizza Sys., Inc.*, No. DKC 16-4002, 2017 WL 3189406, at \*7–9 (D. Md. July 27, 2017); *Ocampo v. 455 Hospitality LLC*, No. 14-CV-9614(KMK), 2016 WL 4926204, at \*7–9 (S.D.N.Y. Sept. 15, 2016); *Cordova v. SCCF, Inc.*, No. 13CIV5665-LTS-HP, 2014 WL 3512838, at \*5 (S.D.N.Y. July 16, 2014); *Olvera v. Bareburger Group LLC*, 73 F. Supp. 3d 201, 207 (S.D.N.Y. 2014). To be sure, many courts have continued to use a narrow standard to find that franchisors are not joint employers of franchise store employees. See, e.g., *Pope v. Espeseth, Inc.*, 228 F. Supp. 3d 884, 889–91 (W.D. Wis. 2017) (rejecting evidence of a suggested compensation rate because the evidence that the franchisee was required to adopt it was lacking); *Wright v. Mountain View Lawn Care, LLC*, No. 7:15-cv-00224, 2016 WL 1060341, at \*6 (W.D. Va. Mar. 11, 2016) (rejecting plaintiff's argument that franchisee depended on franchisor, which controlled franchisee's operations, because "this is not the relevant inquiry in the joint employment analysis").

<sup>159</sup> See *Salinas v. Commercial Interiors, Inc.*, 848 F.3d 125, 141 (4th Cir. 2017) (observing that the joint employer "codetermination" standard evaluates the relationship between the contractor and subcontractor, not those parties and the putative employee).

<sup>160</sup> See Hyde, *supra* note 16, at 414–16.

would not recognize the franchisor's implicit promises to franchisees and franchise store employees that may mask or encourage employment law violations. Even those franchisors that could be considered joint employers under a broad standard are likely to restructure operations to avoid liability instead of taking measures to improve compliance.<sup>161</sup>

It is impossible, moreover, to ignore the political backlash that has accompanied attempts to broaden the joint employer doctrine in franchising. After the 2015 NLRB decision in *Browning-Ferris Industries of California*, in which the NLRB adopted a broad joint employer standard for the National Labor Relations Act ("NLRA"),<sup>162</sup> franchisors responded by successfully lobbying for legislation that limits franchisor liability. To date, nine states have adopted the franchisors' model legislation exempting franchisors from employment law liability as joint employers of franchise store employees.<sup>163</sup> The U.S. House of Representatives recently passed the Save Local Business Act, which would amend the FLSA and NLRA joint employer tests, codifying the narrow right to control test.<sup>164</sup> Most recently, the NLRB in *Hy-Brand Industrial Contractors, Ltd.*<sup>165</sup> sought to reverse *Browning-Ferris* and reinstitute a narrower joint employer test that would exclude franchisors from NLRA's reach.<sup>166</sup> The NLRB withdrew *Hy-Brand* amid criticism that a board member participating in the decision had a conflict of interest, and *Browning-Ferris* remains the current NLRB statement on the NLRA joint employer stan-

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<sup>161</sup> See Elmore, *supra* note 147, at 88–89 (arguing that franchisors are likely to respond to concerns of joint employer, apparent agency, and misrepresentation/franchise law liability by distancing themselves further from franchisees' personnel policies, increasing the capital requirements of franchisees, and by subcontracting monitoring to a third party); see Arlen & MacLeod, *supra* note 142, at 130–32.

<sup>162</sup> See 362 N.L.R.B. No. 186, at 15–19 (2015).

<sup>163</sup> See *Proactive Joint Employer Legislation*, INT'L FRANCHISE ASS'N, <https://www.franchise.org/proactive-joint-employer-legislation> [<https://perma.cc/RFD4-G4PS>]. For example, the Michigan statute provides that "[e]xcept as specifically provided in the franchise agreement, as between a franchisee and a franchisor, the franchisee is considered the sole employer of workers for whom the franchisee provides a benefit plan or pays wages." MICH. COMP. LAWS ANN. § 408.471(d) (West 2016). This effectively precludes a franchisor joint employer determination for state wage-and-hour, safety and health, and employment discrimination standards in these states.

<sup>164</sup> Save Local Business Act, H.R. 3441, 115th Cong. (2017). The bill limits joint employer liability for all contractors—not just franchisors—to those entities that "directly, actually, and immediately, and not in a limited and routine manner, exercise[] significant control over essential terms and conditions of employment." *Id.* at § 2(a)(2).

<sup>165</sup> 365 N.L.R.B. No. 156 (2017).

<sup>166</sup> *Id.* at 6.

dard.<sup>167</sup> But the NLRB's announced intention to reverse the *Browning-Ferris* standard has placed its future in considerable doubt.

Exempting franchisors from joint employer liability, as franchisors have sought, would likely increase employment law non-compliance in franchise stores by leaving franchisors free to impose standards and recommendations on franchisees that trigger employment law obligations without monitoring legal compliance because they can externalize the cost of noncompliance to franchisees.<sup>168</sup> For those franchisees who are judgment proof, this effectively shifts the costs of franchise store employment law violations to franchise store employees. It would remove the reputational harm to franchisors that the possibility of liability under a potentially broad joint employer standard might cause. Whether or not this even narrower standard becomes the dominant rule, the current impasse, in which franchisors have countered a broader joint employer rule in franchising with legislative reform to narrow it even further, virtually assures that a uniform, broad joint employer standard in franchising is unlikely in the near term.<sup>169</sup>

For the near term, and for franchisors near or beyond the outer boundary of joint employer status, two recent cases, *Ochoa v. McDonald's*<sup>170</sup> and *People v. Domino's Pizza, Inc.*,<sup>171</sup> have revealed existing third-party liability theories that may improve employment law compliance in franchise stores and that do not depend on joint employer status.<sup>172</sup> Plaintiffs in both *Ochoa* and *Domino's Pizza* claim that the franchisors are joint employers based on traditional factors including the franchisors' comprehensive operational standards and monitoring, and their direct intervention in the hiring, supervision, discipline, and termination decisions in franchise stores.<sup>173</sup> But they also assert state law claims that invoke apparent agency and misrepresentation theories to extend liability to franchisors based on their dependency, con-

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<sup>167</sup> See Press Release, Nat'l Labor Relations Bd., Board Vacates Hy-Brand Decision (Feb. 26, 2018), <https://www.nlr.gov/news-outreach/news-story/board-vacates-hy-brand-decision> [<https://perma.cc/V7AQ-8LQZ>].

<sup>168</sup> See Arlen & MacLeod, *supra* note 142, at 115.

<sup>169</sup> See Hyde, *supra* note 16, at 414–16 (arguing that one of the most pressing problems in joint employer litigation is the lack of a categorical rule that can be applied broadly).

<sup>170</sup> *Ochoa v. McDonald's*, 133 F. Supp. 3d 1228 (N.D. Cal. 2015)

<sup>171</sup> Verified Petition for New York Court 3, *People v. Domino's Pizza, Inc.*, No. 450627/2016 (N.Y. Sup. Ct. May 23, 2016).

<sup>172</sup> See *Ochoa*, 133 F. Supp. 3d 1228; V. Pet. for New York, *supra* note 41.

<sup>173</sup> See *Ochoa*, 133 F. Supp. 3d at 1232–35; V. Pet. for N.Y., *supra* note 41, at 2; see also *Domino's Gerstein Aff. Supp. V. Pet.*, *supra* note 103, paras. 133–61, 180–207.

trol, and loyalty measures not accounted for in the joint employer test.<sup>174</sup>

The next Part will evaluate the theories underlying these claims and offer them as a means to improve the franchisor's standard of care.

### III. THIRD-PARTY LIABILITY THEORIES TO IMPROVE THE STANDARD OF CARE IN FRANCHISING

The previous Part has shown that courts in adopting the right to control standard in joint employer inquiries in franchising ignore the franchisee's dependency on and loyalty to franchisors and the franchisor's relationship with franchise store employees. These unique features of franchising can mask or encourage employment law violations, while discouraging franchisors from taking precautionary measures that might evince a joint employer relationship. A broader joint employer standard would account for the franchisee's loyalty to and dependency on franchisors, but would still ignore the relationship between the franchisor and franchise store employee and would not define a boundary for the franchisor's liability for policies that may trigger employment law violations.

