Joint employer liability in franchise relationships

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Introduction

Most franchise agreements set out various forms of control that franchisors may exercise over franchisees in connection with IP issues, operations, finances and employment standards. However, certain recent decisions of the US National Labour Relations Board (NLRB) – an independent federal agency that oversees employee rights in connection with collective bargaining and makes decisions regarding unfair labour practices – may ultimately undermine certain advantages of franchising arrangements in the United States, especially as they relate to employment issues, and could give rise to a willingness by decision-making authorities to blur the fundamental legal separation between franchisors and their franchisees – at least as concerns collective bargaining and perhaps other types of liability for employment-related matters.

As a result, several concerns arise for franchised networks, particularly given that a significant expansion of the scope of a franchisor's liability for such matters has not historically been contemplated by franchise arrangements or those using the franchised business model.

Whether similar concerns may arise in Canada remains uncertain. However, certain developments relating to labour and employment law suggest that there may be an impending risk to franchisors in Canada.

NLRB rulings

In 2014 the NLRB general counsel found that well-known franchisor McDonald's could be held liable as a joint employer with its franchisees in connection with wage and labour complaints related to the operations of independent franchises. A decision on the merits of the case is not expected for many months or even years.

More recently, the NLRB also revised the standard for determining joint employer status for purposes of collective bargaining in *Browning-Ferris*.(1) Under the previous standard, an alleged joint employer had to possess and exercise authority over employment issues in order for the NLRB to consider it a joint employer. However, the NLRB now considers that in order to be considered a joint employer, it will suffice simply to possess control over employment matters, whether through indirect control or by having reserved authority in that regard, irrespective of whether that control or authority is in fact exercised. While *Browning-Ferris* did not specifically involve a franchise relationship, the revised standard for joint employer status could indeed have implications for franchisors.

When the NLRB was recently called on to consider whether a franchisor should be considered a joint employer in a case involving the Freshii chain,(2) its review of the franchise agreement resulted in a finding that the franchised system standards did not include mandatory labour and employment standards, despite Freshii being entitled to make labour and employment policies and procedures available for use by franchisees on an optional basis. Since provision of the materials and franchisee

compliance were not compulsory in that case, the NLRB concluded that Freshii "neither dictates nor controls labor or employment matters for franchisees and their employees".

Taken together, these cases create a significant level of uncertainty in the United States with respect to a franchisor's potential liability for actions and decisions that are fundamentally part of its franchisees' daily operations, and have resulted in speculation by members of the franchise industry as to just how far the NLRB may be willing to stretch the limits of a franchisor's direct liability towards employees of the franchised system.

Risks

Canadian courts, tribunals and regulatory authorities have had to address whether to hold franchisors responsible for certain conduct carried out by their franchisees in the context of such franchisees' employment relationships with their employees.

In the collective bargaining context, labour boards have considered whether to declare a franchisor and franchisee related employers in respect of employees of individual franchised establishments. A 'related employer' finding in Canada produces effects similar to 'joint employer' status in the United States: a franchisor found to be a related employer will be deemed to be a single employer with the franchisee. Related employers are bound to each other's collective bargaining obligations and are liable for each other's conduct in connection with such matters. The Ontario Labour Relations Act 1995(3) allows the Ontario Labour Relations Board (OLRB) – the Ontario equivalent of the NLRB – to declare distinct entities to be related employers if they are engaged in related activities or businesses and fall under common control or direction. Despite these criteria, the OLRB enjoys discretion in making related employer determinations. In exercising its discretion, it is an established practice that the OLRB generally seeks to preserve existing bargaining rights, but not necessarily to extend them.(4) In the past the OLRB has made at least one finding that is very similar to the NLRB's finding in *Browning-Ferris*,(5) although its related employer finding in that case similarly did not relate to employers in the franchise context.

The application of the related employer concept has been specifically considered by the OLRB in the franchise context. For example, in exercising its discretionary power in *United Brotherhood of Carpenters and Joiners of America, Local 785 v Second Cup Ltd*(6) the OLRB held that the franchisor and two of its franchisees were related employers, and the collective agreement between the union and the franchisor extended to franchisees in relation to renovations performed on franchised establishments. An important part of the OLRB's decision in this case was its analysis of the degree of control exercised by the franchisor over the renovation work. The OLRB also found a grocery franchisor and its franchisee to be related employers in a case where it took into consideration the control that the franchisor exercised with respect to its franchisee's product offering, cost structure and profit margins in order to evaluate which parties had control over the daily lives of employees with a view to including all the right parties in the collective bargaining process.(7) This finding occurred in the context of the implementation of a franchised system where employees had formerly been employed directly by the franchisor, and the finding was fundamentally intended to preserve their bargaining rights. As such, it is uncertain whether a franchisor's control over aspects of the business that are not directly related to the employment relationship will be relevant for purposes of a related employer analysis in any other context.

