NOT YET SCHEDULED FOR ORAL ARGUMENT
Case Nos. 16-1028, 16-1063, 16-1064

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

BROWNING-FERRIS INDUSTRIES OF CALIFORNIA, INC.
d/b/a/ BFI NEWBY ISLAND RECYCLERY,

Petitioner/Cross-Respondent,

v.

NATIONAL LABOR RELATIONS BOARD,

Respondent/Cross-Petitioner,

and
INTERNATIONAL BROTHERHOOD OF TEAMSTERS LOCAL 350,

Intervenor.

AMICUS BRIEF OF ASSOCIATED BUILDERS AND CONTRACTORS, ASSOCIATED GENERAL CONTRACTORS OF AMERICA, AMERICAN HOSPITAL ASSOCIATION, AMERICAN HOTEL AND LODGING ASSOCIATION, INTERNATIONAL FRANCHISE ASSOCIATION, NATIONAL ASSOCIATION OF HOME BUILDERS AND NATIONAL RETAIL FEDERATION IN SUPPORT OF BROWNING-FERRIS INDUSTRIES OF CALIFORNIA, INC. d/b/a/ BFI NEWBY ISLAND RECYCLERY

Kurt G. Larkin
HUNTON & WILLIAMS LLP
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, VA 23219-4074
804.788.8200
804.788.8218 (fax)
klarkin@hunton.com

Ronald Meisburg
Andrea R. Calem
HUNTON & WILLIAMS LLP
2200 Pennsylvania Avenue NW
Washington, DC 20037-1701
202.955.1500
202.778.2201 (fax)
rmeisburg@hunton.com
acalem@hunton.com

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES

Pursuant to D.C. Circuit Rule 28(a)(1), undersigned counsel certifies as follows:

A. Parties and *Amici*

All parties, intervenors, and *amici* appearing before this Court are listed in the brief of Petitioner/Cross-Respondent, Browning-Ferris Industries of California, Inc. d/b/a BFI Newby Island Recyclery, or in the Notices of Intent to Participate as A*mici Curiae* filed with the Court on May 5, 2016 (ECF #1612163).

B. Rulings Under Review

The rulings under review are listed in the brief of the Petitioner/Cross-Respondent.

C. Related Cases

Counsel for *amici* are not aware of any related case involving substantially the same parties and the same or similar issues.

RULE 26.1 CORPORATE DISCLOSURE STATEMENT

Pursuant to Rule 26.1 of the Federal Rules of Appellate Procedure and D.C. Circuit Rule 26.1, a*mici curiae* certify that none of the *amici curiae* has outstanding shares or debt securities in the hands of the public, and none has a parent company. No publicly held company has a 10% or greater ownership interest in any of the *amici curiae*.

TABLE OF CONTENTS

Page

CERTIFICATE AS TO PARTIES, RULINGS AND RELATED CASES ii

RULE 26.1 CORPORATE DISCLOSURE STATEMENT.................................... ii

TABLE OF AUTHORITIES v

GLOSSARY OF ABBREVIATIONS AND ACRONYMS viii

STATEMENT OF IDENTITY, INTEREST OF *AMICI CURIAE* AND SOURCE OF AUTHORITY..1

RULE 29(c)(5) CERTIFICATION..1

CIRCUIT RULE 29(d) CERTIFICATION 2

STATUTES AND REGULATIONS..2

SUMMARY OF ARGUMENT 2

ARGUMENT 3

I. Introduction..3

II. *BFI* POSES A GRAVE THREAT TO THE FRANCHISOR – FRANCHISEE RELATIONSHIP 6

A. Franchising Predictably Allocates Risk and Responsibility in a Variety of Business Settings 7

B. The Uncertainty Created by the New Joint Employer Standard Will Affect the Economic Vitality of the Franchise Industry..10

C. Local Communities Will Be Adversely Impacted by *BFI*'s Disruption of Franchising 14

III. *BFI* IS A THREAT TO MANY OTHER THIRD-PARTY BUSINESS RELATIONSHIPS..16

A. Temporary Staffing Arrangements 16

B. Subcontracting And Outsourcing Arrangements..18

IV. *BFI* THREATENS THE CREATION OF NEW BUSINESS MODELS 24

V. THE RAMIFICATIONS OF JOINT EMPLOYER STATUS FOR THE *AMICI* AND THEIR MEMBERS WOULD BE CONSEQUENTIAL 28

VI. CONCLUSION..31

CERTIFICATE OF COMPLIANCE..33
CERTIFICATE OF SERVICE 34
ADDENDUM

TABLE OF AUTHORITIES

Page

CASES

*Browning-Ferris Industries,
362 NLRB No. 186 (Aug. 27, 2015) 3, 4, 6, 10, 12, 14, 16, 17, 18, 19, 20, 22, 23, 34, 27, 28, 29, 30, 31

STATUTES

National Labor Relations Act, as amended, 29 U.S.C. § 151 et seq. 2

OTHER AUTHORITIES

Exec. Order 13,673, 3 C.F.R. 13673 (July 31, 2014) 30

Expanding Joint Employer Status: What Does it Mean for Workers and Job Creators, H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 113th Cong. 16-18 (Sept. 9, 2014) (testimony of Clint Ehlers, owner/operator FASTSIGNS franchises)..8, 9

Expanding Joint Employer Status: What Does it Mean for Workers and Job Creators, H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 113th Cong. 24-26 (Sept. 9, 2014) (testimony of Jagruti Panwala, hotel owner and operator)..9

FRANdata Key Findings and Survey Results: 2015 National Labor Relations Board Joint-Employer Ruling, November 2015 13

---

* Authorities upon which we chiefly rely are marked with asterisks. D.C. Cir. R. 28(a)(2).

Page

Healthcare Transformation Task Force, http://www.hcttf.org/ 26

H.R. 3459, "Protecting Local Business Opportunity Act,"
H. Comm. on Education and the Workforce,
Subcomm. on Health, Employment, Labor and Pensions,
114th Cong. (Sept. 29, 2015) (testimony of Ed Braddy,
Burger King franchisee) 9, 15

H.R. 3459, "Protecting Local Business Opportunity Act,"
H. Comm. on Education and the Workforce,
Subcomm. on Health, Employment, Labor and Pensions,
114th Cong. (Sept. 29, 2015) (testimony of Kevin R. Cole,
CEO, Ennis Electric Co., on behalf of
Independent Electrical Contractors) 20

Impact on Franchise Businesses of NLRB Actions Treating a
Franchisor as a Joint Employer, IHS Economics, April 10, 2015 7

NLRB Office of the General Counsel Authorizes Complaint
Against McDonald's Franchisees and Determines
McDonald's USA, LLC is a Joint Employer,
NLRB Press Release, July 29, 2014 6

Risky Business: Effects of New Joint Employer Standards
for Small Firms, H. Small Business Comm.,
Subcomm. on Investigations, Oversight and Regulations,
114th Cong. (March 17, 2016) (testimony of Danny Farrar,
CEO and founder of SoldierFit) 9, 13,14

Risky Business: Effects of New Joint Employer Standards
for Small Firms, H. Small Business Comm.,
Subcomm. on Investigations, Oversight and Regulations,
114th Cong. (March 17, 2016) (testimony of Vinay Patel,
President and CEO of Fairbrook Hotels)...9, 14, 15

Page

Risky Business: Effects of New Joint Employer Standards for Small Firms, H. Small Business Comm., Subcomm. on Investigations, Oversight and Regulations, 114th Cong. (March 17, 2016) (written statement of Stuart Hershman, Esq. on behalf of International Franchise Association) 9

S. 2015, Stealing the American Dream of Business Ownership: The NLRB's Joint Employer Decision, S. Comm. on Health, Education, Labor and Pensions, 114th Cong. (Oct. 6, 2015) (testimony of Edward Martin, President and CEO of Tilson Home Corporation) 23

U.S. Census Bureau, Economic Census Report, Franchise Statistics: 2007 7

Who's the Boss? The "Joint Employer" Standard and Business Ownership, S. Comm. on Health, Education, Labor and Pensions, 114th Cong. (Feb. 5, 2015) (testimony of John Sims IV, owner/operator Rainbow Station at the Boulders)..9

GLOSSARY OF ABBREVIATIONS AND ACRONYMS

ACO – Accountable Care Organization

BFI – Petitioner/Cross-Respondent, Browning-Ferris Industries of California d/b/a BFI Newby Island Recyclery

BFI – Browning-Ferris Industries, 362 NLRB No. 186 (Aug. 27, 2015)

NLRB – National Labor Relations Board

NLRA or the Act – National Labor Relations Act, as amended, 29 U.S.C. §151 et seq.

STATEMENT OF IDENTITY, INTEREST OF *AMICI CURIAE* AND SOURCE OF AUTHORITY

Pursuant to the Notice of Intent to Participate as a*mici curiae* filed with the Court in this matter on May 5, 2016 ("Notice of Intent"), the Associated Builders and Contractors, Associated General Contractors of America, American Hospital Association, American Hotel and Lodging Association, International Franchise Association, National Association of Home Builders and National Retail Federation respectfully submit this brief *amici curiae* in support of Petitioner/Cross-Respondent Browning-Ferris Industries of California, Inc. d/b/a BFI Newby Island Recyclery ("BFI)." The interest of the a*mici curiae* is as stated in the Notice of Intent, and all parties have consented to the filing of this brief, as certified in the Notice of Intent.

RULE 29(c)(5) CERTIFICATION

Pursuant to Fed. R. App. P. 29(c)(5), *amici* state that no party's counsel authored this brief in whole or in part; no party or party's counsel contributed money that was intended to fund preparing or submitting the brief; and no person – other than the *amici*, their members, or their counsel – contributed money to fund preparing or submitting this brief. Petitioners have consented to the filing of this brief.

CIRCUIT RULE 29(d) CERTIFICATION

Pursuant to D.C. Circuit Rule 29(d), undersigned counsel for amici certifies that a separate brief is necessary. This is so because of the immense breadth of impact of the expanded joint employer test announced by the National Labor Relations Board ("NLRB") in this case. This expanded test raises a host of legal and policy concerns under the National Labor Relations Act ("NLRA" or the "Act"). The brief of the petitioner is necessarily focused on those legal and other issues specific to the rule's application to it. This brief will bring to the court's attention the concerns, particularly the practical policy concerns, of the major sectors of our nation's economy represented by the amici on this brief – construction, health care, retail, hospitality - and the overall impact on franchising which exists to a greater or lesser degree in each of these sectors.

STATUTES AND REGULATIONS

Pursuant to D.C. Circuit Rule 28(a)(5), all applicable statutes and regulations are contained in the Addendum to the Brief of Petitioner/Cross-Respondent.

SUMMARY OF ARGUMENT

The a*mici curiae* agree with the arguments presented by BFI in its opening brief on the merits. It is the purpose of this brief *amici curiae* to supplement BFI's brief by demonstrating the adverse impact of the underlying decision of the NLRB on a broad range of the American economy, as represented by construction, healthcare, hospitality, retailing and franchising. As detailed below, the NLRB's

unwarranted expansion of its joint employer test will have a range of adverse impacts on these important sectors of the economy.

