This article originally ran in the *New York Law Journal*

Is Franchising Being Threatened (Again)?

There is new legislation being proposed at state and federal levels that seeks to address a myriad of wage and labor issues resulting from the pandemic. It's important to know what the legislation provides, consider the consequences, and determine the manner in which franchising parties may avoid or mitigate them, if necessary.

By Marc Lieberstein, Kitt Shipe and Chris Caiaccio | May 20, 2021

Franchise Agreement

It appears that every year or so, franchising comes under attack. In September 2019, this very column discussed: "Is the Franchise Model Under Attack?" And yet, since then, franchising shows no signs of slowing down. Of course, certain franchise areas, in particular, travel and hospitality, saw slower growth, significant closures and layoffs during the COVID-19 pandemic. But other franchise areas saw just the opposite, e.g., commercial/residential services, real estate, and retail food, products and services all saw growth. And projections for franchise growth in 2021 do not indicate any significant slowdown in franchising in 2021 or beyond. FRANdata's 2021 Economic Outlook for Franchising projects an increase of $100B in economic output from franchising in 2021, as well as an increase of almost 700,000 new jobs.

The most recent threat to franchising could likely be viewed as a by-product of the COVID-19 pandemic. Layoffs and other hardships experienced by many U.S. workers during the pandemic exposed a myriad of wage and labor issues resulting in increased unionizing. And, as a result of increased unionizing activity, employers pushed back. Not surprisingly, there is new legislation being proposed at the state and federal levels that seeks to address these issues. Right or wrong, left or right, blue or red, it's important to know what the legislation provides, consider the consequences, and determine the manner in which franchising parties may avoid or mitigate them, if necessary.

PRO Act

Up first for discussion is The Protecting the Right to Organize Act (PRO Act) that recently passed the House of Representatives in March. Some say the PRO Act would level the playing field between labor and business owners, facilitate union organization, and pave the way for wage equality. Others say the PRO Act would hurt workers' rights, create labor disputes, increase wages in a manner that will disrupt the economy (and franchising in particular), and force employees to join unions and pay union dues. Clearly, any legislation that threatens to force business owners to pay higher wages could hurt franchise growth, and could force employers to lay off workers. For better or worse, franchises may be forced to figure how to automate their businesses and essentially eliminate certain jobs entirely. Whether that hurts franchise growth or makes it more efficient/profitable is a debate for another column.

Some provisions of the PRO Act include: banning state right-to-work laws, which prohibit the requirement that employees pay union dues as a condition of their employment; significantly reducing the time period between the filing of a petition to unionize and the holding of an election, which gives employers much less time to convey their message to employees as to why unionization is not in anyone's best interest; preventing employers from interfering in union organizing activities and voting, including making it illegal for companies to hold mandatory captive audience meetings that are set up to lobby against unions; making it illegal for employers to use an employee's immigration statu**s** when negotiating employment terms; potentially making C-Suite executives personally liable for corporate activities that violate employee rights; creating a private civil right of action for unfair labor practices; removing the ban on secondary boycotts; and explicitly overruling several pro-employer NLRB decisions, including a decision which held that employees do not have an unfettered right to use their employer's email system for union organizing purposes. Of particular significance to franchisors,

the PRO Act would modify the test for “independent contractor” status by essentially codifying the ABC Test (as was done in California under its AB-5 legislation). The PRO Act also codifies the joint employer standard set forth in the National Labor Relations Board’s 2015 *Browning-Ferris* decision, making it more likely that a franchisor could be considered the joint employer of a worker employed by a franchisee.

ABC Test

As discussed in this column in September 2019, the ABC Test, which is not new and has been implemented in several states already in one form or another (e.g., California and Connecticut), makes it very difficult to have an independent contractor relationship. If globally applied in the franchise context, the ABC Test could convert franchisees, who thought they were independent business owners, into employees overnight. Such a change in status could result in massive class action misclassification lawsuits for wages, benefits and other unfair labor practices. Or not. One would think that if franchisees are doing well, and being treated fairly, they will be far less likely to dispute their status as independent business owners. Indeed, since the passage of the AB-5 legislation in California, yes, there have been lawsuits, class actions and an uptick in arbitration over the franchisee status in some industries, but franchising has not died, and as noted above, despite the pandemic, some franchises have seen steady growth and continued to flourish.

