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Litigation and Employment and Labour Relations Bulletin

August 2016

From Franchisor to Joint Employer – Update on Potentially Increasing Liabilities of Franchisors for the Employees of their Franchisees

Franchise agreements typically provide franchisors with the ability to exert significant control over several aspects of their franchisees' businesses, from setting the prices of supplies as well as goods and services sold by franchisees, establishing various operational standards and requirements, to imposing standards with respect to the hiring, training and firing of employees. Recent labour and employment law developments in both the United States and Ontario, however, threaten to expand the scope of franchisor liability with regards to the employees of their franchisees. These developments, which in some cases stem from the mere ability of franchisors to exercise control over the employment practices of their franchisees, could expose franchisors to claims by the employees of their franchisees for wrongful dismissal, human rights violations and wage and overtime class actions, among others. This bulletin summarizes these recent developments and addresses the risk that franchisors may be held to be "joint" or "related" employers of their franchisees' employees.

Franchisors as Joint Employers - Recent Developments in the U.S.

Two significant developments regarding the law of joint employer status have occurred in the United States in the past couple of years.

First, in the summer of 2014 the U.S. National Labor Relations Board (**"NLRB"**) recommended that McDonalds USA LLC be named as a joint employer with several of its independently owned franchisees in connection with 43 complaints, brought by employees of the franchisees, alleging violations of the *National Labor Relations Act*. The NLRB did so because, in its view, McDonalds as a franchisor controls the working conditions of its franchisee employees to such an extent (from stipulating questions to be asked when interviewing and hiring employees, to dictating the food order-taking process and restaurant cleaning procedures employees must follow) that McDonalds could be held responsible for what happens to workers subject to those conditions. No decision on the merits has been made, so it remains unclear as to whether any of the alleged wage and labour violations occurred or whether McDonalds will be found to be a joint employer (and on what basis) with its franchisees.

Second, in 2015 the NLRB revised the standard for determining joint employer status for the purposes of collective bargaining. Under the prior standard, the NLRB considered whether the alleged joint employer possessed, and in *fact exercised*, direct and immediate control over the terms and conditions of employment. In *Browning-Ferris*, however, the NLRB relaxed the standard – such that an entity can be considered a joint employer if it possesses control over employment matters, either indirectly or by reserving its authority in that regard, and *regardless if it ever in fact exercises that authority*.[1]

Although *Browning-Ferris* did not involve a franchise relationship (it considered whether Browning-Ferris was a joint employer of workers provided by a staffing agency under a temporary labour services agreement), the NLRB's relaxation of the joint employer test in that

[1] *Browning-Ferris Industries of California, Inc*, 2015 BL 278454, 362 NLRB No 186 (2015).

case coupled with its approach involving McDonalds (noted above) has created much uncertainty in the United States. Many are concerned about the potentially far-reaching implications of these changes, and what they mean for franchisors.

Are U.S. Style Joint Employer Developments Coming to Canada?

It is not just franchisors in the U.S. who are worried about the potential expansion of joint employer liability and its consequences. While more cases will need to be resolved in the U.S. before we know the extent to which franchisors will be held liable as joint employers, there is reason to believe that such expanded liability may be coming to Canada. In fact, the Canadian Franchise Association has identified the joint employer issue as one of the top five issues that will impact franchisors in 2016.

Canada, of course, already has a common law principle known as the "common employer" doctrine. It is most frequently used in circumstances where a dismissed employee sues the legal entity that employed him or her, as well as one or more companies who are closely affiliated with that entity. If there is a sufficient nexus between the different entities, and if they function as one integrated unit, those entities may be held responsible for the employee's wrongful dismissal together with the legal entity that employed the individual. While it would likely be a stretch to apply this common employer doctrine to franchisors (as franchisees are typically independent and not affiliated with their franchisors), it is not beyond the realm of possible.

In addition to the common law, Ontario and other provinces also have labour and employment standards legislation that are used to determine whether a company is a "related employer" with another. For example, the Ontario *Labour Relations Act* permits the Ontario Labour Relations Board (the **"OLRB"**, being the Ontario equivalent of the NLRB) to declare that companies are "related employers" if they are engaged in related businesses and fall under common control or direction. Being declared a "related employer" in Ontario is similar to being found a "joint employer" in the U.S. – the related employers

will be deemed to be a single employer and bound to any collective bargaining obligations of their related entities. The OLRB has been asked to treat franchisors and franchisees as related employers in a few cases, and it has done so in some, but not all, of them.

As another example, the Ontario *Employment Standards Act* provides that companies may be treated as one employer if associated or related businesses are carried on by an employer and one or more persons and the "intent or effect of their doing so is or has been to indirectly or directly defeat the intent or purpose" of the legislation.