ARGUMENT

I. INTRODUCTION

For decades, the NLRB adhered to a simple and straightforward standard for determining whether separate companies should be treated as "joint employers" under the Act. Under its old precedent, the NLRB would look to whether a firm actually exercised direct and immediate control over hiring, firing, discipline, pay and other significant aspects of the employment terms of another firm's employees. This standard was easy for businesses to understand and, more importantly, to plan for and apply.

That all changed this past year. In *Browning-Ferris Industries*, 362 NLRB No. 186 (Aug. 27, 2015) ("*BFI*"), the NLRB established a sweeping new test that dramatically expands the definition of a joint employer and threatens to redefine the employer-employee relationship across all areas of business and industry. Under *BFI*, an entity will be found to be a joint employer if it exercises merely *indirect* control over the terms and conditions of another firm's employees, or – even more troubling – if it simply *possesses*, but never exercises, the ability to control such terms.

The new test announced by the NLRB lacks legal validity, as the Petitioner has argued in its brief. As emphasized in this brief, the NLRB's test is tone deaf to the practicalities of American business and threatens to undermine a broad range of business relationships which are vital to the Nation's economy. Further, the "potential control" and "indirect control" standards announced in *BFI* are broad enough to cover virtually *any* business relationship, and the murky guidance provided in the majority opinion makes it virtually impossible for businesses to apply the new standard with any confidence as to whether they are getting it right.

Because *BFI*'s new standard is so potentially destructive of business relationships and unworkably vague, *amici* are greatly concerned that it will have the perverse effect of jeopardizing job creation in many American industries. Businesses in the industries represented by *amici* are now faced with the task of altering longstanding business models in attempts to protect themselves from the increased regulatory risk associated with joint employer liability for the conduct of their business partners. For example, some larger companies may decide that if they are going to be responsible for the liabilities of their smaller business partners, they must exert more control over their day-to-day operations so they can be more aware of, and seek to mitigate, those liabilities. Their administrative costs will skyrocket and their business partners will be reduced to middle managers with less (or no) autonomy.

In other cases, employers may decide to avoid joint employer liability by reducing their level of coordination with and oversight of business partners. The potential unintended consequences of a reduction in coordination and oversight could include such things as the introduction of unnecessary safety and health risks on common jobsites and the dilution of the integrity of trademarked brands and brand standards.

In still other cases, employers seeking to completely eliminate third-party risk may decide to reduce or discontinue their reliance on certain business models or third-party relationships altogether, thereby eliminating an avenue of job creation and new business growth in the already struggling economy.

Ultimately, and regardless of which course any particular employer may choose, it is clear that the NLRB's revised joint employer standard will have a substantial adverse impact on the manner in which employers in this country do business. As described in more detail below, the new standard already is having a negative impact on employers in the franchising, construction, healthcare, retail and hospitality sectors. Together, *amici* urge the Court to grant BFI's petition for review and reject the NLRB's new joint employer test, which threatens to upend the businesses of their members.

II. *BFI* POSES A GRAVE THREAT TO THE FRANCHISOR – FRANCHISEE RELATIONSHIP[1]

The *BFI* majority rejected the notion that its holding altered the status of any business relationship besides the one example before it (that of a temporary labor supplier and its customer), asserting with regard to arrangements such as franchisor-franchisee, contractor-subcontractor, and contractor-consumer: "None of those situations are before us today." *BFI*, slip op. at 20, n.120. But the Board's actions subsequent to *BFI* suggest that the majority's holding is intended precisely to be applied to such relationships in future cases. Foremost among them is the franchisor-franchisee relationship, as demonstrated by the NLRB General Counsel's sprawling complaints against McDonald's USA, LLC and 78 of its franchisees alleging that McDonald's is jointly liable for unfair labor practices allegedly committed by the franchisees.[2] Validating the *BFI* standard in this case could pave the way for the NLRB to find joint employer status in the franchising context and beyond.

---

[1] *Amici* International Franchise Association, National Retail Federation and American Hospitality & Lodging Association in particular share the concerns discussed in this section, as they each represent members utilizing franchising in their business operations.

[2] *See NLRB Office of the General Counsel Authorizes Complaints Against McDonald's Franchisees and Determines McDonald's, USA, LLC is a Joint Employer*, NLRB Press Release, July 29, 2014.

A. Franchising Predictably Allocates Risk and Responsibility in a Variety of Business Settings

Franchising is a powerful engine of economic growth in many different business sectors, including in retail and hospitality. The U.S. Census Bureau reported that in 2007, franchise establishments in the United States employed approximately 7.8 million people, with a combined annual payroll of $154 billion.[3] There were more than 780,000 franchise establishments in the United States in 2015, which employed almost nine million people. Those businesses produced an economic output in nominal dollars of $892 billion, and accounted for approximately 3% of U.S. GDP ($523 billion).[4]

Brand standardization is the key to most franchise systems. Consistent product quality, appearance and layout of structures, marketing materials, logos, and other business identifiers allow consumers to make informed choices about goods and services. To that end, franchisors must convey the operational principles of their business models to their franchisees and ensure that newly-established franchise businesses are properly developed, launched and maintained. In turn, franchisees obtain assistance in best management and operational practices

[3] U.S. Census Bureau, Economic Census Report, "Franchise Statistics: 2007."

[4] *Impact on Franchise Businesses of NLRB Actions Treating a Franchisor as a Joint Employer,* IHS Economics, April 10, 2015. (Attached hereto as Addendum A).

from the franchisor, which both protect the franchisor's brand and enhance the franchisee's likelihood of success.

This symbiotic relationship is particularly important to the many franchisees who are small business owners (many of them first-time business owners). The structure, support and predictability of a franchised brand – such as a major hotel chain, fast food restaurant, fitness center or other retail offering – hedges against the risk inherent in starting a new business. Franchisees can avail themselves of the franchisor's training programs, guidelines for construction, layout, design and décor, vetted lists of high-quality contractors, suggestions for site selection based on experiences of franchisees in similar locations, nationally-negotiated price rates for standard inventory items, national marketing campaigns, and other services that allow them to maximize business efficiencies, such as point of sale systems and reservation portals. They can further benefit from franchisors' quality assurance oversight, which makes it less likely that a bad experience at one franchise location will discourage a customer from patronizing another location.[5]

At the same time, the vast majority of franchisees operate their businesses autonomously by, among other things: determining their own staffing needs; hiring, firing, disciplining, scheduling, supervising and setting performance metrics

[5] *See* Testimony of Clint Ehlers, owner/operator FASTSIGNS franchises, *Expanding Joint Employer Status: What Does it Mean for Workers and Job Creators*, H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 113th Cong. 16-18 (Sept. 9, 2014).

for employees; setting wage and compensation schedules; selecting employee benefits; choosing local vendors; pricing products; acquiring insurance and financing; determining zoning constraints; working with the community to provide opportunities to disadvantaged populations; and making business decisions based on local market conditions and local laws and regulations.[6] They accept the corresponding legal responsibility for such decisions, which may include liability for employment-related conflicts over compensation, violations of equal employment opportunity laws, and the obligation to bargain collectively with duly-elected employee representatives under the NLRA.

---

[6] *See* Testimony of Clint Ehlers, President, FASTSIGNS, testimony of Catherine Monson, CEO, FASTSIGNS, and testimony of Jagruti Panwala, hotel owner and operator (*Expanding Joint Employer Status: What Does it Mean for Workers and Job Creators*, H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 113th Cong. 16-18; 24-26, (Sept. 9, 2014)); Testimony of John Sims IV, Owner/Operator Rainbow Station at the Boulders (*Who's the Boss? The "Joint Employer" Standard and Business Ownership*, S. Comm. on Health, Education, Labor and Pensions, 114th Cong. (Feb. 5, 2015)); Testimony of Ed Braddy, Burger King franchisee (*H.R. 3459, "Protecting Local Business Opportunity Act,"* H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 114th Cong. (Sept. 29, 2015)); Testimony of Danny Farrar, CEO and Founder of SoldierFit, testimony of Vinay Patel, President and CEO, Fairbrook Hotels, and written statement of Stuart Hershman, Esq. on behalf of International Franchise Association (*Risky Business: Effects of New Joint Employer Standards for Small Firms*, H. Small Business Comm., Subcomm. on Investigations, Oversight and Regulations 114th Cong. (March 17, 2016). Mr. Hershman's written statement is attached hereto as Addendum B.

B. The Uncertainty Created by the New Joint Employer Standard Will Affect the Economic Vitality of the Franchise Industry

The *BFI* decision upends this balance by potentially converting the hallmarks of brand protection and franchisee oversight and assistance into indicia of joint employment. Franchisors can no longer be certain whether the commercial efforts they undertake to maintain brand identity and protection (for example, distributing marketing materials; hosting seminars or webinars on topics ranging from electronic technology to developments in labor law; making site visits to assess consistency of presentation, product quality and customer service) will turn them into joint employers under *BFI*.

Although the existence of a joint employer relationship has always been a fact-based determination, the *BFI* majority's focus on retained but unexercised and/or indirect control frustrates franchisors' ability to intelligently assess their risk exposure relating to their franchisees' business decisions and operations. Any of the standard commercial brand-protection activities described above could be characterized by the NLRB as "indirect control" over, or the "unexercised reserved right to control," a franchisee's operations. Franchisors may find themselves jointly liable for franchisee unfair labor practices, or may be required to bargain collectively over terms and conditions of employment, of which they have little knowledge and no practical ability to control. Their liability could increase

exponentially if franchisees and their local contractors or vendors are additionally deemed to be joint employers.

One could imagine, for example, the nightmare scenario of a major hotel franchisor being found a joint employer with the franchisee-operator of one of its branded hotels at the same time the franchisee is found to be a joint employer with the cleaning, security and food services contractors it has hired to work in the hotel. Would the franchisee's joint employer liability for unfair labor practices committed by the cleaning contractor fall ultimately on the franchisor? Under the NLRB's new test, the answer may very well be yes, as employer liability loses its focus on the unitary employer and instead becomes diffused among groups of employers purely on the basis of their commercial economic relationships.

Perhaps even more troubling, the steps to best protect against these new risks could dramatically curtail business opportunities for local business owners (and their business partners) and deprive local communities of needed jobs. Franchisors might choose to repurchase franchises upon expiration of the franchise agreement, allowing them to consolidate and control all labor practices. Similarly, they may be disinclined to expand the number of franchises they license. Or, they might consolidate franchises by arranging for larger franchise operators (with more resources and perhaps an internal human resources infrastructure) to buy out other franchisees. The result will be fewer and/or larger franchise operations, which can

be monitored more easily, reducing liability exposure. As a result, only those who can afford to purchase tens or hundreds of businesses will remain in business as franchisees, denying business opportunities to small and independent owners.

Alternatively, even if franchisors continue to license many small franchises, they may decide that prudence requires expanded oversight over activities such as franchisee hiring and employee relations practices. These increased overhead expenses – with inevitable attendant legal expenses – will be passed along to franchisees in the form of higher licensing fees and royalties. If franchisees decide they cannot in turn pass along those cost increases to customers, their economic viability could be threatened.