Much like the related employer concept, the Canadian 'common employer' principle considers whether two companies function "as a single, integrated unit" in order to attribute liability. This principle is most commonly cited in wrongful dismissal cases by employees who allege being employed by a group of entities, and courts will look beyond formal corporate structures and contractual relationships in order to assess the rights of wrongfully dismissed employees.(8) It remains unclear whether this principle may be specifically applied in the franchise context, particularly given that independent franchisees are not typically affiliated with their franchisors. However, it is not inconceivable that this theory could eventually be expanded to apply to franchisors.

The principles applicable to related and common employment in Canada may also ultimately result in an extension of franchisor liability in connection with human rights and discrimination issues. While no clear trend has emerged from Canadian courts in this regard, a handful of rulings suggest

that such an approach may be gaining traction. For example, preliminary objections raised by franchisors in respect of human rights violations affecting franchise network employees have been rejected on more than one occasion, based on findings that the franchisor's involvement in or control over the daily operations of a franchisee and its employment practices would need to be decided through an appreciation of the evidence brought forth at the hearing stage.(9) However, these preliminary findings are not dispositive of the franchisors' actual liability and decisions on the merits have yet to be rendered.

Franchisors may also be unexpectedly affected by the manner of appreciating whether control is exercised over an employee or an employment relationship, such as in connection with workplace health and safety and benefit programmes (including pension plans and collective insurance). These issues have not been specifically addressed by the judiciary in Canada in connection with franchised businesses. However, the perspective from which collective bargaining, wrongful dismissal and human rights matters have been considered in the franchise relationship recently may be cause for concern with respect to franchisors' potential liability arising from many other employment matters.

Mitigating risks

As a result of the shifting landscape in liability for labour and employment matters involving franchisors and franchisees, those conducting operations through a franchised business model are encouraged to monitor developments on the manner in which their rights may be affected.

Further, franchisors that impose strict policies with respect to franchisee labour and employment practices must acknowledge the heightened risk of liability flowing from such matters. Franchisors should review their policies and practices with a view to limiting their potential liability in connection with labour and employment matters in Canada. In particular, franchisors should review their franchise agreements, manuals and guidelines in order to reduce the overall level of authority and control reserved to the franchisor in connection with labour and employment matters.

Instead of exercising authority, franchisors may seek to communicate to franchisees ultimate objectives and goals to strive for in relation to labour and employment, while adopting an interested but non-interfering approach in connection with their franchisees' actual operations. One way of achieving this result may be for franchisors to influence franchisees' conduct by rewarding compliance with stated best practices in labour and employment that are not identified as compulsory in the context of the franchise relationship.

In practice, franchisors should avoid reserving any unilateral rights in connection with employment matters unless this is essential, and resist interfering with or exercising operational control over many aspects of franchisees' labour and employment practices, including in the following particularly sensitive areas:

- scheduling and task assignment processes;
- compensation programmes;
- payroll processing and payment methods;
- performance evaluation and disciplinary procedures; and
- recruitment, staffing and training models.

In addition, franchisors should consider reinforcing preventive measures, perhaps by providing franchisees with detailed training on legal and practical concerns relating to labour and employment issues, with a view to reducing the potential threat of claims from employees against either franchisees or the franchisor.

Finally, while there is currently no guidance with respect to whether such an approach may ultimately withstand judicial or regulatory scrutiny, it may be advisable for franchisors to include contractual provisions in their franchise agreements specifying that they are not joint, related or common employers of any franchisee employees, as well as an indemnity by franchisees for any liability accruing to the franchisor as a result of any finding that it is a joint, related or common employer for any reason.

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Endnotes

(1) *Browning-Ferris Industries of California*, 362 NLRB No 186.

(2) Advice Memorandum regarding Nutritionality, Inc, d/b/a Freshii from Barry J Kearney, associate general counsel, NLRB Office of the General Counsel, to Peter Sung Ohn, regional director, NLRB Region 13.

(3) SO 1995, Chapter 1, Schedule A.

(4) Similar rules apply in other Canadian provinces and are applied in a similar manner. For example, see the decision of the British Columbia Court of Appeal in *White Spot Ltd v British Columbia Labour Relations Board*, 1999 BCCA 0093.

(5) See *Teamsters Local Union No 419 v Metro Waste Paper Recovery Inc (Metro Municipal Recycling Services Inc)*, 2009 CanLII 60617 (ON LRB).

(6) 1993 CanLII 7903 (ON LRB).

(7) *Penmarkay Foods Limited v Retail Wholesale & Department Store Union, Local 414*, 1984 1128 (ON LRB).

(8) See *Downtown Eatery (1993) Ltd v Ontario*, 54 OR (3d) 161.

(9) See *Lindsey* v *McDonald's Restaurants of Canada Limited*, 2014 HRTO 372 (CanLII)*; United Steelworkers v Tim Hortons* (No 2), 2015 BCHRT 168 (CanLII).

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