In response to these shortcomings, employment scholars have explored the possibility of third-party liability regimes in holding lead firms responsible for employment law compliance regardless of whether or not they meet the legal definition of joint employers.<sup>175</sup> Brishen Rogers, discussing the failings of the joint employer doctrine in imposing responsibility on lead firms to police their subcontractors, proposes a negligence-based standard of reasonable care on firms that have considerable discretion over the operation of subordinate firms in supply chains.<sup>176</sup> Alan Hyde, likewise, urges "a standard of responsibility for labor-standards compliance" for parties, like franchisors, that benefit from labor but are not, or are not easily categorizable as, employers.<sup>177</sup>

But calls for expanding contractor liability have thus far failed to locate an appropriate source of law for third-party liability claims or

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<sup>174</sup> *Ochoa*, 133 F. Supp. 3d at 1230–31; V. Pet. for N.Y., *supra* note 41, paras. 170–74.

<sup>175</sup> These proposals flow from a more general criticism of contract principles that enable parties with a superior bargaining position to contract out liability to judgment-proof agents. See Alan O. Sykes, *The Economics of Vicarious Liability*, 93 YALE L.J. 1231, 1277–78 (1984); see also Lynn M. LoPucki, *Toward a Trademark-Based Liability System*, 49 UCLA L. REV. 1099 (2002) (arguing in favor of imposition of liability for trademark owners including franchisors).

<sup>176</sup> See Rogers, *supra* note 16, at 49–53.

<sup>177</sup> Hyde, *supra* note 16, at 416.

develop clear boundaries for liability that would improve the franchisor's standard of care without causing overdeterrence. The most logical standard, a general negligence standard of reasonable care necessary to protect third parties, typically only applies to physical harm<sup>178</sup> and where the contractor has reason to know that control is necessary to prevent harm.<sup>179</sup> For the economic harms that are the subject of employment laws<sup>180</sup> and for franchisor policies that may encourage but do not require employment law violations, a general negligence duty cannot be found in existing law.<sup>181</sup>

Although scholars have identified nondelegable duties under similar circumstances,<sup>182</sup> existing law does not support a nondelegable franchisor duty to franchise store employees either. Matthew Bodie has recently argued that the employment relationship is of a quasi-fiduciary character, imposing nondelegable duties on employers.<sup>183</sup> Robert Emerson similarly identifies specific fiduciary duties by franchisors to franchisees in clauses in franchise agreements under state franchise law.<sup>184</sup> To date, however, courts have not recognized a

<sup>178</sup> See Catherine M. Sharkey, *Can Data Breach Claims Survive the Economic Loss Rule?*, 66 DEPAUL L. REV. 339, 349–53 (2017) (discussing majority “economic loss” rule that forecloses economic losses as the basis of a negligence action, “absent some sort of special relationship that would warrant imposing on the defendant a duty to act with reasonable care towards those with whom he is not in a direct relationship”).

<sup>179</sup> RESTATEMENT (SECOND) OF TORTS §§ 317, 323 (AM. LAW INST. 1965).

<sup>180</sup> There are, of course, some employment laws that protect against employee injury and that can result from the franchisor's direct negligence. See, e.g., *Wise v. Ky. Fried Chicken Corp.*, 555 F. Supp. 991, 995–96 (D.N.H. 1983) (denying summary judgment to franchisor because franchisor may have had a duty to warn of risk involved in use of pressure fryer cooker that injured franchise store employee).

<sup>181</sup> See, e.g., *Myers v. Garfield & Johnson Enters.*, 679 F. Supp. 2d 598, 616–17 (E.D. Pa. 2010) (dismissing negligence action in employment discrimination case against franchisor by franchise employee even though court found sufficient evidence to deny motion to dismiss on joint employer claim).

<sup>182</sup> This is analogous to the nondelegable duty by landlords to prevent negligent repairs by independent contractors that harm tenants. See, e.g., *Dowling v. 257 Assocs.*, 652 N.Y.S.2d 736, 736 (N.Y. App. Div. 1997) (noting that municipal law imposes a nondelegable duty on landlords to maintain a premises in good repair, and holding them vicariously liable for independent contractor negligence in making repairs that harm tenants); *Damron v. C.R. Anthony Co.*, 586 S.W.2d 907, 913 (Tex. Civ. App. 1979) (explaining that “the landlord has primary liability for discharge of the duty and cannot insulate himself from the negligent discharge of the duty by his independent contractor”).

<sup>183</sup> See Matthew T. Bodie, *Employment as Fiduciary Relationship*, 105 GEO. L.J. 819, 827, 837–45 (2017) (identifying employer duties of workplace safety and privacy, wages, benefits, discipline, termination, and bargaining as separate duties).

<sup>184</sup> Emerson, *supra* note 62, at 923, 934–43 (arguing that franchisor has a fiduciary duty to franchisee in various terms of the franchise agreement, including operational standards, in which franchisees have a reasonable belief that they are purchasing the franchisor's expertise, the franchisor can exploit information asymmetries for opportunistic gain, the agreement is incom-

franchisor nondelegable duty to franchise store employees under state franchise law or any other existing standard.

This Part contributes to this literature by offering two distinct third-party liability theories, found in existing law, that can address the unique features of franchising that can mask and encourage employment law violations. The first, apparent agency, extends liability for employment law violations to franchisors that franchise store employees reasonably believe are their coemployers.<sup>185</sup> The second, a misrepresentation theory, would impose liability on franchisors that require franchisees to adopt personnel standards and business tools that may encourage employment law violations without ensuring compliance with those standards.<sup>186</sup> Scholars who have identified these theories as significant in franchising<sup>187</sup> have not discussed their significance in improving employment law compliance in franchise stores. These claims, although in need of elaboration, offer a framework through existing law to regulate the franchisor's representations to franchisees and franchise store employees, notwithstanding the franchisor's joint employer status.

This Part will first show how apparent agency and misrepresentation claims, found in common law and in state labor, fraud, and franchise laws, might better reflect the features of franchising that can mask and encourage employment law violations in franchise stores. It will then build on these theories in proposed regulations and address critiques that franchise regulations that draw from apparent agency and misrepresentation theories may result in over- or under-deterrence.

#### A. *Regulating the Franchise Relationship Through Apparent Agency and Misrepresentation Theories*

Apparent agency and misrepresentation claims take account of the unique ways that franchisors can create a direct relationship with

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plete, and, "absent some external motive, the interests of franchisor and franchisee are the same").

<sup>185</sup> See *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1239–40 (N.D. Cal. 2015) (finding that measures by franchisor to instill brand loyalty in franchise store employees can give rise to an apparent agency claim).

<sup>186</sup> See *V. Pet. for N.Y.*, *supra* note 41, paras. 3–4. (alleging that payroll system provided by franchisor to franchisees contained flaws that underreported owed wages and that failure to notify franchisees about these flaws violated state franchise and antimisrepresentation laws).

<sup>187</sup> See Robert W. Emerson, *Franchisors' Liability When Franchisees Are Apparent Agents: An Empirical and Policy Analysis of "Common Knowledge" About Franchising*, 20 HOFSTRA L. REV. 609, 624–29 (1992); Joseph H. King, Jr., *Limiting the Vicarious Liability of Franchisors for the Torts of Their Franchisees*, 62 WASH. & LEE L. REV. 417, 438–59 (2005).



franchise store employees and encourage employment law violations through recommendations that trigger employment law obligations. Both are limited to representations by franchisors that franchisors can modify or eliminate in order to avoid liability. They can, however, include reliance requirements that limit their relevance in some jurisdictions.