The other option for franchisors – reducing or eliminating operational support of, and control over, franchisees in order to avoid the indicia of indirect control – carries the obvious potential risk of devaluing the brand. Moreover, even considering this option places franchisors in the legally untenable position of having to decide between maintaining brand protections or risking labor and employment liability for the actions of franchisees. As the *BFI* dissent aptly noted, a franchisor must maintain sufficient control over its trademark so that the mark is not deemed to have been abandoned. *BFI*, slip op. at 45-46 (Miscimarra & Johnson, dissent). The new test thus threatens a business model structured to satisfy a federally-protected business interest.

Even if franchisors could legally and practically justify reducing oversight over franchisees, doing so would heap potentially unsupportable burdens on the franchisees themselves. They would be forced to incur new expenses associated with training, information technology, and legal and administrative services. The potential reduction in profit would put many businesses at risk. In this regard, a report entitled "FRANdata Key Findings and Survey Results: 2015 National Labor Relations Board Joint-Employer Ruling," written in November 2015 by an independent research and advisory company focused on the franchise industry, concludes that under such circumstances, the equity value of franchise businesses is expected to drop by as much as one third to one half. Because the value of most franchised units is based on multiples of free cash flow, rising costs will have a negative impact on valuations.[7] That report also concludes that an estimated 40,000 franchise businesses are at risk of failure due to increases in labor and operating costs beyond operating margins. As a result, more than 600,000 jobs may be lost or not created, with a predicable overall negative impact on the industry's U.S. GDP contributions.

[7] The conclusions set forth in the FRANdata report were submitted to the House Small Business Subcommittee through the March 17, 2016 testimony of Danny Farrar, CEO and Founder of SoldierFit, a franchised fitness company targeted primarily to veterans.

These scenarios are not unsupported hyperbole – they are real concerns articulated by real business owners who are deeply troubled by the regulatory cloud that they believe *BFI* presents to their businesses.[8]

C. Local Communities Will Be Adversely Impacted by *BFI*'s Disruption of Franchising

The many small business owners who testified at the Congressional hearings referenced above view themselves as entrepreneurs, not joint owners of businesses with franchisors. They object to being reduced to the status of middle managers, which they perceive will be the outcome of the *BFI* decision. Small businesses are concerned that they will lose the autonomy and flexibility to make impactful contributions in their local communities if they are considered joint employers of franchisors.

This concern is particularly acute in the retail food service and hospitality industries, both of which are heavily franchised. One of the witnesses at the House subcommittee hearing on September 29, 2015 was a Burger King franchisee, Ed Braddy. He is the owner of a single franchise in a low-income neighborhood in Baltimore, where he hires community members who have difficulty obtaining jobs: former criminal offenders, single mothers, high school students. All work part-

---

[8] *See* Testimony of Danny Farrar, CEO and Founder of SoldierFit and testimony of Vinay Patel, President and CEO, Fairbrook Hotels (*Risky Business: Effects of New Joint Employer Standards for Small Firms*, H. Small Business Comm., Subcomm. on Investigations, Oversight and Regulations 114th Cong. (March 17, 2016).

time and are on some form of government assistance, and come to him through programs such as America Works, Women in Transition, and other recovery and development programs. His restaurant is so important to the local community that neighbors and other community members helped him protect it from destruction during the recent civil unrest in Baltimore.

As Mr. Braddy told Congress, he is worried that the economic pressures created by the new joint employer standard will lead Burger King to repurchase his franchise once the contract expires. If that happens, he no longer will be able to effectuate positive change in his community and offer assistance to low-wage workers.[9]

Hotel industry franchisees describe experiences similar to Mr. Braddy's.[10] Vinay Patel, President and CEO of Fairbrook Hotels, started with a single small hotel, and later turned to franchising once he had accumulated enough experience to obtain a license. He now owns eleven hotels, which employ over 150 workers from local communities. He is deeply concerned about the potential costs that might be passed down to him if his franchisors decided to take a more active role

---

[9] Testimony of Ed Braddy, Burger King franchisee, *H.R. 3459, "Protecting Local Business Opportunity Act,"* H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 114th Cong., (Sept. 29, 2015).

[10] *See*, *e.g.*, Testimony of Vinay Patel (*Risky Business: Effects of New Joint Employer Standards for Small Firms*, H. Small Business Comm., Subcomm. on Investigations, Oversight and Regulations 114th Cong., (March 17, 2016).

in his business. If maintaining his franchise becomes untenable, he will lose the business he spent years building, and be unable to provide local jobs.

Franchising is a significant driver of economic activity across multiple industries in this country. In promulgating its new joint employer test, the NLRB plainly has failed to consider the forces that might stall growth in this industry and thereby harm the very workers it seeks to protect.

III. *BFI* IS A THREAT TO MANY OTHER THIRD-PARTY BUSINESS RELATIONSHIPS

BFI's new and open-ended test will also have an adverse impact on many other business relationships. The decision focused on temporary labor services that one business provided to another. Many of the *amici* find that such services are important to their members and find it troubling that such services are directly threatened. But *amici* are constrained to observe that many other business arrangements are also threatened by the broad test that the NLRB announced in *BFI*.

A. Temporary Staffing Arrangements

BFI's emphasis on reserved and indirect control threatens to completely upend the business of temporary staffing, harming many of the *amici* and their members.

Construction. The construction industry has a severe workforce shortage that is making it harder than ever for general and specialty contractors to meet their

contractual obligations and regularly forcing them to juggle their workers, and particularly their craft workers. Under current circumstances, temporary staffing companies often play a critical role. They enable contractors, and particularly small firms, to meet the peak loads in their work. To be profitable, all contractors have to perform on time. Without the assistance that temporary staffing companies can provide, some contractors would find that impossible. The ripple effects on other contractors, and delays in the completion of entire projects, would only increase the economic harm.

Should arm's-length arrangements with these companies result in joint employer status, as the *BFI* decision suggests, the increased costs associated with that relationship (e.g., resources devoted to employee/labor relations administration, potential exposure to unfair labor practice liability for acts of the other employer, etc.) will create financial hardships, particularly for the small businesses that comprise a substantial portion of the American construction industry.

Healthcare. *BFI*'s impact on temporary labor services will also impact the healthcare field, which routinely wrestles with a shortage of professionals, including nurses. Temporary staffing agencies supply employees – many of whom prefer the flexibility offered by temporary work in a high-demand profession – to fill in the gaps created by temporary workforce shortages and to accommodate the

evolving demands of patient care. As noted above, the new joint employer standard raises questions about the extent to which companies that rely on staffing agencies for temporary labor must bargain jointly with those agencies if the temporary employees unionize. This is of particular concern in the healthcare field, which is already significantly unionized and a continued focus for new organizing efforts.

B. Subcontracting And Outsourcing Arrangements

The new joint employer standard will also cause problems in industries that have traditionally subcontracted and outsourced certain services, no matter how well established those patterns may be.

Commercial Construction. *BFI* could be particularly disruptive of the construction industry, given the role general contractors have to play. Construction jobsites are multiemployer worksites and it falls to the general contractor to schedule and coordinate the work that many subcontractors, often in multiple tiers, have to perform simultaneously or in sequence. The general contractor directs the work on the site and controls the schedule, which may be affected by weather, availability of materials, local building inspection regimes and many other factors. A general contractor must exercise a certain amount of control over its subcontractors and their employees simply to ensure the safe and efficient performance of the work.

A prime construction contract with a project owner inevitably requires the contractor to exercise control over the project in ways that impact the terms and conditions of everyone's employment on the site. A prime construction contract for a commercial project very typically requires the prime contractor to coordinate hours of work and the delivery of materials and/or equipment. Further, the contract may expressly require the prime contractor to flow down to all subcontractors the obligation to comply with a variety of federal, state and local laws and regulations relating to wages, hours, safety, drug testing, discrimination, harassment, immigration and more. To meet these obligations, a prime contractor frequently includes a variety of clauses in its subcontracts, such as clauses that require subcontractors to: remove or terminate employees on the general contractor's demand; employ only workers who are approved by the general contractor; employ only workers who pass drug tests; receive general contractor approval before working overtime; work only during certain times of the day or certain days of the week; comply with pre-assignment procedures such as criminal background checks; follow specific safety rules, including attending safety meetings, wearing protective gear on site, and reporting accidents and injuries; and follow work rules established by the general contractor. Under *BFI*, merely maintaining these compliance-related requirements may be sufficient to establish a joint employer relationship.

Similarly, certain construction industry practices, rooted in the economic reality that many small businesses contribute to large projects, may create joint employment where none is intended. General contractors may, for instance monitor or audit a subcontractor's payroll to ensure that its employees are paid on a timely basis and at proper rates.

The potential burdens of joint employer status in this industry fall more heavily on smaller employers with fewer resources.[11] For instance, a first-tier subcontractor that employs a smaller second-tier subcontractor to perform a specialized portion of the work may find that the smaller company requires a significant amount of oversight and guidance regarding the overall project. It may need instruction as to the parameters of its work, the hours and location of its work, the relationship of its work to the activities of other contractors, its interaction with the general contractor, its use of equipment owned by other companies, site rules of conduct, and many similar matters. Under the *BFI* decision, this type of commonplace project oversight and coordination could create a joint employer relationship between the two subcontractors, and subject one to the collective bargaining or other labor related obligations of the other.

---

[11] Input on the practical implications of the *BFI* decision on smaller construction industry employers can be found in the testimony of Kevin R. Cole, CEO, Ennis Electric Co., on behalf of the Independent Electrical Contractors, (*H.R. 3459, "Protecting Local Business Opportunity Act,"* H. Comm. on Education and the Workforce, Subcomm. on Health, Employment, Labor and Pensions, 114th Cong., (Sept. 29, 2015).

The resulting implications for small, minority, women or veteran-owned businesses are significant. Such businesses do not have the resources or economic bargaining power to bid directly on large projects, but instead are brought into the fold as second-tier subcontractors. First-tier subcontractors will be less likely to do this if ultimately they will be deemed joint employers of the second-tier employees, particularly if the smaller businesses are unionized.

Hospitality/Lodging. Beyond their alarm about damage to the traditional franchise model, hotel and lodging businesses also are justifiably concerned about the potential costs and liabilities associated with the web of business partnerships that are integral to their operations. A full-service lodging experience for customers can include some or all of the following: parking garages, laundry services, restaurant and bar service, tourist/sightseeing services, car rentals, beauty salon, spa and shopping. Joint employer relationships with those businesses, with attendant costs and unpredictable permutations of bargaining obligations, would disrupt this business model. Eliminating or insourcing some of these services (which would impact the partner businesses, their employees, and customers) could be a real-world consequence of the uncertainty created by the expanded joint employer standard.

Retail. Retail businesses face these same concerns, particularly because their business model is dependent on a number of different contractor services.

Retailers routinely engage logistics operators to manage their warehouses efficiently, to make deliveries, or to contract with service vendors (such as food services or janitorial employees) to work in their facilities. They also do business with landscape, snow removal, maintenance and other similar contractors on a regular basis, both to keep their properties in a safe condition and to comply with federal and state laws regarding access for individuals with disabilities. In addition, many retailers lease space in their stores to various independent vendors, such as athletic shoes, sunglasses, luxury leather goods and other products.