FAST Act

If the federal PRO Act was not enough, California appears to have made a decision that its fast food industry needs fixing with its introduction of The California FAST Recovery Act. Needless to say, franchising plays a large role in fast food, and it is clearly the target of this Act. California seems to be moving ahead to pass this legislation to improve the state of fast food operations in the state. The FAST Act calls for creating a sectoral council, which would bring together workers, franchisors/franchisee employers, and the public to recommend ways to address compensation, safety, scheduling, and training standards for the fast food industry. It appears to be an attempt to give franchisees and their employees a mechanism to convince (or force) franchisors to change their current practices, even if such changes are not truly needed. Another interesting component is that it appears to adopt the joint employer/joint liability standard similar to that contained in the PRO Act. The FAST Act might initially look bad for fast food franchising in California, but it’s hard to predict what may result from the creation of a sectoral council that brings all voices together to improve it.

FLSA Rules

Last, but not least, we have the federal Department of Labor (DOL) trying to threaten franchising with its revocation of the Fair Labor Standards Act (FLSA) joint employer and independent contractor rules. On March 11, 2021, the DOL rescinded its regulations interpreting joint employer status under the FLSA, and the DOL’s standard for determining whether a given worker is an employee covered under the FLSA or an independent contractor (and thus outside of the FLSA’s coverage). On the joint employer question, the prevailing view used to be that if one employer exerted direct or indirect control over another employer, both employers could be jointly and severally liable for activities of other employer. Under the Trump administration, the rule was changed to a requirement that there be direct control. In the franchise context, the “direct or indirect” control standard resulted in much litigation over whether a franchisor was jointly liable for the actions/inactions of its franchisees. It’s not difficult to see how a franchisor could easily be ensnared by the indirect control standard, as under any franchise agreement the franchisor usually exerts a minimum amount of control over the franchisee to maintain consistency across its franchise system. The direct control standard was viewed more favorably by franchisors to limit their joint liability over franchisee activities that they did not have control over.

On the independent contractor question, the final rule focused on two factors—who had control over the work performed, and who took on the risk for profit or loss. With the DOL's withdrawal of the independent contractor final rule, worker status will be assessed under the "economic realities test," as applied on a jurisdiction by jurisdiction basis, pursuant to which many more workers will likely be deemed employees and not independent contractors. Similar to the PRO Act, this could impact franchisors significantly because many franchisees, who formerly fell within the definition of an independent contractor, will become FLSA-defined employees entitled to FLSA-mandated wages and benefits, including overtime pay. The liabilities for such wages and benefits threatens to put many franchisors out of business, among other negative ramifications.

Conclusion

While there has been much legislative activity and costly litigation over these control standards and definitions, the franchise model continues to persevere. It also isn't clear that franchisors and franchisees couldn't resolve many of these issues with better franchise agreement terms and possibly insurance policies. One can see the thread among these legislative proposals—a desire to level the playing field and make things more fair for labor, albeit at the expense of business owners. Whether these legislative proposals are reasonable or unfair, or will hamper the future growth of franchising is not something anyone can really predict. Many of these proposals, or portions of them, have been around and in place in some states for years with no appreciable impact on franchising. Moreover, there are ways for franchisors to mitigate the risks and consequences of such legislation, namely, (1) treat your franchisees fairly and work together to ensure fairness in wages for employees, along with safe workplaces and health standards; (2) franchisors should leave the business operations to the franchisee and instead focus on controls and standards that will maintain brand consistency and value; and (3) consider getting better insurance coverage for potential liabilities arising out of a broader joint employer standard.

So, is franchising being threatened, again? It does look that way, but maybe franchising will adapt and still flourish despite the threats. We shall see.

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