### 1. Apparent Agency

The most plausible extension of liability to franchisors for harms caused by franchisees outside of joint employment is the apparent, or ostensible, agency doctrine, which holds the franchisor liable, even if the franchisee is not an agent, if franchisor representations cause the harmed party to reasonably believe that the franchisee is an agent of the franchisor.<sup>188</sup> A franchisor whose franchisee is an apparent agent is strictly liable for the franchisee's legal violations, similar to a franchisor found to be a joint employer. But unlike the joint employer test, which directs its inquiry to the relationship between franchisor and franchisee, apparent agency is established based on franchisor representations to franchise store employees. As a result, the apparent agency theory complements the joint employer test by expanding the inquiry to the franchisor–franchise store employee relationship.

Although apparent agency has most commonly been used in vicarious liability claims against franchisors for harms to consumers in franchise stores,<sup>189</sup> courts have endorsed the apparent agency theory that a franchisor's measures to ensure brand uniformity can create a reasonable belief in franchise store employees that the franchisee is an agent of the franchisor as well. In *Myers v. Garfield Johnson Enterprises*,<sup>190</sup> for example, the court held that a franchise employee “may

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<sup>188</sup> RESTATEMENT (SECOND) OF AGENCY § 267 (AM. LAW INST. 1958) (“One who represents that another is his servant or other agent and thereby causes a third person justifiably to rely upon the care or skill of such apparent agent is subject to liability to the third person for harm caused by the lack of care or skill of the one appearing to be a servant or other agent as if he were such.”).

<sup>189</sup> See *Crinkley v. Holiday Inns, Inc.*, 844 F.2d 156, 166–67 (4th Cir. 1988) (affirming jury decision finding franchisor liable for harm to franchisee customer under apparent agency theory); *Bartholomew v. Burger King Corp.*, 15 F. Supp. 3d 1043, 1051 (D. Haw. 2014) (reasoning that the franchisor's required sign, “architectural and color scheme,” and materials inside the store with the franchisor's name and mark all could lead to a consumer's justifiable reliance “upon an apparent agency relationship between [the franchisee] and Burger King”); *Butler v. McDonald's Corp.*, 110 F. Supp. 2d 62, 70 (D.R.I. 2000) (finding sufficient questions of fact to preclude summary judgment on apparent agency theory); *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1113–14 (Or. Ct. App. 1997); *King*, *supra* note 187, at 439.

<sup>190</sup> 679 F. Supp. 2d 598 (E.D. Pa. 2010).

establish Title VII liability based on [the franchisor's] apparent control over [the franchisee]."<sup>191</sup> In that case, internal branding measures, including evidence that the franchisor's training materials referred to employees at franchise stores as "employees" and that franchisor employees supervised franchise store employee work were sufficient to allege the franchisor's apparent authority.<sup>192</sup> The court in *Miller v. D.F. Zee's* likewise found that the franchisor's required conspicuous posting of its marks in the franchise store along with the lack of indication that the franchisee was the owner of the store and the fact that the franchise store employees "believed they were [the franchisor's] employees" were sufficient to allege apparent authority.<sup>193</sup>

*Ochoa*, which alleged the apparent agency of a McDonald's franchisee under state wage-and-hour law, suggests the potential of apparent agency claims based on the franchisor's control and loyalty measures.<sup>194</sup> In *Ochoa*, plaintiff franchise store employees asserted that independent of the franchisee's joint employer status with McDonald's, the franchisor was jointly and severally liable for employment law violations because the franchisee was its apparent agent.<sup>195</sup> In their apparent agent theory, plaintiffs alleged that franchise store employees reasonably believed that McDonald's employed them based on uncontroverted evidence that "they wear McDonald's uniforms, serve McDonald's food in McDonald's packaging, receive paystubs and orientation materials marked with McDonald's name and logo, and . . . applied for a job through McDonald's website."<sup>196</sup> While dismissing the plaintiffs' joint employer claim, the *Ochoa* court found that these internal branding measures sufficed for a reasonable jury to conclude that the franchisee was an apparent agent of McDonald's.<sup>197</sup>

These cases illustrate how, independent of whether the franchisor-franchisee relationship is sufficient to show a joint employer relationship, an apparent agency theory can account for the franchisor's implicit promise in the franchisor-franchise store employee relationship of a workplace that complies with employment laws.<sup>198</sup> Grounded in the franchisor's own representations, apparent

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<sup>191</sup> *Id.* at 613.

<sup>192</sup> *Id.* at 615.

<sup>193</sup> 31 F. Supp. 2d 792, 808 (D. Or. 1998).

<sup>194</sup> *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1235–36 (N.D. Cal. 2015).

<sup>195</sup> *Id.* at 1239.

<sup>196</sup> *Id.* at 1240.

<sup>197</sup> *Id.* at 1235–40.

<sup>198</sup> *See id.*

agency recognizes the franchisor's considerable indirect control over franchise store employee work and use of internal branding measures to enlist franchise store employee loyalty to champion the franchisor's brand to the consumer, despite the lack of a contractual relationship.

## 2. *Misrepresentation*

Franchisor liability may also arise from the franchisor's omissions about a franchisor's policy, recommendation, or business tools that trigger employment law requirements. Unlike the apparent agency theory, a misrepresentation claim recognizes the franchisor's liability for representations to the franchisee that may harm the franchise store employee as a third party and, ultimately, solvent franchisees held liable for the employment law violations. It recognizes the franchisee's dependency on the franchisor, who, as the more sophisticated party, is better positioned to understand how to use a standard or business tool in a manner that is legally compliant. It also recognizes the implicit promise in the franchisor-franchisee relationship that franchisees that adopt the franchisor's required and recommended policies and business tools can operate a stable and profitable business by extending liability to franchisors for representations that instead encourage employment law violations that ultimately harm the franchisee's business.

Although courts narrowly construe common law misrepresentation claims,<sup>199</sup> courts have adopted a broader standard under state fraud and franchise laws, which prohibit deceptive business conduct<sup>200</sup> and impose a duty of good faith and fair dealing on franchisors.<sup>201</sup> State consumer protection statutes, which can protect franchisees,<sup>202</sup> often define misrepresentation broadly to prohibit business conduct

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<sup>199</sup> See, e.g., *Credit Alliance Corp. v. Arthur Andersen & Co.*, 483 N.E.2d 110, 118–19 (N.Y. 1985) (requiring a showing that the parties “sufficiently approach[] privity” and that the defendant “must have” known that the other parties would rely on its representations).

<sup>200</sup> See Cary Silverman & Jonathan L. Wilson, *State Attorney General Enforcement of Unfair or Deceptive Acts and Practices Laws: Emerging Concerns and Solutions*, 65 U. KAN. L. REV. 209, 215–16, 215 n.40 (2016).

<sup>201</sup> Emerson, *supra* note 184, at 929. Franchise law creates a general duty for franchisors not to misrepresent the franchise terms to franchisees, with specific disclosure requirements. 15 U.S.C. § 45(m) (2012); 16 C.F.R. §§ 436.1–.5 (2016). The Federal Trade Commission (“FTC”) and many states began to regulate franchisor disclosures in the 1970s as a response to the perceived growth in unfair and deceptive practices in franchising. See, e.g., *Clapp v. Peterson*, 327 N.W.2d 585, 586 (Minn. 1982) (explaining that state franchise law “was adopted in 1973 as remedial legislation designed to protect potential franchisees within Minnesota from unfair contracts and other prevalent and previously unregulated abuses in a growing national franchise industry”).