Retailers do not hire, fire or discipline any of the employees of such contractors and lessees. Nonetheless, in order to protect their brand they must have some opportunity to control the quality of the products and services offered by the latter, to ensure that those services are being performed to specifications. This type of interest, together with routine instructions associated with the coordination of these services, should not be cause for concern about joint employer liability.

The nebulous "indirect control" standard articulated in *BFI* might also interfere with a retailer's desire to incentivize contractor performance with bonuses or increases in contractor compensation. If any such compensation is passed along to the contractor's employees, the retailer could be deemed to be meaningfully affecting the employment terms of those employees. Joint employer status could quickly follow.

Home Building. The considerations set forth above apply equally to the home improvement and construction industry, in which the risks attendant to a construction project are spread among smaller businesses working on a tighter time frame.[12] A residential home builder will contract with an average of 22 different subcontractors and specialty trades to perform a range of services, including landscaping, HVAC work, cleaning and roofing. Successful delivery of homes is inextricably tied to the ability to promptly schedule the work of different trades and manage issues that could result in production delays.

The *BFI* decision leaves residential contractors uncertain about what level of necessary oversight and coordination will trigger joint employer liability. And what of homeowners, who control access to the job site, working hours, and many day-to-day conditions of employment, and who retain the ability to fire any contractor with which they are dissatisfied? Under the vague *BFI* standard, they meet the definition of joint employers, as well.

If residential homebuilders are hamstrung in their ability to manage projects in the manner that is traditional in their industry, they will become less flexible and less competitive. Fewer home building companies translates to greater

---

[12] A discussion of the pressures created by the *BFI* decision on the residential building industry can be found in the testimony of Edward Martin, President and CEO of Tilson Home Corporation. *S. 2015, Stealing the American Dream of Business Ownership: The NLRB's Joint Employer Decision*, S. Comm. on Health, Education, Labor and Pensions, 114th Cong. (Oct. 6, 2015).

centralization of the industry, less competition, and higher home prices for consumers – another business casualty of the unpredictable and cumbersome joint employer standard.

IV. *BFI* THREATENS THE CREATION OF NEW BUSINESS MODELS

It is concerning enough that the *BFI* test has created unanticipated regulatory risk for all types of existing business relationships. But the chilling effect wrought by the NLRB's new standard is also threatening to discourage some industries from moving forward with *new* types of business relationships. Nowhere is this phenomenon more apparent than in healthcare, which is in the process of shifting from a traditional, fee for service business model to an integrated, value-driven model of health care delivery. *BFI* has profoundly complicated this transition.

The healthcare field's contemplation of fundamental change has been accelerated in large part by the Affordable Care Act, which requires the Department of Health and Human Services to develop innovative payment and service delivery models for beneficiaries of Medicare, Medicaid and the Children's Health Insurance Program.

One such model is the accountable care organization ("ACO"), a shared savings program in which providers of healthcare services are accountable for the quality and experience of care for an assigned population of Medicare beneficiaries, and for reducing the rate of growth of health care spending for that

population. In some models, ACOs may be penalized for poor health outcomes in the assigned population.

ACOs may consist of individual or groups of practitioners, networks of individual practices and professionals, partnerships or joint venture arrangements between hospitals and ACO professionals, and hospitals employing ACO professionals. Integrated services offered by ACOs may include hospital inpatient care, skilled nursing, rehabilitation, outpatient care of different kinds, including specialty services, and home health care, all available to the same patient. The linchpin of such integration is an information technology system which affords the network of providers access to common patient records, statistics, utilization information, and other relevant data necessary for managing population health.

Value-based health care is increasingly demanded by patients, insurers and purchasers of care. The private sector Health Care Transformation Task Force was formed in 2015 (consisting of insurers, provider organizations, thought leaders and purchases of health care services) with the goal of accelerating the healthcare industry's shift to value-based health care. Task force projects include improvements to the ACO model, developing a standardized system of bundled payments, and improving high-cost care. Task force members committed to

placing 75% of their businesses for the next five years into value-based arrangements.[13]

Organizations seeking to change to a system of value-based health care must put into place creative business partnerships in order to integrate health care services and deliver them more efficiently across the full continuum of care. At the same time, they must navigate complex statutory schemes embodying competing public policies, such as the antitrust laws, laws establishing ethics in patient referral, and anti-kickback laws, as well as state laws which prohibit the corporate practice of medicine and state insurance regulations. The new joint employer standard imposes significant burdens and risks to the modernization and integration of health care services.

All members of clinically integrated arrangements, which could include an ACO, must work toward common quality goals. To do so, some shared control among those members is essential. A hospital will control who is credentialed to admit patients at the hospital, and will report quality of care information for all organizations in its network to the Center for Medicare and Medicaid Services. Medical staff may work under the integrated management of hospital and physician practice leaders, although they may be employed by separate professional corporations, in part to comply with state laws which prohibit

---

[13] *See Healthcare Transformation Task Force*, http://www.hcttf.org/.

hospitals from directly employing physicians. Different organizations within the ACO must designate staff to coordinate patient care. Under the *BFI* decision, these overlapping quality-related goals and functions may create joint employment among the organizations that comprise the ACO.

Application of the *BFI* standard in this arena raises many troubling questions. For instance, healthcare is heavily unionized. Will specialty practices that join an ACO be subject to pre-existing collective bargaining agreements in other member organizations? If so, to what extent will each part of the ACO be required to bargain? How will bargaining work if any of the member organizations have adverse financial interests? Will each organization in the ACO be liable for unfair labor practices committed by other member organizations with entirely different functions? If a member of the ACO does not meet quality standards, will the ACO be obliged to bargain over the decision to remove that member? Will providers of IT services be deemed joint employers as well?

If ACO member organizations are going to be considered joint employers under *BFI*, it is likely that resources will have to be devoted to centralized employee relations functions which can oversee multiple collective bargaining processes. Legal expenses will be incurred in the defense of unfair labor practice charges. The increased costs associated with this infrastructure will drastically

undercut the efficiencies and cost savings essential to a successful value-based model of health care.

The *BFI* standard thus appears to be fundamentally incompatible with the needs of a changing health care field, and has the potential to significantly impede the transition to a value-based delivery model that has been shown to produce the best outcomes for the care of patients.

V. THE RAMIFICATIONS OF JOINT EMPLOYER STATUS FOR THE *AMICI* AND THEIR MEMBERS WOULD BE CONSEQUENTIAL

One of the biggest problems with the *BFI* test is that its wide net is likely to ensnare businesses that never dreamed that the business relationships into which they were entering would turn them into joint employers. Because the old test focused appropriately on the bright line of actual exercise of direct control, businesses could enter into franchising, subcontracting, outsourcing and other arrangements free of the fear that their business relationships would result in increased labor and employment liabilities. As described in detail above, *BFI* has thrown all of their careful planning into chaotic doubt.

Thus, the *amici* and their members are left grasping at straws – and contemplating fundamental changes in the way they do business – as they struggle with how to address the risks presented by the *BFI* test. And the stakes are high – the consequences of a joint employer finding can be significant and confounding. For example, the *BFI* dissent painstakingly describes the potential complications

associated with forcing separate companies with diverse interests to the bargaining table based on the theory that they are joint employers. *BFI*, slip op. at 37-43 (Miscimarra & Johnson, dissent). Unresolved questions about which employers must participate in bargaining and with which bargaining units, what subjects must be addressed by which companies and bargaining units, what happens when the joint employers disagree among themselves about subjects of bargaining, and the duration and termination of contracts, all tend to create instability in labor relations – precisely what the NLRA was designed to avoid. Of particular concern is the possibility that companies with competing financial interests will gain access to the others' sensitive or confidential information if such disclosure is viewed as essential to good faith and meaningful bargaining efforts. *Id.* at 39, 42.

The expanded joint employer definition also may expose employers to what would otherwise be secondary boycott activity with respect to labor practices and disputes that are not directly their own. It could also make establishing a valid reserved gate system – where the general contractor on a multi-employer site sets up a separate gate for the employees of a subcontractor with whom its union has a dispute – virtually impossible to maintain. Such consequences would unfairly dilute the NLRA's protections against secondary boycotts. *See id*. at 47.

But the potential damage done by an expanded joint employer standard does not end with the NLRB – there is a "spillover" effect on the horizon that the *BFI*

majority clearly never contemplated in reaching its holding. For example, many federal labor and employment statutes – such as Title VII of the Civil Rights Act – have small business exceptions that exempt employers with a certain minimum number of employees. A finding that a small business owner, be it a franchisee, subcontractor, or outsourced service provider, is a joint employer with its business partner could artificially eliminate those exceptions and expose small businesses to liabilities they are not equipped to handle.

Additionally, the President's recent Executive Order 13673, entitled "Fair Pay and Safe Workplaces," requires federal contractors to disclose all of their labor violations for a 3-year period preceding their bid for federal contract work. The disclosure obligations include NLRB charges and extends to subcontractors and supply chain partners. The *BFI* standard could be interpreted to require a bidding contractor to report on the violations of vendors, suppliers and other contractors that it does not plan to use in the performance of the federal contract – all based on the fear that if the bidder is a joint employer with those vendors and suppliers, but does not report their labor violations, it will have submitted an incomplete (i.e., false) bid. Federal contractors thus face an added unanticipated burden from *BFI* – avoiding potential False Claims Act liability for misreporting on the labor and employment liabilities of business partners with whom they may be joint employers.

VI. CONCLUSION

As described throughout, *BFI*'s expanded new test has thrust an unexpected and practically unworkable regulatory risk on the *amici* and their members, and has already thrown many corners of the business community into turmoil. The *BFI* dissent aptly noted that the NLRB "owe[s] a greater duty to the public than to launch some massive ship of new design into unsettled waters and tell the nervous passengers only that 'we'll see how it floats.'" *BFI*, slip op. at 48 (Miscimarra and Johnson, dissent). But that is *exactly* what the NLRB's new joint employer standard represents to the *amici* and the thousands of businesses that make up their memberships. The uncertainty over *BFI*'s application will have a paralyzing effect on all walks of American business.

Amici respectfully urge this Court to consider the substantial chilling effect the new *BFI* standard will have on American business when deciding whether to enforce the NLRB's Order. The Court's decision could have consequences that extend well beyond the participants in this case.

Dated: June 14, 2016

Respectfully submitted,
HUNTON & WILLIAMS LLP

By: /s/ Kurt G. Larkin

Kurt G. Larkin
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, VA 23219-4074
804.788.8200
804.788.8218 (fax)
klarkin@hunton.com

Ronald E. Meisburg
Andrea R. Calem
2200 Pennsylvania Avenue NW
Washington, DC 20037-1701
202.955.1500
202.778.2201 (fax)
rmeisburg@hunton.com
acalem@hunton.com

Counsel for Amici Curiae

CERTIFICATE OF COMPLIANCE

Pursuant to Rule 32(a)(7)(C) of the Federal Rules of Appellate Procedure, I certify that this brief complies with the limitations of Fed. R. App. P. 29(d) because it contains 6,856 words, excluding the parts of the brief exempted by Fed. R. App. P. 32(a)(7)(B)(iii).