Moreover, the Ontario Human Rights Tribunal (the **"OHRT"**) has considered whether franchisors could potentially be held liable for harassment and discrimination claims made by employees of franchisees. Similar to the NLRB, the OHRT has ruled on several occasions that it will not remove a franchisor from a complaint at the preliminary stage on the basis that the franchise agreement (or the franchisor's exercise of controls under the agreement) may have been a factor that caused the alleged discrimination.

While current Canadian "common" and "related" employer principles could result in liability to franchisors for the wrongs committed by their franchisees, no clear line of cases has been developed in that regard.

However, potentially seismic changes may be afoot. The Ontario Ministry of Labour is currently in the process of reviewing Ontario's labour and employment legislation in a project called "The Changing Workplaces Review" and, on July 27, 2016, released its Interim Report. The purpose of the Changing Workplaces Review is to identify amendments to Ontario's *Labour Relations Act* and *Employment Standards Act* to better protect workers while supporting business in today's economy. The Interim Report summarizes the results of public consultation conducted over the course of 2015 with various stakeholders, and identifies numerous issues and various options for potential legislative reform.

With respect to the *Labour Relations Act*, the options identified in the Interim Report include:

- maintain the status quo;
- add a separate general provision permitting the OLRB to declare two or more entities to be "joint employers" and specify the criteria to be applied, even where the entities are not under common control or direction; or
- create a model for certification that applies specifically to the franchise industry, and introduce a new joint employer provision whereby the franchisor and franchisee could be declared joint employers: i) for all those working in the franchisee's operations; or ii) only in certain industries or sectors where there are large numbers of vulnerable workers in precarious jobs.

With respect to the *Employment Standards Act*, the options identified in the Interim Report include:

- maintain the status quo;
- create a joint employer test akin to the policy developed in the U.S.;
- make franchisors liable for the employment standards violations of their franchisees: i) in all circumstances; ii) where the franchisor takes and active role; iii) in certain industries only; or iv) in no circumstances; or
- repeal the "intent to defeat or effect of defeating the purpose of the legislation" requirement referred to above.

Some stakeholders who argue for expanded franchisor liability do so on the basis that, regardless of the amount of actual control exercised by franchisors over their franchisee operations, collective bargaining cannot be effective unless the real economic players in the enterprise are required to bargain with employees. They also argue that, because franchisors have overall control of the brand, the business model and many details of how the business operates, it is appropriate to make franchisors responsible for complying with employment standards legislation jointly with their franchisees.

Conversely, franchisor stakeholders argue that making them liable for the obligations of their franchisees is unnecessary, would be costly and burdensome and could threaten the franchise model in its entirety. In their view, the existing "related employer" provision is sufficient to address situations where a franchisor exerts significant control over, or has direct involvement in, decisions concerning a franchisee's employees.

Whether Ontario's legislation will ultimately be modified to expand franchisor liability for the labour and employment matters of their franchisees remains to be seen. The Ministry of Labour is asking for public comments and input on the issues and options identified in its Interim Report by October 14, 2016. At some point thereafter, a Final Report will be prepared with specific recommendations for legislative change.

At this point, there is no certainty about what, if any, amendments are coming to Ontario, let alone the rest of Canada. However, given the recent developments in the U.S., and the fact that the "Changing Workplaces Review" aims to better protect workers specifically, it is certainly a very real possibility that franchisors will face U.S style expanded liability in Ontario very soon.

Mitigating the Risks

Obviously, being found to be a joint, common or related employer, whether under the current legal regime in Ontario or under potentially more expansive future legislative amendments, can result in serious consequences for franchisors. Among other things, franchisors may face increased:

- liability regarding their franchisees' employment obligations, including for wages, overtime and benefits, severance pay and withholding taxes as well as exposure to wrongful dismissal and human rights complaints;
- risks that employees of their franchisees will become unionized, and that franchisors will be required to be involved in the collective bargaining process; and

- expenses and time burdens associated with making sure franchisees comply with labour and employment legislation.

While we await the results of the ”Changing Workplaces Review” (and what may be similar developments in other Canadian provinces), franchisors would be well advised to review their franchise agreements and related operating manuals and policies to identify provisions that may be more likely to increase the risk of joint employer exposure. In short, although there is currently no bright line test in Canada, the more control a franchisor has or in fact exerts over the employment practices of its franchisees, the more likely it will be found to be a joint employer.

Franchisors would also be wise to consider better educating their franchisees about labour and employment laws and obligations with a view to reducing the likelihood of employee claims being brought against both their franchisees as well as themselves.

Moreover, franchisors should consider whether coverage is available under Employment Practices Liability insurance (which is often purchased by franchisors for their corporate-owned stores) to protect against employment-related actions brought by the employees of their franchisees. Such insurance policies can provide coverage against actions for wrongful dismissal, harassment and discrimination brought by the employees of franchisees.

McMillan’s interdisciplinary team of franchise, labour and employment lawyers can assist franchisors in assessing their current exposure to joint employer issues, and to prepare for whatever legislative changes result from the “Changing Workplaces Review” in the near future.

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a cautionary note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.