<sup>202</sup> See, e.g., *Canha v. LaRoche*, No. CA 95510, 1996 WL 1186959, at \*6 (Super. Ct. Mass.

that has the tendency or capacity to deceive and do not require a showing of the common law fraud elements of reliance and intent to deceive.<sup>203</sup>

State franchise laws, similar to consumer fraud statutes, create a general duty for franchisors not to defraud franchisees, with corollary, specific disclosure requirements.<sup>204</sup> Under New York franchise law, for example, it is

unlawful for a person, in connection with the offer, sale or purchase of any franchise, to directly or indirectly: . . . (b) [m]ake any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading.<sup>205</sup>

This can include representations that trigger employment law obligations. In *Gadson v. Supershuttle International*,<sup>206</sup> for example, the court denied a motion to dismiss a Maryland franchise law claim by franchisees, who drove vans for the franchisor, alleging that the franchisor employed them but improperly failed to disclose costs and fees that diminished their earnings to below the state minimum wage.<sup>207</sup> The court held that plaintiffs' allegation that the franchisor omitted information about the illegal costs and fees drivers would incur sufficed to allege a violation of state franchise law.<sup>208</sup>

Pending litigation by the New York Attorney General against the franchisor Domino's Pizza illustrates how franchisor policies and business tools that encourage employment law violations can support a misrepresentation theory under state fraud and franchise laws.<sup>209</sup> The New York Attorney General brought *Domino's Pizza* against the franchisor after an investigation of twelve franchisees in New York State, in which all franchisees admitted violations of wage-and-hour

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Aug. 12, 1996) (holding that franchisees may bring action against franchisors for violation of Massachusetts consumer protection laws).

<sup>203</sup> Silverman & Wilson, *supra* note 200; *see, e.g.*, *People v. Coventry First LLC*, 861 N.Y.S.2d 9, 10–11 (N.Y. App. Div. 2008), *aff'd*, 915 N.E.2d 616, 621 (N.Y. 2009); *People v. Apple Health & Sports Clubs, Ltd.*, 613 N.Y.S.2d 868, 869 (N.Y. App. Div. 1994).

<sup>204</sup> The Federal Trade Commission's franchisor rule ("FTC Rule") places a duty on franchisors to disclose details about the franchisor's business and the nature of the franchise relationship and subjects franchisors who engage in unfair or deceptive practices to penalties and injunctive relief. 15 U.S.C. § 45(a) (2012).

<sup>205</sup> N.Y. GEN. BUS. LAW § 687(2)(b).

<sup>206</sup> No. 10-cv-01057-AW, 2011 WL 1231311 (D. Md. Mar. 30, 2011).

<sup>207</sup> *Id.* at \*1–2.

<sup>208</sup> *Id.* at \*12.

<sup>209</sup> *Domino's Gerstein Aff. Supp. V. Pet.*, *supra* note 103, paras. 34, 36, 40–45.

laws. The New York Attorney General alleges that Domino's required franchisees to use a payroll system that it knew systematically underreported owed wages.<sup>210</sup> It is allegedly impossible for franchisees to discover this because the payroll system does not show its underlying calculations.<sup>211</sup> The franchisor was allegedly aware for years that the payroll system systematically underreported wages but did not fix the software or report the problem to franchisees.<sup>212</sup> According to the suit, at least some franchise store employees were underpaid in amounts that track the underreported wages owed in the franchisor's payroll program.<sup>213</sup>

As asserted in *Domino's Pizza*, franchisor-required or -recommended personnel policies and business tools may violate state fraud and franchise laws, insofar as a known defect in a mandatory business tool may constitute a material fact that the franchisor must disclose under state franchise law, and the failure to disclose or correct the defect may constitute statutory misrepresentation.<sup>214</sup> Unlike the traditional joint employer doctrine, which often disregards evidence of franchisor recommendations and business tools that the franchisor presents as optional, a misrepresentation theory takes into account the dependence of franchisees on franchisors for operational guidance and their loyalty in implementing these measures without question. Accounting for these dependence and loyalty measures will be crucial in addressing the unique incentives in franchising that can encourage employment law violations in franchise stores.

These emergent<sup>215</sup> theories have improved the narrow control-based test often used in franchisor joint employer cases. Together, apparent agency and misrepresentation theories complement the joint employer test by accounting for the control, dependency, and loyalty measures that franchisors use to protect their brand in franchise stores, including in ways that can encourage employment law violations. These emergent theories, therefore, can be an important corrective for the shortcomings of the joint employer doctrine.

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210 Amended Memorandum of Law in Support of Verified Petition at 5, *People v. Domino's Pizza, Inc.*, No.450627/2016 (N.Y. Sup. Ct. Nov. 4, 2016).

211 *Id.* at 37–38.

212 *Id.* at 5–8.

213 *Id.* at 36–41; see Elmore, *supra* note 147, at 79.

214 This is the New York Attorney General's theory in *Domino's*. See Amended Memorandum of Law in Support of Verified Petition, *supra* note 210, at 36–41.

215 As of this writing, the *Domino's Pizza* case is still pending. McDonald's "provide[d] no argument to the contrary" regarding employees' reasonable beliefs, effectively conceding that element of the apparent agency claim. *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1239–40 (N.D. Cal. 2015).

### 3. *The Defeasibility of Apparent Agency and Misrepresentation Claims Through Heightened Reliance Requirements*

As theories centered on the franchisor's representations, the most important limitation to apparent agency and misrepresentation theories in franchising cases is a reliance requirement<sup>216</sup> that would permit franchisors to defeat both claims through conspicuous notice in the franchise agreement and to franchise store employees. Franchisors can overcome claims of apparent agency with adequate disclosure of the franchisee's independent ownership,<sup>217</sup> while in a misrepresentation claim, which focuses on the franchisor-franchisee relationship, franchisors may avoid liability through merger, integration, and non-reliance clauses in the franchise agreement.<sup>218</sup>

*Salazar v. McDonald's Corp.*,<sup>219</sup> a companion case to *Ochoa* with the same facts, demonstrates the limitation that a reliance requirement can impose, particularly in class-wide allegations of employment law violations. California adopts a restrictive form of the apparent agency test, requiring a heightened reliance showing of actual, subjective belief and reasonable, nonnegligent belief.<sup>220</sup> The *Salazar* court demonstrated the difficulty of meeting these elements on a class-wide basis, holding (1) that the reasonable belief element of an apparent agency claim requires an "individualized inquiry," and (2) that evidence that some franchise store employees did not receive the same orientation materials or training, and did not understand the franchisee to be an agent of McDonald's, preclude class certification.<sup>221</sup> The long tenure of some franchise store employees, who were more aware of the separate operation of the franchise store by the franchisee than short-term employees, led the court to conclude that the

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<sup>216</sup> In a misrepresentation claim, the franchisee must show reasonable reliance on the franchisor's representation. See *Cook v. Little Caesar's Enters.*, 210 F.3d 653, 659 (6th Cir. 2000) (holding that misrepresentation claim under Michigan franchise law requires a showing of reasonable reliance).

<sup>217</sup> See, e.g., *Allen v. Greenville Hotel Partners, Inc.*, 409 F. Supp. 2d 672, 680–82 (D.S.C. 2006) (finding use of franchisor's marks in hotel and advertisements insufficient to establish apparent agency because of prominent notice in hotel registration desk and elsewhere that hotel was owned and operated by the franchisee).

<sup>218</sup> See, e.g., *Papa John's Int'l, Inc. v. Dynamic Pizza, Inc.*, 317 F. Supp. 2d 740, 747–48 (W.D. Ky. 2004) (finding that merger clause made any franchisee reliance on oral representations by the franchisor unreasonable).

<sup>219</sup> No. 14-cv-02096-RS, 2017 WL 88999 (N.D. Cal. Jan. 5, 2017).

<sup>220</sup> *Id.* at \*2–7. Under California law, apparent "agency exists where (1) the person dealing with the agent does so with reasonable belief in the agent's authority; (2) that belief is 'generated by some act or neglect of the principal sought to be charged,' and (3) the relying party is not negligent." *Ochoa*, 133 F. Supp. 3d at 1239.

<sup>221</sup> *Salazar*, 2017 WL 88999, at \*3.

franchise store employees' experiences "are too varied" to support a finding of subjective belief, foreclosing a class-wide apparent agency theory for all franchise store employees.<sup>222</sup>

*Salazar* suggests that a test that hinges on reliance, by the franchisee or franchise store employee, may create daunting challenges as a vehicle for aggregate litigation of employment law violations because claims may be easily defeated through cosmetic changes that would not improve employment law compliance in franchise stores. Franchisors may, for example, seek to defeat liability under both regimes by providing notice to franchise store employees that they are not joint employers and to the franchisees about the possibility that a recommendation or policy tool could trigger an employment law obligation, or with merger and nonreliance provisions in the franchise agreement. As with a narrow version of the joint employer test, it would not incentivize franchisor precautions to deter employment law violations, but rather provide franchisors with an incentive to restructure operations to avoid liability.