This brief complies with the typeface requirements of Fed. R. App. P. 32(a)(5) and the type-style requirements of Fed. R. App. P. 32(a)(6) because it has been prepared in a proportionally spaced typeface using Microsoft Word 2010 in Times New Roman 14-point font.

Dated: June 14, 2016

By: /s/ Kurt G. Larkin
Kurt G. Larkin
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, VA 23219-4074
804.788.8200
804.788.8218 (fax)
klarkin@hunton.com

CERTIFICATE OF SERVICE

I hereby certify that on this 14th day of June, 2016, a true and correct copy of the foregoing Brief of Amici Curiae Associated Builders and Contractors, Associated General Contractors of America, American Hospital Association, American Hotel and Lodging Association, International Franchise Association, National Association of Home Builders and National Retail Federation was filed with the Clerk of the United States Court of Appeals for the D.C. Circuit via the Court's CM/ECF system. Counsel for all parties are registered CM/ECF users and will be served by the appellate CM/ECF system.

HUNTON & WILLIAMS LLP

By: /s/ Kurt G. Larkin
Kurt G. Larkin
Riverfront Plaza, East Tower
951 East Byrd Street
Richmond, VA 23219-4074
804.788.8200
804.788.8218 (fax)
klarkin@hunton.com

ADDENDUM TABLE OF CONTENTS

Addendum

Impact on Franchise Businesses of NLRB Actions Treating a Franchisor as a Joint Employer, IHS Economics, April 10, 2015 .... A

Risky Business: Effects of New Joint Employer Standards for Small Firms, H. Small Business Comm., Subcomm. on Investigations, Oversight and Regulations 114th Cong. (March 17, 2016) (written statement of Stuart Hershman, Esq. on behalf of International Franchise Association) .... B

ADDENDUM A

Impact on Franchise Businesses of NLRB Actions Treating a Franchisor as a Joint Employer

Phase I Report

Report Prepared for:
International Franchise Association

By:
IHS Economics
1150 Connecticut Ave, NW, Suite 401
Washington, D.C. 20036

April 10, 2015

Contact Information

James Gillula
Managing Director
Consulting Services
1150 Connecticut Ave., NW Suite 401
Washington, DC 20036
+1 202-481-9217
james.gillula@ihs.com

Karim Jeafarqomi
Senior Consultant
Consulting Services
1150 Connecticut Ave., NW Suite 401
Washington, DC 20036
+1 202-481-9299
karim.jeafarqomi@ihs.com

TABLE OF CONTENTS

EXECUTIVE SUMMARY **2**

INTRODUCTION **1**

OVERVIEW OF THE SURVEY 1

CHARACTERISTICS OF RESPONDENTS **2**

FRANCHISOR SURVEY **4**

HUMAN RESOURCES PROVISIONS IN LICENSE AGREEMENTS 4
CHANGES IN BUSINESS OPERATIONS 4

FRANCHISEE SURVEY **7**

HUMAN RESOURCES PROVISIONS IN LICENSE AGREEMENTS 7
CHANGES IN BUSINESS OPERATIONS 7

CONCLUSION AND RECOMMENDATIONS **10**

Executive Summary

In December 2014 the National Labor Relations Board (NLRB) issued several complaints against McDonald's Corp. relating to employment practices of McDonald's franchisees based on the NLRB General Counsel's ruling that McDonald's can be considered a joint employer with its franchisees. The International franchise Association Educational Foundation (IFA) commissioned IHS Global, Inc. (IHS) to undertake a study of the potential impact of this fundamental change in the legal status of franchise businesses on both franchisors and franchisees. The study is to be undertaken in two phases. This report presents the results of the first phase – a pilot study in which a survey questionnaire was designed and data were collected from a small sample of franchise businesses and their franchisees. Twelve franchisors and four franchisees completed survey forms. The principal findings of this pilot study are summarized below:

- Among the 12 franchisors who responded, only a single instance was reported where any provision in a license agreement gave a franchisor control over any of four basic aspects of the employment and wages of their franchisees.
- Ten of the 12 franchisors that responded either have already made changes in their current business operations or expect to make changes if the NLRB actions are not reversed.
- Over half of the franchisors who responded have already incurred some additional legal expense to prepare themselves for the impact of the NLRB actions. Others report expected changes in oversight and training of their franchisees.
- Only two franchisors surveyed reported no changes made or anticipated in six categories of business operations that could be affected by the NLRB actions.
- Franchisors have not yet begun to make changes in their overall business development strategy with respect to adding new franchises. However, if the NLRB actions are not reversed, most expect to slow or reduce the growth of new franchises, and nearly all expect to need to negotiate changes in their existing franchise licensing agreements.
- One-fourth of the franchisor respondents anticipate changes in their licensing agreement that will result in higher franchise fees and/or royalties if the NLRB actions are not reversed. Seven of 12 said it would be difficult or impossible to pass higher costs on to franchisees.
- Three-fourths of franchisors reported that it would be difficult to pass increased costs on to customers in the form of higher prices. Seven of 12 said the result would be a decline in their profitability.

All franchisors who responded provided basic financial information on 2014 revenue, operating costs and profits. Five of the 12 respondents provided information on current costs in selected areas of business operations that could be affected by the NLRB actions. Data on the estimated increase in costs due to changes in business operations were not always provided. Given the limited sample, no attempt is made in this report to estimate the impact on costs or profitability of changes made by franchisors in response to the NLRB actions.

The response rate for franchisees contacted to participate in the survey was lower – only 4 of 10 completed the survey. Selected results from this very small sample were as follows:

- Responses from these franchisees on whether there are provisions in their license agreements that give franchisors control over human resources operations mirrored the responses in the survey of franchisors.
- Two of four franchisees expect some change in franchisor oversight or reporting requirements.
- Three of four reported their response would be to halt or delay increasing the number of establishments they operate.
- Three of four responded that their cost of operations would be negatively affected.
- None expected to be able to pass higher costs on to customers in the form of higher prices.

This pilot study has demonstrated that there are significant concerns among both franchisors and franchisees about the effects of the NLRB's joint-employer actions against McDonald's. The larger survey planned in Phase II of the study should be able to generate more robust estimates of the responses of franchise businesses to the NLRB's actions and the overall economic impact of these actions. Recommendations for minor improvements in the survey process based upon the experience of the pilot study are presented in the concluding section.

Introduction

In December 2014 the National Labor Relations Board (NLRB) issued several complaints against McDonald's Corp. relating to actions of McDonald's franchisees based on the NLRB General Counsel's ruling that McDonald's can be considered a joint employer with its franchisees and is therefore jointly liable for labor law violations of which they may be accused. This NLRB action is a potential concern to all franchisors and franchisees because it has created uncertainty about the legal liability of franchisors and, if it survives legal challenge, it could result in increased costs of doing business and require changes in the basic license agreement between franchisors and their franchisees. The International Franchise Association Educational Foundation (IFA) engaged IHS to conduct a study of the impact of these NLRB actions on franchise businesses generally.

To ensure that the study succeeds in identifying all ways in which the joint employer ruling could affect franchise businesses, the study is being done in two phases. This report presents the results of the first phase in which IHS conducted a pilot survey to gather information from a selected group of franchisors and franchisees about their business operations and their views about the impact of the NLRB actions on their Human Resource (HR) practices and their business planning and outlook. In Phase II, the survey process will be refined based on the information gathered in Phase I and additional data will be collected from a larger sample of companies.

Overview of the Survey

Given the pilot study's objective of getting information from a small number of companies on a quick-turnaround basis, IFA contacted 16 franchisors[1] that are IFA members and 10 of their franchisees to request their participation in completing an on-line survey designed by IHS. To ensure the security of collecting financial data, the questionnaires were presented in a secure and interactive web-based survey.

IHS developed separate survey documents for franchisors and franchisees to permit addressing the different possible impacts and potential concerns of the NLRB actions on the two groups.

The franchisor survey was designed to gather information in the following areas:

- Do franchisors' license agreements include provisions regarding their involvement in HR operations?
- Have franchisors made any changes in their operations to date as a result of the NLRB actions?
- Do franchisors anticipate making any changes in their operations if the NLRB action is not reversed?

Information was requested about the cost of any operational changes made to date or anticipated. Basic financial operating data were requested (revenue, operating costs – total and in selected categories – and profit margin) in order to analyse the impact of any increased costs on total operating costs and profitability and to identify differences in these impacts by size of business. Other data gathered include information on product(s)/service(s) offered to permit

[1] Four of the franchisors are under one holding company.

classifying firms by industry, data on the number of establishments and their location(s), and the legal/tax structure of the company.

The franchisee survey included similar questions about the extent of control the license agreement gives their franchisor over HR operations and whether they have made, or anticipate making, any changes in business operations as a result of the NLRB actions.

Both groups were asked general questions about the possible impact on the franchise business model generally.

The survey data were collected in the last two weeks of March, 2015. Financial information was requested for the most recent fiscal year.

The next section provides summary data on the types of franchise businesses that were included in the survey and selected financial characteristics of respondents. Results of the separate surveys of franchisors and franchisees are presented in the following two sections. IHS's recommendations for improvements of the survey process to be implemented in Phase II are presented in the concluding section.

Characteristics of Respondents

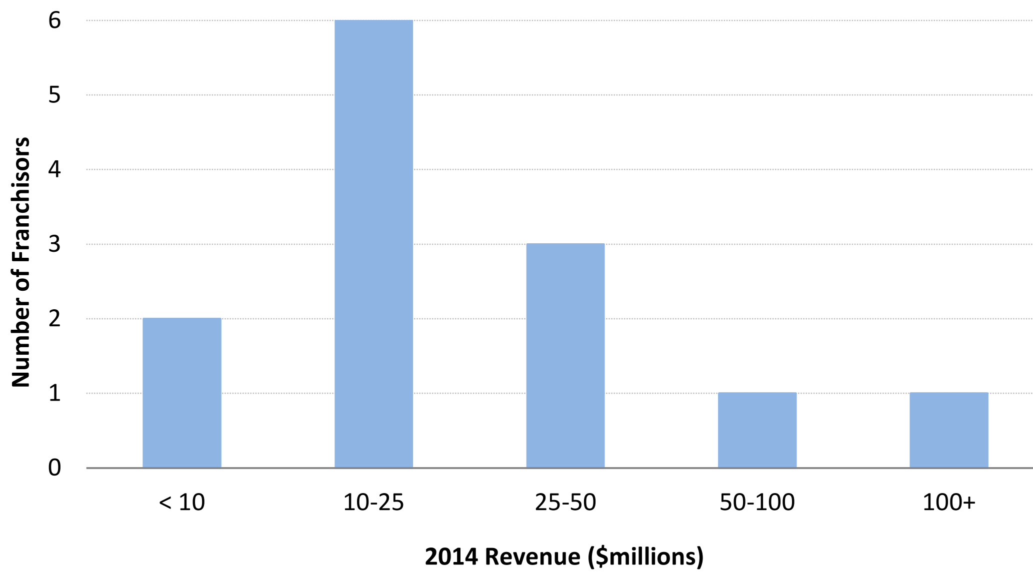
Twelve franchisors (three-fourths of the total number contacted) responded to the survey. Only 4 of the 10 franchisees responded.

