



## **AAFD White Paper Series:**

# **The New NLRB Joint Employer Rule—Unpacking the Conundrum for Franchisees: Why AAFD Accreditation can eliminate the Joint Employer Threat in Franchising**

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Addressing how franchisees should ‘engage’ the specter of the National Labor Relations Board (NLRB) newly revised Joint Employer Rule is a complicated and vexing subject. On one hand, the threat that a franchisor may be found to be the ‘joint employer’ of a franchisee’s employees has influenced many franchisors to withdraw valuable support services, especially human resources and training, adding significant expense for franchisees. On the other hand, the excessive control exerted by some franchisors over a franchisee’s ownership of the franchised business is at the heart of the AAFD’s long standing war against onerous one-sided franchise agreements and cultures, which not only addresses the issue of joint employer, but also whether a franchisee is truly an independent contractor.

In an ideal world, the threat that a franchisor will be subjected to a finding that it is the *joint employer* of the employees of the franchised business can be a tool to help franchisees claw back vital incidents of business ownership. But unfortunately, the NLRB’s criteria to determine a *joint employer* holding focuses primarily on matters relating to the enforcement of brand standards rather than important encroachments of the franchisee’s status as ‘business owner.’ This is a significant concern, because all agree (including the NLRB staff) that the enforcement of uniform brand standards is an essential advantage—even necessity—of a successful franchise system and brand.

The NLRB focuses on a franchisor’s involvement, influence and control over matters involving the franchisee’s labor – employee manuals, employee training that may be provided by the franchisor, policies regarding hours, employee uniforms, and even perhaps criteria for employment. While these support services may logically imply influence and control over the ‘line’ employees, they are all services that are of vital importance to quality and control with respect to *brand standards*. These brand standards are an essential ingredient and attraction to a great brand and are often the very reason a prospective franchisee has been drawn to invest in the franchise system and brand.

The AAFD submits the focus should be on a franchisor’s *control over vital incidents of ownership and equity* are the factors that encroach the franchisee’s authority over the franchised business and that should give rise to a finding that the franchisor has become the ‘joint employer’ of the franchise. Rather than focus on services that imply control of employee conduct, the AAFD urges that there also be a finding that the franchisor is exerting significant encroachment over the equity ownership of the business.

Some of the critical elements that exemplify control over the ownership of the business:

1. Control over hours of operation of the business without a business necessity.
2. **Control over the franchisee’s bank account, and the ability to pull funds from the franchisee’s accounts at will, or in some instances all revenues directed to the franchisor who pays the franchisee his, her, or its share.**
3. **Total control over the franchisee’s suppliers, including the right to designate (and profit from) specific suppliers at the franchisee’s expense (as opposed to allowing a franchisee to shop and negotiate competitive suppliers that meet system standards).<sup>i</sup>**
4. Excessive control over a franchisee’s customers.
5. Point of Sale (POS) systems that provide a franchisor with full knowledge, data, access and sometimes control of the franchisee’s customers.
6. Limits on the ability for the franchisee to renew the franchise without accepting material modifications that often impose new and onerous provisions, or materially change the business model that the franchisee initially bought into.
7. Limits on the ability of a franchisee to sell or transfer the franchised business.
8. Influence over the capital expenditures required of the business, including remodeling, equipment and computer purchases, and including mandated insurance.
9. A complete lack of negotiability of the franchise agreement and operating standards.

All these examples are basic tenets of business ownership that are typically enjoyed by any business owner, but which most franchise agreements confer substantial control to the franchisor. While it may be argued that none of these examples bear directly on the control of labor, the AAFD contends that, in the franchising context, a nexus between the control of the business and influence over labor needs to be established before there should be a holding of *joint employer* applicable to a franchisor.

The establishment and enforcement of *brand standards* is a benefit to all parties – the franchisor, the franchisee, the employees and even consumers—delivering predictable uniformity of brand products and services to the benefit of consumers. Imposing liability solely on the grounds of significant support (even control) over the delivery of brand quality would seem to be at odds with a wise commercial objective. However, add the nexus of control over the equity of the business, and the logic for holding the franchisor liable as the joint employer is much more easily justified.

