



# Looking at the Regulatory Challenges

What we all can agree upon

Franchising is simply  
an alternative method of expansion  
and distribution

# Franchising is effective

- It affordably allows new brands and ideas to come to market and compete effectively.
- It achieves consistent – sustainable – replication.
- It allows for the creation of market critical mass.
- It is effective in a fragmented industry (i.e., massage, senior care, daycare, haircare, lawncare, residential and commercial cleaning).

# Consistent – Sustainable - Replication

- **Consistent:** Does not mean the offering should be identical for either the consumer or each **class** of franchisee.
- **Sustainable:** The economics needs to be sustainable at both the unit level operation and for the franchise system.
- **Replication:** The franchisor should be able to leverage the network for the benefit of the franchisees and the franchisor (marketing, costs, IT, field support, validation for growth, etc).

# It's simply a license

- Franchisor grants franchisees the right to use its marks.
- Franchisor establishes and enforces brand standards.
- There is a financial relationship.

**But - because it's simply a license – to avoid liability**

Franchisors must focus on **Brand Standards**  
and  
**Not** on Day-to-Day **Control**

# It's not a partnership

- There is no fiduciary relationship between a franchisor and a franchisee.
- A franchisor and franchisee share a common brand but may have different interests.
- The franchisee is contractually obligated to follow the system - even when they disagree with it.

# Franchisors and Franchisee are Arguably **Not** in the Same Business

- Franchisors and franchisees merely share a common brand.
  - They maintain themselves as separate entities.
  - They each have a distinct and meaningful role in the overall operation.
  - They require different organizations and skills
    - Franchisor is responsible for developing the system and the brand - licensing it, protecting it and supporting its franchisees.
    - Franchisees are responsible for providing the product or service to consumers in a way that meets the franchisor's brand standards.



# Brands are important

We've spent decades convincing consumers we are a chain because brands eliminate risk in the customer's mind.

But

Doing such a good job has made franchising a target for union organizing and resultant regulations.

# The Beginning of Regulation

# Federal Lanham (Trademark) Act - 1946

- 15 U.S.C. 1051.
- Trademarks indicate that the trademark owner is associated with the product and service.
- To protect its marks a franchisor must have “adequate control” over the quality of goods and services offered under its marks.
- Franchisors must monitor and **control** the use of their intellectual property to ensure that the use of the trademark does not deceive or mislead the public as to the quality of the goods and services.

# FTC Franchise Rule – Defines a Franchise

- Three key elements of a franchise under the **Federal Trade Commission's Franchise Rule**:
  1. Franchisee's business is *substantially associated* with Franchisor's TRADEMARK
  2. Franchisor exerts significant **CONTROL** over, or provides significant ASSISTANCE to Franchisee
  3. Franchisee pays a required FEE to Franchisor or its affiliates for the right to engage in the business

The FTC definition is not going to be a barrier to  
Joint Employment

# The beginning of regulation

- Public franchisor stocks start to slide.
- One-time fees recorded as income upon sale.
- Celebrities lending their names without any involvement
  - Minnie Pearl, Johnny Carson, Jerry Lewis, Edie Adams, Tony Bennett, Muhammad Ali, Eva Gabor, Mickey Mantle, Mahalia Jackson, Fats Domino, Arthur Treacher, Rocky Graziano, Dizzy Dean, Arthur Treacher, Tennessee Ernie Ford, Roy Rogers, James Brown, Pat Boone, Willie Mays, Joe Namath, Eddie Arnold, Al Hurt.
  - Bogus offerings (chinchilla farms).

# The beginning of regulation

- Litigation
  - Standard Oil and Richfield Oil – antitrust
  - Carvel – tying
  - Chicken Delight – tying
- Public hearings and proposed regulation
  - Federal
  - State

# Regulation begins

- Delaware Franchise Security Law (1970)
  - No pre-sale disclosure
  - Termination and non-renewal notice requirement
- California Franchise Investment Law (CFIL) (1971)
  - Pre-sale disclosure
  - Franchise registration
- New Jersey Franchise Practices Act (1971)
  - Termination
- Washington State Franchise Investment Protection Act (1972)
  - Pre-sale disclosure
  - Relationship law

# International Franchise Association

- Founded 1960
- Played a major role in negotiating limits on franchise regulation
- Proposed model franchise disclosure and deceptive practices act to States



# Federal Trade Commission Rule

- Proposed federal pre-sale disclosure law (1971)
- Hearings (1972)
- Issued Disclosure Requirements and Prohibitions Concerning Franchising and Business Opportunity Ventures (1978)
  - “FTC Rule” 16 C.F.R. 436 - (Amended 2007)
  - Pre-sale disclosure - no relationship law provisions
  - Governed acts of franchisors and sales brokers
  - Definition not uniform in all states
- A Franchise Disclosure Document (“FDD”) is provided to prospective franchisees to make an informed decision.
- The FDD was called a Uniform Franchise Offering Circular (UFOC) prior to 2007.
- FTC is reviewing current FDD. The IFA is lobbying for retention of the current rule without change.