Recognizing the unfairness of permitting franchisors to avoid liability through cosmetic notices and franchise agreement waivers, some courts have found franchisor disclaimers of an agency relationship insufficient, instead requiring consideration of the entire record.<sup>223</sup> As in *Ochoa*, plaintiffs may satisfy a reliance requirement with a showing that they believed that the franchise store would comply with employment law because of the franchisor's control over workplace operations.<sup>224</sup> Other courts narrowly construe general merger clauses in the franchise agreement, finding that they do not contradict extrinsic evidence of the franchisor's representations to the franchisee.<sup>225</sup> As a result, the extent to which reliance represents a significant limitation to these theories will depend on the jurisdiction and may be addressed through lawmaking, which will be explored in the next Section.

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<sup>222</sup> *Id.* at \*7.

<sup>223</sup> See, e.g., *Bartholomew v. Burger King Corp.*, 15 F. Supp. 3d 1043, 1051 (D. Haw. 2014).

<sup>224</sup> See *Miller v. McDonald's Corp.*, 945 P.2d 1107, 1113 (Or. Ct. App. 1997) (finding that detrimental reliance is not a required element of apparent agency doctrine, and that even if it were, customer's reliance on quality of McDonald's food and service was based on the reasonable belief that it would be the same as in the other McDonald's stores she patronized).

<sup>225</sup> See, e.g., *Travelodge Hotels Inc. v. Honeysuckle Enters.*, 357 F. Supp. 2d 788, 795–96 (D.N.J. 2005) (finding that merger and integration clauses were too general to disclaim misrepresentations). In this analysis, a merger clause may still provide a defense to a misrepresentation claim if the provision is sufficiently specific about the particular types of representations that the franchisor has made to the franchisee that would defeat a misrepresentation claim. See, e.g., *Prince Heaton Enters. v. Buffalo's Franchise Concepts, Inc.*, 117 F. Supp. 2d 1357, 1361–62 (N.D. Ga. 2000).

## B. Franchise Regulation for Optimal Deterrence

Although apparent agency and misrepresentation theories have their origin in common law, it is no accident that the most prominent examples of them allege violations of statutes that integrate these theories in their liability regimes.<sup>226</sup> Generally, lawmaking can add precision to any common law standard of care. Here, lawmaking can limit or eliminate common law reliance elements that might foreclose liability, and address the potential objection of overbreadth, which may sweep in passive investors or small franchisors,<sup>227</sup> by expressly exempting these franchisors from liability.

Although federal law could certainly incorporate these standards, state law<sup>228</sup> has long regulated the relationship between franchisors and franchisees, and may also address other factors that may cause over- or underdeterrence, such as franchisee insolvency, blanket indemnity clauses, choice of law provisions and general waivers, and the possibility of crippling liability under vicarious liability or frivolous claims.<sup>229</sup> Unlike federal franchise law, which contains no private right of action,<sup>230</sup> states may confer a contract law remedy to franchise store employees harmed by franchisor policies and business tools that en-

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<sup>226</sup> The misrepresentation claim in *Domino's Pizza* arises from the state fraud and franchise law statutes, V. Pet. for N.Y., *supra* note 41, paras. 6–7, while *Ochoa* claims a violation of California wage-and-hour law, which defines employment to include entities that “directly or indirectly, or through an agent or any other person . . . exercis[ing] control over wages, hours, or working conditions of any person.” *Ochoa v. McDonald's Corp.*, 133 F. Supp. 3d 1228, 1235–39 (N.D. Cal. 2015) (alterations in original) (citation omitted).

<sup>227</sup> See David J. Franklyn, *Toward a Coherent Theory of Strict Tort Liability for Trademark Licensees*, 72 S. CAL. L. REV. 1, 41–48 (1998).

<sup>228</sup> Although the FTC also regulates franchisors, its regulation is restricted to disclosure requirements. See 16 C.F.R. § 436.2 (2017). In contrast, twenty-two states regulate the sale of franchises and eighteen regulate the postpurchase franchising relationship. Emerson, *supra* note 62, at 910, 912. In addition to the states' more robust regulation of franchising, the federal government is an unlikely source for near-term regulation of the joint employer relationship, as DOL withdrew its guidance about joint employment. See News Release, U.S. Dep't of Labor, U.S. Secretary of Labor Withdraws Joint Employment, Independent Contractor Informal Guidance (June 7, 2017), <https://www.dol.gov/newsroom/releases/opa/opa20170607> [<https://perma.cc/W5Y9-Y5N6>].

<sup>229</sup> States prohibit choice of law provisions and waivers in franchise agreements to contract around state franchise law obligations, which will foreclose evasions of a liability through waiver. See, e.g., MINN. STAT. ANN. § 80C.21 (West 2016) (prohibiting waiver of franchise law by “any condition, stipulation or provision, including any choice of law provision, purporting to bind any person”); *Wright-Moore Corp. v. Ricoh Corp.*, 908 F.2d 128, 133 (7th Cir. 1990) (holding that Indiana franchise law applied despite choice of law provision).

<sup>230</sup> See, e.g., *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 382 (D.D.C. 2014) (holding no private right of action to enforce FTC Rule).



courage employment law violations, either directly or by making them third-party beneficiaries to these specific obligations.<sup>231</sup>

These factors make a strong case for a liability regime established through state lawmaking, holding franchisors jointly and severally liable for employment law violations in franchise stores where (1) franchise store employees reasonably believe that the franchisor is a joint employer or (2) franchisors make representations to franchisees about recommended or required business practices that create a likelihood of employment law violations unless franchisors take affirmative actions to ensure compliance.

Both standards could draw from existing common law standards to amend existing state labor, fraud, and franchise laws. To extend its apparent agent theory in employment law, California, for example, could broaden its apparent agency test by relaxing the reliance requirement, relieving the need for an individualized inquiry into whether a franchise store employee's belief of an employment relationship with the franchisor is reasonable. States could define the franchisor's obligation in state fraud and franchise laws by elaborating the required franchisor actions to ensure employment law compliance for recommended and required personnel policies and business tools that trigger employment law obligations. Lawmaking may further provide that franchisor notices are not dispositive and that a determination of the franchise store employees' reasonable beliefs and the reasonable likelihood of employment law violations cannot be waived in the franchise agreement and must be drawn from the whole record.

In addition, lawmaking can also address the possibility of franchisee insolvency by requiring franchisee insurance to avoid underdeterrence. If a significant portion of franchisees are judgment proof, expanding liability to franchisors is unlikely to deter franchisee employment law violations because judgment-proof franchisees are not exposed to the full costs of their activity. Moreover, franchisor strict liability for a judgment-proof franchisee's harm may lead to overdeterrence in the form of reducing the number of franchise-owned stores or franchising only to multiunit franchisees.<sup>232</sup> This suggests the additional need for franchisees to obtain sufficient insurance

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<sup>231</sup> Franchise laws can direct franchisors to include specific terms in franchise agreements, including terms that can be enforced by franchise store employees. *See, e.g.*, *Chen v. St. Beat Sportswear, Inc.*, 226 F. Supp. 2d 355, 361–66 (E.D.N.Y. 2005) (finding that garment workers as third-party beneficiaries could claim breach of contract between garment manufacturer and DOL to comply with wage-and-hour law).

<sup>232</sup> *See* STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF LAW* 260 (2004).

coverage for foreseeable harms that might occur through employment law violations. A more robust liability insurance market can introduce insurers to engage in risk management with franchisors, which may lead to further regulatory refinements as these stakeholders identify optimal precautions.<sup>233</sup>

In sum, extending third-party liability to franchisors in instances in which the employees reasonably believe that a franchisor is a joint employer, and in which the franchisor provides policies, recommendations, and business tools to franchisees that may trigger employment law violations, backed by an insurance requirement for potentially insolvent franchisees, is more likely to improve employment law compliance than the status quo.