And there is significant precedent for the logic of tying the finding of business control to finding a joint enterprise. A prime example has been the denial of SBA lending and contracting where a franchise system has been found to exert excessive control over the franchise such that the SBA (and courts) have held that there is no small business to benefit.

The logic behind the AAFD’s evaluation regarding the *NLRB Joint Employer Rule* has led us to a somewhat convoluted position: The AAFD has opposed the Rule to the extent that it *solely* looks at the legitimate purpose of enforcing brand standards but supports the Rule where the nexus over excessive equity control is present. *The AAFD might even argue that where a franchisor is found to exert excessive control over the franchisee and the brand, the franchisor might be deemed to be the sole ‘employer’ with full liability with respect to wage, hour and financial exposure.*

## ***How AAFD Accreditation may save the day for franchisors and franchisees. . . and the NLRB!***

If the NLRB should embrace the AAFD’s argument that there needs to be a nexus between business control and enforcement of brand standards to find that a *Joint Employer* relationship exists in a franchise system, then there is lurking a significant opportunity for a franchise system to dodge the specter of *joint employer* liability. **The AAFD is asking the NLRB to exempt the threat of *joint employer liability* to any franchisor that has earned the AAFD’s *Fair Franchising Seal*.** As is explained in greater detail below, any company that has earned AAFD accreditation would no longer meet the control criteria to be subjected to a holding of *joint employer*.

## **The AAFD Fair Franchising Standards and AAFD Accreditation**

Some context is needed to understand why AAFD Accreditation should exempt a franchisor from the threat of *Joint Employer* liability.

The American Association of Franchisees and Dealers was founded in 1992 with a mission to ‘define, identify and promote fair and balanced franchise systems and cultures.’ To that end, in 1994 the AAFD established its Fair Franchising Standards Committee and invited franchisors, franchisees, franchise lawyers and both state and federal governments to come together to negotiate and promulgate a body of fair franchising standards. The committee had three voting constituencies – an equal number of franchisor representatives, franchisee representatives and franchise attorneys who represented both franchisors and franchisees.<sup>ii</sup> Representatives from the Federal Trade Commission and the North American State Securities Administrators (NASSA) Franchising Project Group were invited, and frequently attended our sessions, but abstained from voting.

What followed were months, and then years, of in person and telephonic meetings wherein every aspect of franchising and the franchising relationship was dissected, discussed, and negotiated to determine a mutually endorsed common standard on a myriad of subjects. To adopt and promulgate a standard, each standard had to be approved by a majority of our participating interest groups – franchisor group, franchisee group and attorney group – and then the standard had to be approved by two-thirds of the full committee. Most Standards were approved by a unanimous or near unanimous vote.

The first body of standards was published in 1996, but the committee continued its work through 2012 when the current standards were published. To date the AAFD has approved 144 Fair Franchising Standards covering every aspect of the franchise relationship, effectively identifying a comprehensive balance between the rights and obligations of both franchisors and franchisees.

The Fair Franchising Standards Committee also created the AAFD’s Accreditation policy, which became Chapter One of the AAFD Standards. The committee established two levels of accreditation: the opportunity to earn the AAFD Fair Franchising Seal for franchise systems that have been in business for at least five years and have at least twenty-five operating units, and an AAFD Accredited Contract designation for start-up and young franchise brands.