# How is the relationship governed

- The franchise relationship is governed by a contract (the franchise agreement) during and after the term
- Franchisees rely on a franchisor's pre-sale franchise disclosure, and
- Franchisors have relied on a franchisee's pre-sale acknowledgement (Reps and Warranties)
  - Eliminated 18 September 2022 - North American Securities Administrators Association (NASAA)

# Vicarious Liability, Joint Employer and Other Risks

# Vicarious Liability

# Sharing a Common Brand

- The franchisor and franchisee share a common brand.

**It is supposed to feel like one big brand**

**but its made-up of**

**numerous separate independent legal entities**

# What are Brand Standards

*The glue that allows for a consistent and sustainable brand voice that resonates with the consumer.*

*Essential for building brand awareness and trust for the products and services offered.*

# Controls in Franchising

*Franchisors do not exercise day-to-day management control over franchisees.*

*Franchisee performance should be measured on output alone –*

*for example –*

*Does the franchised location's performance meet the franchisor's Brand Standards?*

# Standards vs. Control

## ➤ **Standard:**

- Windows being clean
- Customer wait time under 90 seconds
- Parking lot well lit

## ➤ **Control:**

- Windex, three times a day, who should clean
- Three staff between 3 and 5 in the afternoon
- Lights, seven feet apart, lamp posts 22 feet high



# Big Question

Can a Franchisor maintain and enforce consistent **Brand Standards** with **Minimal Control** over Day-to-Day management and operations?

# Vicarious Liability in Franchising

***When a Franchisor is alleged to be responsible for an act by (or for the inaction of) the Franchisee or at a Franchisee Owned and Operated business.***

# Examples of Vicarious Liability

- Slip-and-fall causing injury to plaintiff.
- Foodborne illness.
- Maintenance or construction of location.
- Criminal acts of franchisees or their employees.

# Actual Agency or Apparent Agency

- **Actual Agency** – the Franchisor allegedly directed the act that caused injury to a third party.
- **Apparent Agency** – the injured party reasonably thought it was dealing directly with the Franchisor and not the Franchisee.

# Practical Prevention

- Franchisee should never use the Franchisor's marks as its identification on:
  - Corporate name
  - Invoices and agreements
  - Credit card receipts
  - HR materials: employment applications, handbooks, paystubs, etc..
  - Acknowledgment forms (that franchisee is the employer and franchisor is not the employer)

# Fictitious Name Filing

- When one entity will be transacting business under the name other than its actual name.
- The franchisee is permitted under state law and required by franchisor to register the name.
- The purpose is to put the world on notice that the franchisee is doing business under the franchisor's licensed brand.

# Practical Prevention – Tell the Public

- While we are sharing a brand, consumers need to know that they're dealing with an Independent Franchisee operating under a license from a Franchisor
- Notify the public that the business is independently owned under license from the Franchisor and include the Franchisee's corporate/LLC name in the public notification.

**This location/business is independently owned and operated by 123 LLC (franchisee) under license from 345 Corporation (franchisor).**

# Practical Prevention – franchisees tell their employees

- The franchisee's employees should also know they're working for an Independent Franchisee operating under a license from a Franchisor.
  - Notify the staff that the business is independently owned under license from the Franchisor.
  - Include the Franchisee's corporate/LLC name in the notification.
  - No use of brand name in Franchisee's corporate/LLC name, HR docs, paystubs, etc..



# Joint Employment

# Joint Employment

- Holding party “A” responsible for the employment and labor-relations activities of party “B”.
- In franchise context, allegations that a Franchisor is responsible for its Franchisee’s HR or labor policies due to control over Franchisee’s day-to-day activities.

# Historic standard of Joint Employment

- A company is a joint employer if it exercises **“substantial direct and immediate control”** over the employees’ essential terms and conditions of employment.
- Controls which companies are responsible for union representation, collective bargaining, and other rights and protections under the National Labor Relations Act (“NLRA”).

# ***Browning-Ferris Industries***

- Obama Era Standard: ***Indirect*** or ***Potential*** control over day-to-day employment matters and working conditions.

**Meant to advance collective bargaining by unions.**

# Current NLRB Joint-Employment Standard – February 2022

- Joint Employment exists when
  - “The two employers share or codetermine the employees’ essential terms and conditions of employment.”
  - Putative joint employer must “possess and exercise such substantial direct and immediate control over one or more essential terms or conditions of their employment as would warrant finding that the entity meaningfully affects matters relating to the employment relationship with those employees.”