Franchisor and franchisee respondents included companies offering the following 11 categories of products and services:

- Lodging
- Homecare/medical staffing
- Bakery
- Snack food
- Restaurant
- Haircut/styling products
- Painting services
- Signs/graphics
- Home improvement
- Home service contract
- Home inspection services

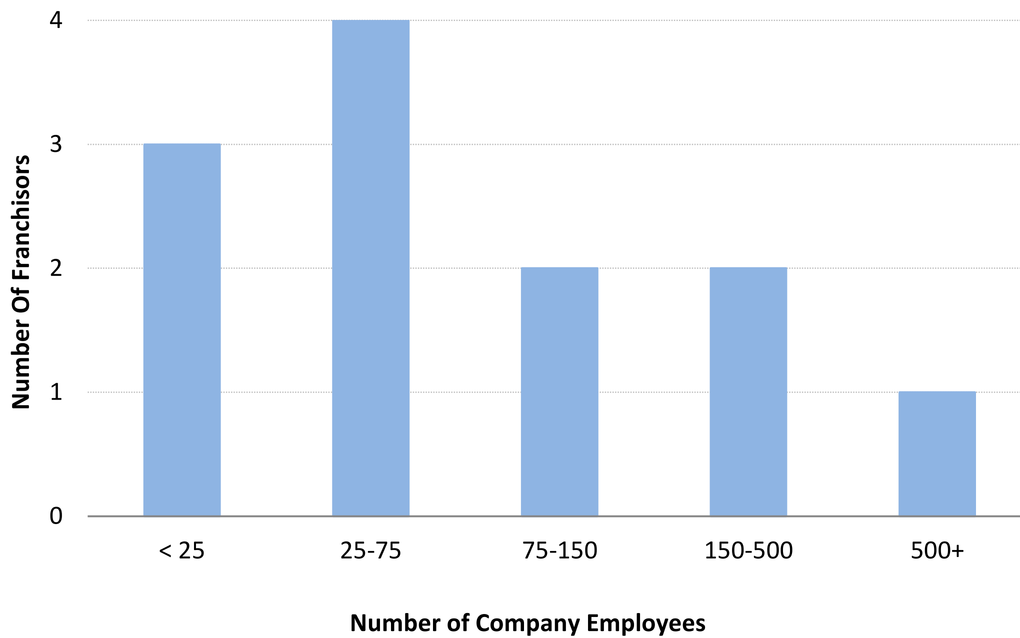
The franchisors who responded have total revenue ranging from just under $10 million to over $700 million. Figure 1 shows the size distribution of the franchisors that responded in terms of annual revenue.

Figure 1 – Number of Franchisor Respondents by Annual Revenue



The franchisors who responded have total employment ranging between 50 and 39,000. Figure 2 depicts the distribution of franchisors in terms of the number of persons directly employed by the company.

Figure 2 – Franchisors' Size Distribution (Company Employees)



Franchisor Survey

Although 12 franchisors responded to this pilot study, not all respondents answered all questions. In the tables below, we present both the total number of respondents to a given question and the number who responded ("Yes" or "No") as indicated in each table.

Human Resources Provisions in License Agreements

Franchisors were asked four questions about the extent of control their standard licensing agreement with their franchisees gives them over franchisees' human resources (HR) operations. These four questions and a summary of survey responses are shown below.

	Does your license agreement with your franchisee include provisions pertaining to any of the following?	**"No" Responses (out of 12)**
1	Require the franchisee to use a certain number of employees – either for overall operations, working shifts, or for specific tasks	11
2	Give you control over employment conditions of franchisee employees	12
3	Set minimum or maximum wage rates for franchisee employees	12
4	Give you control over the day-to-day hiring, direction, supervision, discipline, or discharge of the franchisee's employees	12

Eleven of the 12 franchisors reported having no provisions in their license agreements that give them control over these four basic aspects of employment and wages of their franchisees. One respondent reported a provision pertaining to the number of employees to be used.

Changes in Business Operations

Franchisors were asked about any impact of the NLRB actions on their business operations in two parts. First, they were asked if they had already made changes in their business operations as a result of the uncertainty created by the NLRB ruling. Secondly, they were asked if they anticipated making any changes if the NLRB ruling withstands legal challenges.

Franchisors were asked about changes already made, or anticipated, in six areas of their business operations as indicated below.

	As a result of the NLRB actions, have you already made, or do you anticipate making, any changes in your business operations in any of the following categories?	**"Yes" Responses (out of 12)**	
		Change Already Made	**Change Anticipated if NLRB Action is not Reversed**
1	Change in legal expenses, including external counsel	7	8
2	Change in field support & oversight of franchisees	5	7
3	Change in franchisee training in HR practices	4	7
4	Change in company insurance costs	1	5
5	Change in franchise development/sales budget or personnel	0	1
6	Other actions not listed above	1	4

Looking at the responses in all six categories above for all 12 franchisor respondents:

- Seven of the 12 franchisor respondents reported that they have already made changes in one or more of these categories.
- Ten respondents either have made changes in their business operations or expect to make changes if the NLRB actions are not reversed.
- Only 2 franchisors surveyed have made no changes and expect none as a result of the NLRB actions.

Where franchisors reported that changes had been made or were anticipated in any area of operations, the franchisor was given the option to provide specific information about the changes made and the costs associated with them. As an example of changes in the "Other actions not listed above" category, one franchisor reported that their web site had been changed to more clearly differentiate between corporate positions open and franchisee-location positions that are posted.

Five of the 12 franchisors who responded to the survey provided estimates of expected increases in costs in various categories as a result of the NLRB actions. All five anticipate an increase in their current legal expenses, ranging from 1.5% to 12%. One franchisor indicated that "while not terribly significant at this time, e.g. generally absorbed in our existing budget, but increasing and there will be greater impact in time unless the NLRB position softens." Three of the five expected an increase in their current training costs. Four reported a slight increase in their current field support costs, and only one respondent reported an expected increase in insurance costs.

In addition to the questions about changes in specific aspects of their operations, franchisors were asked if they had made or anticipated broader changes in their business strategy as indicated below:

As a result of the NLRB actions, what changes have you already made, or do you anticipate making, in your operations regarding the number of your franchisees?	**"Yes" Responses (out of 12)**	
	Change Already Made	**Change Anticipated if NLRB Action is not Reversed**
1 Halted or delayed increasing the number of new franchisees	0	4
2 Do you anticipate increasing scrutiny of your franchisee selection process?	n/a	6
3 Reduced the number of franchisees by non-renewal or negotiating early termination of licenses	0	5
4 Reduced the number of franchisees by conversion to company-owned establishments?	0	6
5 Changed policy with respect to increasing the number of company-owned establishments?	0	7

Of the total of 12 respondents, 9 franchisors reported that they would make some change in one or more of these five aspects of their overall business development strategy if the NLRB actions are not reversed.

In addition to these questions about changes in operations and the number of franchises, franchisors were also asked if they had made or anticipated making any changes in their license agreement in the future that would directly affect the cost to franchisees, as indicated below.

As a result of the NLRB actions, what changes have you already made, or do you anticipate making, in:	**"Yes" Responses (out of 12)**	
	Change Already Made	**Change Anticipated if NLRB Action is not Reversed**
Need to negotiate changes in your licensing agreements with existing franchisees if the NLRB action is not overturned?	3	10
Changes in your future licensing agreements with new franchisees or franchisee renewals in any of the following areas?		
1 Franchise fee	1	3
2 Royalty	2	4
3 Total investment cost of franchise	2	4

The next section of the survey asked franchisors about what would happen if the NLRB actions result in higher cost of doing business. The objective was to solicit their opinions about whether higher costs could be passed on to customers in the form of higher prices, how it would affect franchisor profitability, and how it would affect the attractiveness of the franchise opportunity.

	Question	**Distribution of Answers**	
1	To what extent will it be possible to pass these costs on to customers in the form of higher prices?	9: difficult or unlikely 2: would 1: unknown	
2	To what extent will it be possible to pass these costs on to franchisees?	4: cannot 3: would	3: difficult 2: unknown
3	What would be the impact on your profitability?	2: dramatic drop 1: nuisance	5: decrease 4: unknown
4	What would be the impact on the attractiveness of the franchise opportunity that you offer?	6: less attractive 3: no change 3: unknown	
5	The impact on the total number of establishments two years from now compared to prior to the NLRB actions?	7: reduction 3: unchanged 1: change mix 1: unknown	

Franchisors were also asked the following general questions about the impact of the NLRB actions on their outlook toward operating a franchise business.

	Question	**"Yes" Responses (out of 12)**
1	Would you franchise your business if you were to start all over again?	7
2	Would you transition your business out of franchising if you could?	4

Franchisee Survey

Franchisees who participated in the survey were asked to complete a more limited questionnaire with questions designed to solicit their views about and likely response to the reduced autonomy in operations they would face if franchisor oversight of their human resources operations were increased. Information was also requested to categorize franchisee respondents by industry and size of the business.

Four of the 10 franchisees contacted completed the survey.

Human Resources Provisions in License Agreements

Franchisees were asked the same four questions that were asked in the franchisor survey about the extent of control their licensing agreement gives their franchisor over their human resources operations. Responses were as follows:

	Does your license agreement with your franchisor include provisions pertaining to any of the following?	**"No" Responses (out of 4)**
1	Require you to use a certain number of employees – either for overall operations, working shifts, or for specific tasks	3
2	Give franchisor control over employment conditions of franchisee employees	4
3	Set minimum or maximum wage rates for franchisee employees	4
4	Give franchisor control over the day-to-day hiring, direction, supervision, discipline, or discharge of the franchisee's employees	4

Changes in Business Operations

As in the franchisor survey, questions about the impact of NLRB actions on franchisees operations and business plans were asked in two parts – changes that have already occurred and changes that are anticipated if the NLRB actions are not reversed. Franchisees were asked about changes in three areas as indicated below. None of the four franchisee respondents have made any changes in business operations to date as a result of the NLRB actions. The table below reports the results for anticipated impacts.

	Do you anticipate making any changes in your business operations in the future if the NLRB actions are not overturned?	**"No" Responses (out of 4)**
1	Do you anticipate that your franchisor will request any changes in Human Resources practices at your establishment(s)?	2
2	What, if any, changes may you make independently in Human Resources practices at your establishment(s)?	3
3	Do you anticipate that your franchisor will request that you begin reporting new information about Human Resources operations at your establishment(s)?	2

Where franchisees reported that changes were anticipated in any area of operations, the franchisee was given the option to provide specific information about the changes and the costs associated with them. In addition, franchisees were asked if they had made or anticipated broader changes in number of establishments as follows:

	What, if any, changes would you make in plans regarding the number of establishments you operate?	**"No" Responses (out of 4)**
1	To halt or delay increasing the number of establishments	3
2	To reduce the number of establishments by non-renewal or negotiating early termination of your license	2

In response to question 1 above, while other franchisees declared that they would not halt expansion, one franchisee answered: *"I will wait to see if this gives labor a means to organize a franchise system as a whole without my involvement. If that is the case, I may exit the business."*

In addition to the questions above about changes in operations and number of franchises, the survey asked whether the franchisor has, or might be expected to, change the existing licensing agreement. Two of the four respondents said a change in the agreement is expected.