To earn AAFD Accreditation the following criteria must be met:

1. The franchisor must recognize an independent owner's association with authority to negotiate on behalf of system franchisees. A company sponsored Franchise Advisory Council may qualify if it meets certain criteria for independence and negotiating authority.
2. The brand's independent franchisee association and the AAFD must certify that the franchise system's current franchise agreement and actual practices and are consistent with the 'spirit' of the AAFD standards (full compliance is not required). In practice, the AAFD grades the contract against the Standards, and a focus group of system franchisees grades the actual practices of the company.
3. The franchise agreement must have either been negotiated or recommended by the Board of Directors of the owner's association (or FAC) as meriting accreditation and must nominate the franchisor to be accredited by the AAFD.
4. Finally, and perhaps most importantly, 75% of the system open and operating franchisees must vote to approve the accreditation of the franchise system, the franchise agreement, and the actual practices of the franchisor.

It is instructive to look at the AAFD Standard 2.3, which deals with the criteria to determine if a franchisee is a true 'independent contractor' of the franchisor. To achieve AAFD Accreditation, a franchise system would need to meet this standard. In particular, it should be noted how the AAFD commentary looks at control exercised by a franchisor as meeting our standard:

**STANDARD 2.3 INDEPENDENT CONTRACTOR. Where a franchise agreement creates an independent contractor relationship, both the franchisor and franchisee should act in a manner consistent with the legal standards of an independent contractor relationship.**

**Commentary:** The law relating to independent contractors generally provides for the limiting of liability of one party in exchange for a surrender of control over the other party. As applied to franchising, while a franchisee is responsible for the operation of the franchised business as an independent contractor, a franchisor should limit its involvement in the franchisee's exercise of independent business judgments. A franchisor should provide a franchisee with system standards and with adequate training and guidance (including written procedures, sample or required disclaimers, sample or required warranties, etc.). As an illustration, while a franchisor cannot hire or fire a franchisee's employees, a franchisor may be justified in requiring a franchisee to follow the franchisor's hiring guidelines if the nature of the franchised business dictates (e.g., a criminal background check if the employee will be working with children). (*Adopted September 14, 2006 by a vote of 11-1-0*)

Chapter 8 of the AAFD Standards explicitly recognize the franchisor's right and obligation to develop and enforce system standards, but notably the AAFD Standards also explicitly enunciate and endorse that the franchisee should have clear rights of business ownership and control over the activities of the franchised business, such that any franchisor that has earned the AAFD Fair Franchising Seal should be free of any claim of *Joint Employer* liability.

Through 2019, eighteen brands have qualified to earn the AAFD Fair Franchising Seal. For several of these franchise systems, the application to earn the Seal was part of a settlement of a systemwide issue. The AAFD has always intended for its Fair Franchising Seal to provide marketplace protection of franchisees and franchising in general, but we have lacked a significant hook to entice the application and investment to earn the AAFD Seal.

While the AAFD believes that any franchise system that has earned AAFD Accreditation should be also exempt from an NLRB Joint Employer liability, it is also a benefit that franchisees are empowered and protected by the requirements to earn the seal – especially with regard to the recognition of independent owners associations and collectively bargained franchise agreements which are consistent with the goals and objectives underlying the NLRB’s overall mission and objectives.

The AAFD believes it has put in place a vehicle, the AAFD Fair Franchising Seal, which will provide assurance to the NLRB, and protection for franchisors that treat their franchisees fairly, that will justify the NLRB to exempt all AAFD Accredited Franchisors from Joint Employer liability, while also giving the franchise system a reliable indicator that a franchise system has embraced and adopted a collaborative franchise system culture that treats its franchisee’s fairly.

A win-win-win for all concerned.

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<sup>i</sup> Other than to identify this practice as a source of franchisor control that may urge a finding of joint employer, the subject of *Supplier Mandates* needs a full white paper to address another conundrum in the franchising relationship. While *supplier mandates*, including various opportunities and benefits gained by group purchasing, should effectively be embraced for the joint benefit of franchisors and franchisees, the opportunity to abuse and profiteer from a franchisor’s retained right to designate suppliers is massive and deserves a full and separate evaluation.

<sup>ii</sup> A copy of the AAFD Fair Franchising Standards, including a roster of committee members is incorporated in this white paper and is available from the AAFD and from Amazon.com and the Amazon Kindle library.