# Joint Employer Control Factors

- Primary Focus is “Control”
  - Does franchisor control certain actions of the franchisee and franchisee’s employees
    - “Manner and means” of how the franchisee runs its business
    - Essential terms and conditions of employment:
      - Wages, personnel issues, number of employees
      - Work hours, schedules, shift hours, breaks, PTO policies
      - Discipline, discharge, hiring
      - Employee grievances
      - Authorizing overtime
      - Safety rules and standards
      - Production standards
      - Training employees

# No Impact on Joint-Employment Status

- Properly documented:
  - Providing franchisees with a sample employee handbook or sample forms.
  - Two companies participating in an apprenticeship program voluntarily.
  - Asking franchisee to meet quality control standards, institute workplace safety practices and training, etc.

# Proposed Biden Standard – Return to Browning-Ferris - 7 September 2022

- “If the employers share or codetermine those matters governing employees' essential terms and conditions of employment”
  - “Essential Terms and Conditions of Employment” To Generally Include Wages, Benefits, and Other Compensation; Hours of Work and Scheduling; Hiring and Discharge; Discipline; Workplace Health and Safety; Supervision; Assignment; and Work Rules and Directions Governing the Manner, Means, or Methods of Work Performance.”
  - Indirect Control is Sufficient.
  - Reserved Right to Control is Sufficient.



# Proposed Biden Standard – Return to Browning-Ferris - 7 September 2022

- When the employer “possess[es] the authority to control (whether directly, indirectly, or both) or to exercise the power to control (whether directly, indirectly, or both), one or more of the employees’ essential terms and conditions of employment.”
- When the employer “[p]ossessing the authority to control is sufficient to establish status as a joint employer, regardless of whether control is exercised,” and “[c]ontrol exercised through an intermediary person or entity is sufficient to establish status as a joint employer.”

# Proposed Trademark Licensing Protection Act (TLPA)

- Trademark law requires franchises to protect the brand through standardized brand controls.
- NLRB penalizes franchises by deeming them “joint employers” for having the same brand controls.
- Proposed legislation to Amend the Trademark Act – 28 September 2022
- Sponsors – Senators King, Manchin, Sinema, Lankford, Tillis, Collins, Cornyn
- The licensing of a trademark may not be construed as establishing an employment relationship between the owner of the mark and the licensee, or the employees of that licensee.

# What is an Employer

An employer is generally defined as an individual or entity who **“suffers or permits”** another to work.

# California AB-5 and the ABC Test

- California Assembly Bill 5 (AB-5)
  - Passed: September 2019.
  - Effective: January 1, 2020.
  - Adopts the “ABC Test” for determining whether worker is an independent contractor or employee under certain California employment laws.
    - Exemptions for some professions, but not for franchisors.
  - Advanced principally by (SEIU) Service Employees International Union.
  - Dynamex Operations West v Superior Court – independent contractor v employee.
  - IFA and others challenged, and district court dismissed on lack of standing etc.

# California AB-5 and the ABC Test

- The “ABC Test”
  - A worker is presumed an employee, not an independent contractor, unless the hiring entity can show all three of the following:
    - A. Worker is free from control and direction of hiring entity in the performance of the work, both under contract and in fact;
    - B. Worker performs work that is “outside the usual course of the hiring entity’s business”; and
    - C. Worker is customarily engaged in an independently established trade, occupation, or business of the same nature as the work performed for the hiring entity.

# ABC Test – its an open mess

- California
  - US Court of Appeals Ninth Circuit – McDonalds not the joint employer of franchisee’s employees.
  - Proposition 22 – November 2020 – Uber and Lyft exempt.
- Questions that are open
  - FTC Rule’s control definition is not a barrier to employment status.
  - Question whether franchisor and franchisee in same course of business.
  - Question whether the creation of the franchise is a subterfuge to misclassify employee status.
  - Question whether the work of the franchisee is a service to the franchisor simply because it benefits both parties.

# Anti-Poaching

# *Anti-Poaching*

- An agreement between parties not to recruit the other's employees.
- Originally included in franchise agreements at the request of franchisees.
- Most franchisors, under pressure from several states, have already removed anti-poaching language from their agreements.

Difficult to defend against joint-employment with an anti-poaching provision in franchise agreement.



# California Fast Act

# California FAST Act

- California Fast Food Accountability and Standards Recovery Act – 5 September 2022 – Gavin Newsom.
  - Establishes Fast Food Council.
  - Targets fast food restaurants that are part of a chain of 100 or more locations nationwide.
  - Sets minimum standards on wages (up to \$22 per hour minimum wage), working conditions, etc.
  - Driven by SEIU to create joint employment – but that provision was removed from law.
- Makes chain restaurants less competitive than independents that are not subject to council.
- Destroys equity of franchisees.
- IFA is garnering signatures for a ballot initiative to reverse.