Franchisees were also asked the questions that are in the franchisor survey about expected changes in operating costs and how it would affect prices for customers. Responses were as follows:

	If changes have already been made to your business operations, or you expect changes will occur as a result of the NLRB actions, then:	**"Yes" Responses (out of 4)**
1	Do you expect any of these changes to affect your cost of operations?	3
2	Do you expect any impact on the royalty that you pay your franchisor?	2
3	If you experience higher costs or royalties, to what extent might you be able to pass these additional expenses on to customers through higher prices?	0
4	Lower profitability?	3
5	Lower value of business?	4

To question 3 about the ability to raise prices, one franchisee answered: *"None. Franchisor sets maximum pricing,"* and the rest declared little to none.

To question 4 about lower profitability, while three franchisees indicated significant negative impact, one declared "*minimal, unless an organizing effort takes place. Then it would be substantial."*

As in the franchisor survey, franchisors were asked general questions about the impact of the NLRB actions on their outlook toward operating a franchise business. In addition, a specific question relating to the impact on their autonomy in in human resources practices was posed.

	Franchisee Sentiment	"Yes" Responses (out of 4)
1	Do you want the franchisor to set standards for the HR practices including pay, hours, benefits and scheduling?	0
2	Would you invest in a franchise today if the franchisor were to negotiate with unions for the salary and benefits you will pay your employees?	0
3	Would you transition your business out of franchising if you could?	3

In response to question 1 above, one respondent was adamant about the autonomy of its HR practices, stating *"my franchisor is not up to speed on the myriad of HR rules in the State of CA nor do I want them coming in and telling me what to do based on their state's laws, which differ from mine. It's asinine."*

In response to question 3 above, one respondent answered "No" because the franchisee was part of the brand and it was not feasible.

The survey questionnaire also gave franchisees the opportunity to provide comments on any other concerns that they may have regarding to the NLRB ruling. Three of the four respondents that provided a response had significant concerns about the change. Here is an excerpt from one of the respondents:

> *"HR and employee issues are a huge chunk of what my company deals with on a daily basis. I have my own HR department. We work hard to stay current on CA laws. My franchisor is ill equipped to come into my state and advise me. It's a massive waste of everyone's time and will only add more administrator costs and reduced profitability."*

Conclusion and Recommendations

This pilot study has demonstrated that there are significant concerns among both franchisors and franchisees about the effects of the NLRB's joint-employer actions against McDonald's. The larger Phase II study should be able to generate more robust estimates of the responses of franchise businesses to the NLRB's actions and the overall economic impact of these actions.

The survey forms designed for this pilot study served to gather the type of data needed to assess the impact of the NLRB's joint employer actions on franchise businesses. However, some minor adjustments to the survey process could improve results of the Phase II survey.

More than one company contacted with the request to participate in the survey immediately asked for a copy of the full survey questionnaire so they could prepare data off-line before entering their responses. Therefore, when requests for participation are transmitted in the Phase II survey, they should include an electronic file containing a copy of the full survey.

The study requires gathering confidential financial data as well as information on expected impacts of the NLRB ruling. The franchisors that responded provided basic data on revenue, operating costs and profits, but some companies that did not respond might have been dissuaded by the request to provide financial information. These basic financial questions were asked near the beginning of the questionnaire for the pilot study. The on-line survey system captures and stores responses as they are received. Therefore, it is possible that, if these financial questions are asked at the end of the survey, more survey responses with useful information on impacts and responses could be received, even if some respondents continue to omit financial data.

To generate the data needed to estimate the economic impact of the NLRB's joint-employer actions on the franchise sector, the franchisor survey we developed requests detailed data on costs in specific areas of operations such as franchisee oversight, training, legal costs and insurance. Of the ten franchisors who reported changes in business operations as a result of the NLRB's actions, five provided cost estimates for implementing these changes. It is possible that some respondents felt that the costs involved would not be significant. For others, it may have been difficult to gather data on the current amount of these costs or to estimate the amount by which they might change. In the Phase II study, a more direct question should be posed to distinguish between different reasons for non-responses in this area.

An important issue to be resolved in proceeding with the Phase II survey is the process of identifying an additional sample of 15-20 franchise companies willing to participate in the survey. There are two characteristics of franchise companies that must be considered in selecting companies for the Phase II survey – industry and company size. Although all franchises share the same business model, there could be differences among industries that cause the impact of the joint employer ruling to differ by industry. The target number of companies for the Phase II survey does not permit including multiple companies from all industries where the franchise model is prevalent. Therefore, it may be necessary to structure the study to focus on a small number of specific industries that are potentially most affected by the NLRB actions.

The impact of the NLRB's joint-employer actions will likely differ significantly for small and large franchising companies. There could be categories of new costs that franchisors will face that represent a much greater percentage impact on total operating costs for small than for large

companies. Therefore, it is important for the Phase II study to include a sufficient number of small and medium size companies.

It is expected that prospective participants for the Phase II survey will again be drawn from the IFA member list. Given the proposed timing and scale of the Phase II survey, IFA's knowledge of the likelihood of companies to participate will be an important consideration in identifying participants. But results of the full study would be stronger and more compelling if survey participants were selected through a random process from the large pool of franchise companies that the IFA member list represents.

ADDENDUM B

STUART HERSHMAN

PARTNER

DLA PIPER LLP (US)
CHICAGO, ILLINOIS

TESTIMONY BEFORE THE U.S. HOUSE SMALL BUSINESS SUBCOMMITTEE ON INVESTIGATIONS, OVERSIGHT AND REGULATIONS

HEARING ON "RISKY BUSINESS: EFFECTS OF NEW JOINT EMPLOYER STANDARDS FOR SMALL FIRMS"

MARCH 17, 2016

I. Introduction

Chairman Hardy, Ranking Member Adams, and distinguished members of the Subcommittee. My name is Stuart Hershman, and I am a partner in the Chicago, Illinois office of the international law firm DLA Piper LLP (US). I am submitting this testimony on behalf of both myself and the International Franchise Association ("IFA"), the world's oldest and largest organization dedicated to representing and protecting the interests of franchising worldwide, of which DLA Piper has been proud to serve as outside General Counsel for the IFA's entire 56-year existence. I also am submitting this testimony on behalf of, effectively, every person and business in the United States who value and rely on the franchising method of distributing goods and services. Thank you for this opportunity.

All of us involved in franchising—franchisors, franchisees, suppliers and counselors to franchise systems, franchised business employees, small business advocates, and other interested parties—are deeply troubled by the National Labor Relation Board's ("NLRB") recent adoption of a new "joint employer" standard in its partisan 3-2 decision on August 27, 2015, in the *Browning-Ferris* case as well as by increased federal agency intrusion (by the Department of Labor and OSHA) into the franchisor-franchisee small business relationship emboldened by the NLRB's decision.

This Subcommittee and other U.S. House of Representatives and Senate committees have received testimony over the past 18-plus months, even before the *Browning-Ferris* decision, on the threat posed to the franchise business model by any change in the former, long-standing joint employer standard. The prospect of such a change reared its head most prominently in NLRB General Counsel Richard Griffin's December 2013 *amicus* brief in the appeal to the full NLRB of an earlier anti-unionization ruling in the *Browning-Ferris* case. Committee testimony since that time opposing a change in the joint employer standard has been proffered by franchisor executives, franchisee executives, academicians, and lobbying groups, among others. I respectfully submit my testimony from a different perspective—as an attorney who has spent almost 30 years of legal practice focused exclusively on representing businesses wishing to grow their brands domestically and internationally through the franchise model.

II. Uncertainty Due to New Joint Employer Standard

To the dismay of all, however, the NLRB's *Browning-Ferris* decision presents a mortal danger to franchising unseen for close to 50 years. That danger? Uncertainty. Uncertainty in how the dynamic, creative, and vibrant franchisor-franchisee relationship—manifested by roughly 800,000 franchised businesses already open and operating in the United States and by hundreds of thousands of new franchised businesses that we would expect, under ordinary business conditions, to be formed in the future to drive the American economy forward—will be challenged and judged by those with ulterior motives who bristle at its very existence. Uncertainty in how carefully-constructed and crafted interdependent, yet independent, business relationships between franchisors and franchisees, reflected in extant long-term, binding contracts, will be impacted by after-the-fact determinations based on nebulous, unpredictable factors. And uncertainty in how new franchise systems can be expected, confidently and

reliably, to structure new franchised business relationships to avoid the substantial legal risk of later being deemed a joint employer of the franchisee's employees. Uncertainty that can be extinguished, quite frankly, only by restoring to federal labor law the "joint employer" legal standard based on "direct and immediate control" over another's employees.

Why is "uncertainty" so poisonous to franchising and business creation? When businesses structure, develop, document, and implement new franchise programs, and when existing franchise systems review, assess, modify, and improve their programs over time to address economic change and other business exigencies, they focus on how the fundamental principles of the franchising method of distribution impact their businesses. Among other things, they consider:

- How best to convey to franchise owners, executives, and employees the operational underpinnings of their business models, in terms of the quantity and quality of initial and ongoing training programs, guidance, and support;

- How best to ensure that newly-established franchised businesses are properly constructed, developed, launched, and maintained to convey the uniform physical identity and branding the franchisor has created;

- How best to perpetuate and protect the brand promise, and concomitantly comply with their quality control obligations under the federal Lanham Act, that all licensed franchisees will produce, offer, and sell products and services of a consistent quality;

- How best to ensure that franchisees remain good "corporate citizens" by complying with all applicable federal and state laws and pursuing "best practices";

- How best to reflect the franchisor's and franchisees' respective revenue goals and business risks in the franchise system's fee structure to create an economically-balanced and sustainable franchise system; and

- How best to ensure that consumer health and safety are not endangered by substandard franchise operators.

Reciprocally, franchisees crave franchisor controls, directions, and best practices because franchisee success depends in large measure on the sound business decisions franchisors make when structuring their franchise programs.

For decades, franchisors have successfully structured their franchise programs, and franchisors and franchisees have successfully operated their businesses, with substantial certainty about the "rules of the game" in the joint employer context. Absent "direct and immediate" control of the essential terms and conditions of employment of a franchisee's employees (*e.g.*, hiring, firing, wages/benefits, discipline, and supervision), franchisors would not be legally-responsible as "joint employers" for employment-type claims arising in connection with the operation of a franchised business. Decades of business relationships have been structured and decades of business decisions have been made accordingly. Long-term franchise agreements (many

extending 10 to 20 years) were written with those rules in mind and then signed by franchisors and franchisees. Those franchise agreements, conceived under what were well-established rules, continue to bind franchisors and franchisees immutably.

III. Conflict between Joint Employer and Trademark Law

What is the driving force behind the structure we find in the business format franchise model? The mandates of the Lanham Act, *i.e.*, the federal trademark statute. The Lanham Act's passage in 1946 validated the concept of *controlled* trademark licensing by recognizing that a trademark could function to identify product or service quality, even if the particular product or service did not emanate from a specific source. Indeed, for many years before the Lanham Act's passage, franchising as we know it today was not feasible because, under then-current trademark law, trademark licensing generally was not permitted because a trademark needed to identify the physical source or origin of the product or service with which the trademark was associated. Licensed third-party trademark users, as opposed to the trademark owner itself, of course could not be that ultimate source. The Lanham Act, however, was the end of the traditional "source identification" function of trademark use.