### C. *The Overdeterrence Critique and Negligence as an Alternative Liability Standard*

There are two primary critiques to an extension of franchisor liability grounded in franchisor representations to franchisees and franchise store employees. The first is that, similar to the franchisor critiques of *Browning-Ferris*, any extension of third-party liability in franchising will cause overdeterrence, harming franchising as an economic model. Alternatively, one might critique this liability regime for insufficiently encouraging franchisors to monitor and cure franchise store employment law violations unrelated to franchisor representations and propose a broad negligence standard to establish an optimal level of care.

The remainder of this Part will discuss these critiques in turn.

#### 1. *The Overdeterrence Critique*

The primary potential critique of an expanded joint employer liability regime is that increasing regulation may not improve the standard of care but will deter socially beneficial activity.<sup>234</sup> Applied here, extending franchisor liability for franchise store employment law violations may result in a glut of frivolous claims.<sup>235</sup> This may cause franchisors to own their own units instead of franchising them, reducing opportunities for first-time business owners. Franchisors could also restructure operations to remove any operational control over

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<sup>233</sup> See Sharkey, *supra* note 178, at 384 & n.219 (describing how workers' compensation movement turned to "no-fault" insurance to counteract the limitations and inefficiencies of tort law).

<sup>234</sup> See SHAVELL, *supra* note 232, at 260.

<sup>235</sup> See Hanks, *supra* note 43, at 9.

franchise stores, even if inefficient, or opt not to open new units at all.<sup>236</sup>

As a first response to this critique, extending franchisor liability via apparent agency and misrepresentation theories accounts for the franchisor critique of an unbounded joint employer test. These doctrines confine third-party liability to franchisor representations to franchisees and franchise store employees. They do not extend liability to franchisors using franchising models, such as distributorships, that entail little guidance to franchisees or franchise store employees about store operations. For other franchisors, to limit liability, franchisors need only take sufficient action to eliminate a reasonable belief that they are joint employers and to refrain from representations to franchisees likely to cause employment law violations. To the extent that this may result in increased costs, these must be balanced against ensuring legal compliance in a cost-effective manner.

To the extent that a private right of action would result in a glut of frivolous claims,<sup>237</sup> this possibility can be addressed by narrowing or eliminating private enforcement. Liability expansion could be coupled with several, or “guarantor,” status for the franchisor, requiring plaintiffs to first seek recovery from franchisees, and only obligating franchisors to satisfy judgments in cases of franchisee insolvency.<sup>238</sup> Several liability would reduce the incentive for franchisors to select judgment-proof franchisees, but would entail higher administrative costs and erect barriers to justice that would not counteract the rational apathy of franchise store employees.<sup>239</sup> Alternatively, lawmak-

<sup>236</sup> See, e.g., *Save Local Business Act: Hearing on H.R. 3441 Before the H. Subcomm. on Workforce Protections and the H. Subcomm. on Health, Emp’t, Labor and Pensions of the H. Comm. on Educ. and the Workforce*, 115th Cong. 3 (2017) (written statement of Tamra Kennedy, President, Twin City T.J.’s, Inc.) (explaining that franchisor will no longer provide franchisee with employee handbooks “even though my [franchisor] has the expertise and best practices that would be most helpful for me and my employees”).

<sup>237</sup> There are many disincentives to complaining—the hassle and expense of litigation and the possibility of retaliation chief among them—such that it seems equally possible that meritorious claims will be suppressed. See ANNETTE BERNHARDT ET AL., *BROKEN LAWS, UNPROTECTED WORKERS* 25 (2009) (national survey of low-wage workers found that nearly forty-three percent of workers who complained about workplace conditions reported employer retaliation).

<sup>238</sup> See Hanks, *supra* note 43, at 8–9 (arguing that a franchisor guarantor requirement is likely to induce monitoring and policing to ensure optimal precautions by franchisees).

<sup>239</sup> Joint and several liability has the advantage over a guarantor requirement of overcoming the rational apathy and cost aversion of victims by providing incentives to the victim to sue by removing barriers to justice. See Hans-Bernd Schaefer, *The Bundling of Similar Interests in Litigation. The Incentives for Class Actions and Legal Actions Taken by Associations*, 9 EUR. J.L. & ECON. 183, 185 (2000) (Neth.) (discussing rational apathy and cost aversion of tort victims in the class action context).

ing could vest enforcement exclusively in an administrative agency. This would eliminate the possibility of frivolous private claims but would erect greater barriers to access to justice that may result in underdeterrence.<sup>240</sup> Whether deterring frivolous claims or encouraging meritorious ones is preferable depends on whether over- or underdeterrence is more likely. This is an empirical question that can be resolved in either event.

Yet beyond these limited exceptions, a modest extension of liability to franchisors is unlikely to harm franchising as an economic model. Generally, shifting the costs of some employment law violations to franchisors is unlikely to raise franchising costs sufficiently to outweigh the economic incentives to franchise unless damages exceed the harm.<sup>241</sup> As Alan Sykes argues, joint and several liability is particularly efficient in the case of insolvent agents because it avoids imposing arbitrary costs on innocent third parties harmed by the agent's conduct.<sup>242</sup> For solvent franchisees, the franchisor who must compensate the franchise store employee can externalize this cost by exercising a redress against the franchisee.<sup>243</sup> The benefits of franchising to franchisors other than reducing employment law liability—low monitoring costs, no need for upfront capital, and eliminating the risk of business failure—should outweigh the cost of some additional franchisor liability.

Any adverse economic impact of franchise regulation, moreover, is offset by its noneconomic benefits. It prevents the unjust result of shifting the costs of employment law violations to franchise store employees whose franchisees are judgment proof and who are least able to absorb or prevent the harm. Imposing liability on franchisors based

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<sup>240</sup> This is the enforcement regime for the FTC Rule, which does not confer a private right of action and may only be enforced by the FTC. See *A Love of Food I, LLC v. Maoz Vegetarian USA, Inc.*, 70 F. Supp. 3d 376, 382 (D.D.C. 2014) (holding no private right of action to enforce FTC Rule). Courts, however, often consider the FTC Rule disclosure standards in determining the duty under a claim for breach of implied covenant of good faith. See, e.g., *Brill v. Catfish Shaks of Am., Inc.*, 727 F. Supp. 1035, 1041 (E.D. La. 1989).

<sup>241</sup> If damages exceed harm, franchisors may take inefficient precautions. See A. Mitchell Polinsky & Steven Shavell, *Punitive Damages: An Economic Analysis*, 111 HARV. L. REV. 869, 879–81 (1998).

<sup>242</sup> See Alan O. Sykes, *The Boundaries of Vicarious Liability: An Economic Analysis of the Scope of Employment Rule and Related Legal Doctrines*, 101 HARV. L. REV. 563, 609 (1988) (criticizing scope of employment limitations upon respondeat superior liability as inefficient because they incentivize contracting out liability to judgment-proof agents); see also Daryl J. Levinson, *Collective Sanctions*, 56 STAN. L. REV. 345, 362–63 (2003).

<sup>243</sup> See Robert Cooter, *Prices and Sanctions*, 84 COLUM. L. REV. 1523, 1523–24 (1984); Lewis A. Kornhauser & Richard L. Revesz, *Sharing Damages Among Multiple Tortfeasors*, 98 YALE L.J. 831, 831–84 (1989).

on their representations to franchisees and franchise employees is fairer to the parties by recognizing the implicit promises in the franchise relationship that encourage franchisees to adopt policies and business tools that may cause employment law violations and franchise store employees to work in franchise stores under the impression that the franchisor ensures legal compliance. At the same time, it creates a consistent, predictable liability standard that franchisors can control by modifying their representations to franchisees and franchise store employees. Whatever modest costs that might arise are therefore justified to prevent injustice, to more effectively regulate the franchise relationship, and to remove the economic incentive to use franchising as an end run around employment law liability.