# Franchisee Reps and Warranties

# ***NASAA Bans Acknowledgements and Compliance Questionnaires***

- Effective 1 January 2033.
- NASAA states that policy is designed to curb unfair practices of “unscrupulous” franchisors.
- **Basically – NASAA stating franchisees are competent enough to sign a lengthy and complex franchise agreement but are not competent enough to understand and make pre-sale representations. Absurd on its face.**
- Limits/Prohibits questionnaires and acknowledgements in the sales process. Prohibits including similar questions in agreements.
  - That the prospective franchisee has read or understands the FDD. including the franchise or other agreement.
  - That the prospective franchisee is qualified to own the franchise.
  - That no one has made any representation outside of or different from the FDD.
  - That the prospective franchisee has had the opportunity to consult with professional advisors or consultants or other franchisees.

# Some Thoughts to Consider

# Manuals and Training

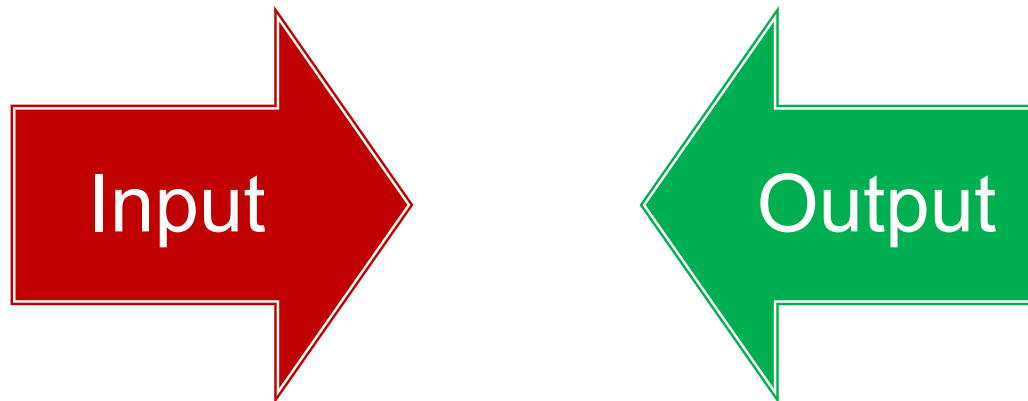
- All language must be geared towards meeting and supporting **Brand Standards**, not personnel policies or procedures
- Explicitly state that the purpose of the manuals is to protect the **Brand Standards**, not **Control** the day-to-day management and operations of the business
- Don't include unnecessary **Controls** and instead measure **Brand Standard** performance.

# Pay attention to what you say

- Clearly identify what are “Requirements and Brand Standards” and what are “Suggestions and Best Practices”
- Words that convey **Requirement:**
  - Must - May not – Required - Prohibited from
- Words that convey **Best Practice:**
  - May – Should – Recommended – Suggested
- Is a **policy** or **control** necessary to maintain system standards?

# Scheduling and Human Resources

- Franchisor's role in employee relations should be limited only to what is necessary to support brand standards
- Hooters can require franchisees to hire women as waitresses because it is a vital element of their brand
- Mandating the number of staff on a particular shift **is not** a vital element of the brand **but** customer wait time is.





# Field Visits and Compliance

- The job of the Field Consultant is to **assess** and **assist** – **not to manage** or **to do**.
  - **MUST** completely understand their roles and responsibilities
  - **MUST** understand vicarious liability and co-employment
  - **MUST never** directly control any of franchisee's employees (unless to prevent imminent harm or danger)
  - **SHOULD** support franchisee's training of staff and with limited exceptions **not directly train staff**
  - **Must** focus on Brand Standards

# Staff Certification

- Franchisor can provide sample training materials for the franchisee to use
- Franchisee should train and certify their own staff
- Franchisee should be able to modify training material provided by franchisor
- Field Consultant should verify that the location is meeting **Brand Standards** - not that any employee has met any prescribed training
- Franchisor can require specific licenses or certification – ServSafe, professional licenses
  - Best to receive an acknowledgement by franchisee that they are in compliance, rather than reviewing each of the franchisee's employee's personnel files

# Indemnification and Insurance

- Include language that the franchisee must indemnify the franchisor for any liability arising from labor or employment law violations
- Make sure indemnification clause includes acts and omissions of the franchisee and their employees
- Consider requiring franchisees to obtain **Employment Practices Liability Insurance (EPLI)** to cover worker's claims against businesses for violation of their legal rights as employees

# Questions and Discussion



*Strategic Advice & Guidance  
Based on Real World Experience*

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