Part and parcel of the Lanham Act's recognition of a trademark's "quality" identification function was the notion that the trademark owner in fact had to police and *control* the quality of the products and services manufactured and sold by third-party licensees (deemed "related companies" under the Lanham Act) under the trademark in order to maintain brand consistency (whether high, low, or mediocre quality), regardless of the precise identity of the actual physical source of the products and services. Quality *control* remains paramount under the Lanham Act, and the trademark owner/licensor must be the ultimate source of the trademark quality standards under which products and services are manufactured and marketed.

Absent adequate control over the nature and quality of products and services that a licensee sells in association with a trademark, the trademark loses its "quality" identifying function, potentially jeopardizing the trademark's very purpose and ownership under abandonment principles. As Seventh Circuit Court of Appeals Judge Richard Posner once stated, the "economic function of a trademark is to provide the consuming public with a concise and unequivocal signal of the trademarked product's source and character, . . . and that function is thwarted if the quality and uniformity of the trademarked product are allowed to vary significantly without notice to the consumer." A trademark owner's failure to ensure the consistency of the trademarked item not only tarnishes the trademark's reputation but also can result in trademark forfeiture.

IV. Impact of the New Joint Employer Standard

What has *Browning-Ferris* done? At its core, it has dramatically, unforeseeably, and unpredictably altered the long-standing rules of the game I mentioned earlier. "Direct and immediate control" of the essential employment terms and conditions of another's employees no longer is the required lynchpin of a potential joint employer claim. After *Browning-Ferris*, direct *or indirect* control, or even an *unexercised reserved right to control*, the essential employment terms and conditions of another's employees will suffice for joint employer liability.

How does this adversely impact franchising? Numerous franchise systems operate within each of the 300 different business industries using franchising as a method for distributing products and services. Franchise systems are necessarily built on franchisor controls targeted at fulfilling the brand promise, satisfying consumer expectations, and protecting trademarks in accordance with the Lanham Act, as I described above. These controls run the gamut of, for example, training, production and delivery, presentation, customer service, days and hours of operation, physical appearance, social media use, advertising and marketing, supply chain, point-of-sale systems, and financial reporting. Yet new malleable and subjective concepts such as "indirect control" and "unexercised reserved right to control" promulgated by the NLRB pose a difficult dilemma for franchisors and franchisees. It is impossible for them to know, with any reasonable certainty, where the joint employer line will be drawn in their business relationships. Will the multiple controls franchisors exercise to protect their brands, for Lanham Act purposes and other legitimate business reasons, be second-guessed as crossing that line?

In one of the most famous phrases ever uttered in jurisprudence, U.S. Supreme Court Justice Potter Stewart remarked in a 1964 Supreme Court decision that, while he could not define the kinds of materials encompassed within hard-core pornography, "I know it when I see it." The problem with the NLRB's new *Browning-Ferris* joint employer standard is that because it is well-nigh impossible to define and apply multiple "control" concepts in franchise business structures, whose common threads and very essence are variety, differentiation, and innovation, it also is impossible for franchisors and franchisees to "know it when they see it."

Uncertainty and unpredictability in the joint employer area mean hundreds of franchisors with thousands of franchisees, whose franchise business models were structured operationally and economically under a long-standing set of rules, may unanticipatedly find themselves legally responsible for alleged franchisee workplace misconduct even though they have no involvement whatsoever in, or real practical control over, their franchisees' day-to-day, on-site operations and employee relations and supervision. The mere "unexercised, reserved right" to control some aspect of the franchisee's operation, having some perceived or inevitable nexus to or impact on the franchisee's employees' terms and conditions of employment, could be alleged by an overreaching and opportunistic government agency to be the basis for a joint employer claim.

Very few franchise systems in the crosshairs of a federal government agency investigation possess the financial wherewithal and other resources, as does a McDonald's Corporation, meaningfully to defend themselves. This Subcommittee knows quite well that McDonald's Corporation, the most well-known franchise brand in the world, now wages battle with the NLRB over the joint employer issue. However, the great preponderance of franchise systems operating in the United States would be gutted, if not driven out of business completely, if forced to defend a similar legal challenge. And that assumes they ultimately would prevail on the merits! There is a recurring misconception that all franchises are large multi-national corporations, like McDonald's Corporation. However, this is far from the truth. Ninety percent of all franchise systems in the United States have fewer than 300 units. A healthy majority of all such franchise systems have fewer than 100 units. Most franchisors of these franchise systems employ fewer than 50 people. Hardly the types of organizations that can withstand

investigations, let alone lengthy formal administrative and other proceedings, over vague standards.

Who knows which franchise system will be the next "test" case under the *Browning-Ferris* joint employer standard, and how that case, and the next one, and the one after that will ripple through the franchise community, all because one cannot predict under the new standard the circumstances where a franchisor crosses the new joint employer line. The new joint employer test is so broad and ambiguous that no contractual relationship, franchise or otherwise, is safe from a joint employer finding. That is why a bright-line test is essential.

Let us consider, for example, a franchisor wanting to train its franchisees on labor policy, particularly an issue of significance such as the anticipated new Department of Labor overtime regulations. May a franchisor host a webinar for its franchisees, give its franchisees sample job descriptions, or establish a hotline to help answer questions about this issue? What happens if franchisees implement the franchisor's suggestions or recommendations?

What about providing technology to help franchisees set labor schedules, bill their customers, and pay their employees, but franchisees determine and fully control labor ratios and their employees' pay and benefits? Is it determinative if a franchisor only makes recommendations about "best practices" and does not mandate franchisee conduct in the labor area?

Franchisee employee training covers outside and inside sales training, production training (how to manufacture products or provide services correctly), how to treat customers, how to implement local marketing, and more. To help franchisees select employees most likely to succeed, franchisors might have a third-party profile tool that helps franchisees assess the personality of employee candidates and whether they are a good fit for a specific position. Franchisees pay the third-party for each job candidate to take the profile. Franchisor staff helps the franchisee interpret the profile results.

These are just several examples of hundreds of different fact patterns that franchisors across myriad industries using the franchise model encounter daily in operating their franchise systems and interacting with franchisees and the franchisees' employees. Do any of them indicate joint employment under *Browning-Ferris*? The age-old response—"it depends on particular facts and circumstances"—does not cut it. Nuanced judgments are impractical in the franchise setting. How can franchisors practicably navigate these landmines without clear and unambiguous rules, like the joint employer standard in effect for decades before *Browning-Ferris*?

Some point to the NLRB Division of Advice's April 2015 memorandum in the *Freshii* case to assuage the franchise community's concern about the NLRB's intentions with the joint employer standard in the franchise space. However, *Freshii* is fool's gold for those genuinely caring about franchising. While the memorandum concluded that the franchisor, Freshii, was not a joint employer with its franchisee under either the old or the new joint employer standard, the decision did not create a blanket rule for franchising, it applied only to the specific facts in that case (which almost certainly will differ from the facts to be evaluated with every other franchisor), and, having been issued four months before *Browning-Ferris*, it has no precedential value whatsoever.

Existing franchisors found to be, or at material risk of being deemed, joint employers under the NLRB's new rule—due to historical controls imposed on franchisees given the franchise system's structure—will have the unenviable choice of (1) exercising even greater control over their franchisees' day-to-day operations in order to manage and limit employment-type risks (*i.e.*, creating a self-fulfilling joint employer prophecy), which will upend the franchisees' business independence and relegate these business owners to the role of middle managers, or (2) ratcheting back support, guidance, and training to franchisees to seek to avoid material joint employer risk, which will deny franchisees the very benefits they expected to receive when they joined the franchise system. All the while, to cover their increased legal exposure, franchisors will have no choice but to charge franchisees higher initial and ongoing fees. This will reduce the value of franchised businesses due to the franchisees' lower profit outlook and, in turn, the attractiveness of the franchise opportunity.

The uncertainty created by the NLRB's *Browning-Ferris* joint employer standard will have a chilling effect on franchising. Existing and nascent franchise organizations unsure of the new rules governing their conduct, and fearing their heightened legal risk, will abate or cease altogether their franchising activities. Perhaps they will have to force franchisees out of the brand because the economics no longer justify the relationship (and triggering an avalanche of litigation). They will opt instead to grow at a slower pace only through company-owned locations. New franchise systems will not materialize, stifling innovation and creativity. And a business model that in 2015 created an estimated 12,790 new businesses, generated 261,000 new jobs, and produced $8.9 billion of economic output will sputter and slowly atrophy.

Imagine how criminal that would be. Look at the IFA Educational Foundation's NextGen in Franchising program, which promotes, recognizes, and nurtures the creativity of budding entrepreneurs the world over who have conceptualized new businesses ripe for franchising. Failing to remove contrived obstacles to their growth counters the very essence of American ingenuity.

And what about the IFA's VetFran program, which provides career opportunities to veterans and their families to ensure an easier transition back into the civilian economy? Hundreds of franchise brands have teamed up voluntarily to offer financial discounts, mentorship, and training for aspiring veteran franchisees and veterans seeking employment. Under the VetFran program, over 238,000 veterans and military spouses have found employment opportunities, including 6,500 veterans who have become franchise business owners since 2011. Don't our veterans deserve to have unfettered business opportunities and to avoid being driven out of the very businesses they started after serving our country?

FRANdata, a leading Virginia-based franchise research firm, released a survey report in November 2015 entitled "FRANdata Key Findings and Survey Results: 2015 National Labor Relations Board Joint-Employer Ruling." After surveying industry leaders and stakeholders, conducting secondary research, and examining franchise company filings to assess the potential negative impact of the NLRB's *Browning Ferris* ruling on franchise businesses and, indirectly, on the economy, FRANdata concluded that:

- An estimated 40,000 franchise businesses, affecting more than 75,000 locations, are at risk of failure because of the joint employer ruling, which will increase labor and operating costs beyond operating margins.

- As a result of business failures, downsizing, and a decline in the rate of new franchise business formation, more than 600,000 jobs may be lost or not created.

- The equity value of franchise businesses is expected to drop by a third to a half. Rising costs will have a negative multiplier effect on valuations. Potentially, hundreds of thousands of franchise business owners will see the equity they have built in their businesses over years decline as the advantages of the franchise model are stripped away, causing higher operating costs.

States appreciate the inanity and dangers of *Browning-Ferris's* new joint employer standard for the franchise model and have acted boldly to revert to or even go beyond the traditional control standard. An ever-increasing number of states has passed "joint employer bills" clearly defining "employer" and explicitly preventing the franchisor from being considered a joint employer with its franchisee under state law. Shouldn't the federal government heed that same call by passing similar federal legislation?

V. Conclusion

All of us respectfully urge this Subcommittee to step forward and help reverse the NLRB's new joint employer standard, codify the joint employer standard that worked for decades before *Browning-Ferris*, and provide the certainty and energy necessary for the franchise model to grow and thrive and perform its critical functions for the American economy. Thank you sincerely for your consideration.