A third-party liability regime may also provide underdiscussed benefits to the franchise relationship, as shown in the close parallel of hospital liability for the medical malpractice of their physicians. Although physicians are independent contractors, and not employees, courts have found that the hospital-physician relationship is one of apparent agency, and that hospitals separately owe a nondelegable duty to the patient to comply with a reasonable standard of care.<sup>244</sup> Similar warnings that expanding hospital liability for medical malpractice will harm patient care<sup>245</sup> did not come to pass. Hospitals themselves largely embraced the nondelegable duty and have integrated its standards into their physician selection and accreditation procedures,<sup>246</sup> and the hospitals' liability for medical malpractice claims has provided hospitals with "rich teaching tools" to improve hospital safety standards.<sup>247</sup> The imposition of liability based on franchisor representations may induce franchisors, like hospitals, to more carefully craft policies, recommendations, and business tools to deter violations, and to admit franchisees and review franchise store practices in ways that will improve employment law compliance.

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<sup>244</sup> *Stewart v. Midani*, 525 F. Supp. 843, 851–53 (N.D. Ga. 1981); *Irving v. Doctors Hosp. of Lake Worth, Inc.*, 415 So. 2d 55, 58 (Fla. Dist. Ct. App. 1982); G. Keith Phoenix & Anne L. Schlueter, *Hospital Liability for the Acts of Independent Contractors: The Ostensible Agency Doctrine*, 30 ST. LOUIS U. L.J. 875, 879 (1986); Earlene P. Weiner, Note, *Managed Health Care: HMO Corporate Liability, Independent Contractors, and the Ostensible Agency Doctrine*, 15 J. CORP. L. 535, 544–50 (1990).

<sup>245</sup> See Joanna C. Schwartz, *A Dose of Reality for Medical Malpractice Reform*, 88 N.Y.U. L. REV. 1224, 1239–43 (2013).

<sup>246</sup> See Kenneth S. Abraham & Paul C. Weiler, *Enterprise Medical Liability and the Evolution of the American Health Care System*, 108 HARV. L. REV. 381, 390 (1994).

<sup>247</sup> Schwartz, *supra* note 245, at 1231.

## 2. *The Negligence Alternative*

Alternatively, one might critique an extension of franchisor liability that hinges on franchisor representations to franchisees and franchise store employees as too narrow, leading to underdeterrence. Franchisors that do not establish a direct relationship with franchise store employees and that do not provide policies, recommendations, or tools that trigger employment law obligations in franchise stores risk no liability, even for harms, such as franchisee wage-and-hour law violations, that are foreseeable and preventable. It would not correct the current joint employer doctrine, which may deter franchisors from monitoring activities that create foreseeable harms for fear of incurring liability for themselves.<sup>248</sup>

A potential alternative approach, which applies a negligence standard for franchisors if their franchisees violate wage-and-hour law, has recently been enacted in Australia.<sup>249</sup> The new legislation imposes liability on all franchisors that have a “significant degree of influence” over their franchisees and that “knew or could reasonably be expected to have known” about employment law violations but failed to take “reasonable steps” to prevent them.<sup>250</sup> The Australian legislation, similar to the third-party liability approach advanced by Brishen Rogers, suggests a negligence standard as an important alternative liability regime.<sup>251</sup>

Conceptually, a negligence standard in franchising may improve employment law compliance in franchise stores, particularly in addressing the problem identified by David Weil, of franchisor standards that impose exorbitant costs on franchisees, which franchisees shift to franchise store employees in the form of wage-and-hour law violations. A negligence standard would impose a duty on franchisors to monitor franchise stores for this foreseeable violation, reward franchisors that monitor effectively by reducing their liability, and lend credibility to franchisor measures that require franchisee compliance.<sup>252</sup> An additional potential benefit of a negligence standard in

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<sup>248</sup> See Rogers, *supra* note 16, at 47–53.

<sup>249</sup> Anna Patty, *Vulnerable Workers Bill Passed with Some Compromises*, SYDNEY MORNING HERALD (Sept. 5, 2017), <http://www.smh.com.au/business/workplace-relations/vulnerable-workers-bill-passed-with-some-compromise-20170904-gyaqy7.html> [<https://perma.cc/9D5S-X7AH>].

<sup>250</sup> *Fair Work Amendment (Protecting Vulnerable Workers) Act 2017* (Cth) sch 1 pts 2, 6.

<sup>251</sup> Rogers, *supra* note 16, at 47–53.

<sup>252</sup> That is, franchisors announcing a monitoring and policing policy to franchisees may be less likely to deter franchisee misconduct in a strict liability regime because the franchisees will know that the franchisor has little incentive to monitor and make good on its threats. See Jen-

franchising is that these benefits would extend to franchisors regardless of their joint employer status. The joint employer doctrine will always leave some franchisors beyond its outer boundary. A uniform negligence standard would apply to all franchisors that can establish an optimal level of care, regardless of operational control.

However, in practice, a general negligence standard cannot be applied on top of the existing joint employer doctrine without undermining either the effectiveness of the negligence or joint employer standard. First, the effectiveness of a negligence standard in inducing optimal care turns on the nature of the franchisor's duty. Sexual harassment law, for example, holds employers liable under a negligence standard for harassment by coemployees. But it only imposes a general duty on employers to take reasonable measures to prevent or stop the harassment.<sup>253</sup> A general reasonableness standard, without articulating an optimal standard of care that includes monitoring compliance, is unlikely to induce franchisor monitoring of franchise stores to ensure compliance with employment law. Franchisors fearing joint employer status are unlikely to undertake specific measures, such as monitoring, that a general duty would not require. This is a serious shortcoming for violations that are difficult to detect without significant monitoring, such as deterring franchise store managers from requiring off-the-books work or adequate implementation of workplace hazard or sex harassment policies. For these violations, franchisors have superior access to measures to induce franchisee compliance, including technology tools, on-site business consultants, and coercive pressure to comply, up to and including franchise nonrenewal and termination. Antidiscrimination law scholars have also criticized this standard for deferring to the employer's measures in a reasonableness

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nifer Arlen & Reinier Kraakman, *Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes*, 72 N.Y.U. L. REV. 687, 699 (1997). Jennifer Arlen and Reinier Kraakman also argue that a broad negligence standard avoids the perverse incentive of a control-based strict liability standard not to undertake monitoring measures that may uncover violations that they will ultimately be liable for because the costs of uncovering violations will be greater than the strict liability that ultimately accrues from not monitoring. *Id.* at 753. It seems equally likely, however, that franchisors may respond to strict liability by aggressively policing franchisee violations and resolving them informally and confidentially, thereby eliminating the reputational cost of noncompliance to the franchisor and shifting the costs of violations to the franchisees. This would, of course, also remove the deterrent effect that wider disclosure might yield.

<sup>253</sup> Levinson, *supra* note 242, at 366. Steven Carvell and David Sherwyn propose this standard in franchising: to require franchisors to "exercise reasonable care to ensure that franchisees are aware of employment laws with which they must comply." Carvell & Sherwyn, *supra* note 16, at 35.

inquiry<sup>254</sup> and for ignoring the heavy incentives<sup>255</sup> for supervisors to discourage complaints.<sup>255</sup>

These limitations to a general duty of care suggest that a negligence regime, particularly for difficulty-to-detect violations, is only likely to be effective in inducing employment law monitoring in franchise stores if backed by specific rules that require an optimal level of care.<sup>256</sup> This is, of course, contingent on the ability of courts, franchise store employees, and government agencies to determine what the optimal monitoring measures are.<sup>257</sup>

But even assuming the ability to identify the appropriate specific negligence standard, this would require franchisors to exert day-to-day supervision over the workplace in ways that may trigger vicarious liability for all harms to franchise store employees and customers. A specific negligence standard may thus require franchisors to choose between violating the negligence standard and creating evidence of joint employment and vicarious liability for all harms to third parties caused by franchise stores, whether or not the franchise relationship played a significant role in them.<sup>258</sup> A franchisor facing this choice

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254 This has been the trend in adjudication of the specific contours of the Faragher/Elleerth standard in sexual harassment cases, see Samuel R. Bagenstos, *The Structural Turn and the Limits of Antidiscrimination Law*, 94 CALIF. L. REV. 1, 24 (2006) (noting that courts rarely second-guess internal compliance procedures); Kimberly D. Krawiec, *Cosmetic Compliance and the Failure of Negotiated Governance*, 81 WASH. U. L.Q. 487, 508–09 (2003), and in state statutes imposing a negligence standard on contractors for wage-and-hour law compliance in subordinate firms' workplaces. See Hyde, *supra* note 16, at 410–11.

255 Samuel R. Bagenstos, *Formalism and Employer Liability*, 2014 U. CHI. LEGAL F. 145, 155–56 (2014).

256 Australia's Fair Work Act seeks to do this by providing an affirmative defense to franchisors that take "reasonable steps" to monitor, receive and address complaints. See *Fair Work Amendment (Protecting Vulnerable Workers) Act 2017* (Cth) sch 1 pt 2 558B(4); see also Tess Hardy, *Big Brands, Big Responsibilities? A Cross-Jurisdictional Review of the Regulation of Work in Franchises 16* (June 2017) (conference paper) (on file with author).

257 Arlen & Kraakman, *supra* note 252, at 705, 709–14 (stating that a negligence standard can equally induce preventive measures when "courts and enforcement officials can cheaply and accurately identify the appropriate measures"). This standard could draw from the franchisor's own existing plural model of franchising, in which franchisors have already adopted employment law compliance policies for franchisor-owned stores and monitoring and policing measures in franchisee-owned stores.

258 This is primarily a concern with franchisors otherwise outside of, but close to, the outer boundary of joint employer and vicarious liability standards. Where courts have upheld employer legal compliance measures as evidence of an employment relationship, this is because the lead firm's compliance measures significantly exceeded a general duty. Compare *Taylor v. Waddell & Reed Inc.*, No. 09CV2909 DMS (WVG), 2010 WL 3212136, at \*3–4 (S.D. Cal. Aug. 12, 2010) (denying motion to dismiss claim that financial services company employed advisors, reasoning that plaintiffs' allegations of intensive day-to-day supervision, including right to discipline and set specific work responsibilities and requirements, "may have gone beyond the general



may rationally conclude that evading the specific negligence standard is cheaper than incurring joint employer and vicarious liability.

Safe harbors are the most common way that lawmaking seeks to avoid creating unforeseen liabilities for the regulated entities.<sup>259</sup> There is precedent for this approach in the safety requirements for motor carriers in federal transportation regulations. Under federal law, motor carriers operating pursuant to United States Department of Transportation (“USDOT”) and state permits must “have exclusive possession, control, and use” of their leased vehicles.<sup>260</sup> USDOT promulgated a regulation in 1992 to clarify that the regulation was not “intended to affect whether the lessor or driver provided by the lessor is an independent contractor or an employee of the authorized carrier lessee.”<sup>261</sup> Courts since 1992 have deferred to USDOT, finding that compliance with the regulation could not be used to show an employment relationship.<sup>262</sup>

But while a safe harbor may induce franchisors to police employment law compliance in franchise stores in some instances, it can also undermine overall compliance by limiting evidence of control in joint employer litigation. The joint employer doctrine remains a crucial means to induce franchisors to deter employment law violations in franchise stores. Even assuming a broad negligence standard, the strict liability standard imposed by the joint employer doctrine is preferable

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supervision required by [financial services regulation] and created an employer-employee relationship”), *with Santangelo v. N.Y. Life Ins.*, No. 12-11295-NMG, 2014 WL 3896323, at \*8–9 (D. Mass. Aug. 7, 2014) (rejecting a firm’s work rules and requirements established by the firm to comply with federal and state financial regulation as evidence of employment of an insurance salesperson, because there was otherwise “no genuine dispute that [the] plaintiff controlled the ‘manner and means’ of his work as an insurance agent”).

<sup>259</sup> A safe harbor provides a statutory exemption to a standard that the conduct would otherwise violate. Section 530 of the Revenue Act of 1978, for example, contains a safe harbor in which employers may avoid federal employment tax liability for having misclassified employees as independent contractors under certain conditions. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 530, 92 Stat. 2763, 2885–86; I.R.C. § 3401 annot. (2012) (reproducing section 530 in the Internal Revenue Code).

<sup>260</sup> 49 C.F.R. § 376.12(c)(1) (2017).

<sup>261</sup> *Id.* § 376.12(c)(4); *see also, e.g.,* HAW. REV. STAT. ANN. § 467-1.5 (LexisNexis 2017) (“Nothing in this chapter or in any of the rules adopted to implement this chapter shall be deemed to create an employer-employee relationship between a real estate broker and the broker’s licensees; provided that the commission shall have all power necessary to regulate the relationships, duties and liabilities among real estate brokers and real estate salespersons in order to protect the public.”).

<sup>262</sup> *See, e.g.,* Huggins v. FedEx Ground Package Sys., Inc., 592 F.3d 853, 862–63 (8th Cir. 2010); Simpson v. Empire Truck Lines, Inc., 571 F.3d 475, 477–78 (5th Cir. 2009); Penn v. Va. Int’l Terminals, Inc., 819 F. Supp. 514, 523 (E.D. Va. 1993); Kistner v. Cupples, 372 S.W.3d 339, 342–43 (Ark. 2010).

for easily detectable employment law violations, such as employment policies that facially violate antidiscrimination laws and payments below the minimum wage. In these instances, the government and franchise store employees may easily identify violations from hiring and employment policies and payroll records. Franchisors strictly liable for violation of these standards have an incentive to use informal means not accessible to the government to deter these violations.<sup>263</sup> To the extent that a specific negligence standard requires a safe harbor that would exclude evidence of joint employer status from employment law litigation, imposition of a negligence standard in franchising may erode the overall standard of care by removing the incentive effects of other liability regimes. For employment law, in which the joint employer doctrine is the primary means to induce compliance measures by franchisors, this is a serious tradeoff, and one that should not be undertaken without evidence that it is worth the cost.

In sum, although a negligence standard presents advantages over a liability extension grounded in apparent agency and misrepresentation, an important benefit of these theories in franchising is that they would complement, and not act as a substitute for, joint employer liability. A negligence standard is unlikely to improve compliance unless it includes specific monitoring requirements, but these requirements are unlikely to be followed unless they come with a safe harbor, which may undermine the deterrent effect of the joint employer doctrine and other liability regimes. This analysis suggests that a negligence standard, although potentially inducing monitoring necessary to uncover and cure violations in franchise stores, requires difficult tradeoffs with uncertain outcomes. The new negligence standard in Australia provides an important case study for empirical research about whether these tradeoffs are justified.

#### CONCLUSION

This Article has shown how the franchisor's measures to protect its brand can create a reasonable belief in franchise store employees that franchisors employ them and can induce franchisees to adopt business policies and tools that trigger employment law obligations that

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<sup>263</sup> See Levinson, *supra* note 242, at 373. These are particularly compelling justifications in franchising, where the franchisor has a variety of means to efficiently allocate risk and avoid selecting judgment-proof franchisees at the contract formation stage. Professor LoPucki makes a similar argument in favor of a trademark-based liability system: "The effect of the rule is to remove most of the risk of defective products and licensee insolvency from the customer and place it on the trademark owner, to the extent of the trademark owner's wealth." LoPucki, *supra* note 175, at 1115.

franchisees often violate. The current debate about whether to expand or contract the joint employer doctrine to address the problem of employment law violations in franchise stores ignores the broader failure of the joint employer doctrine to address these unique features of franchising that can mask and encourage employment law violations. This Article offers emergent apparent agency and misrepresentation theories to improve employment law compliance in franchise stores, which can be further refined through state regulation. These standards have important implications for other contracting arrangements in which firms contract out for labor costs but rely on employees to faithfully represent the brand to the consumer.