Alert

October 22, 2019

COZEN O'CONNOR

Ninth Circuit Court of Appeals Holds Franchisor Not Liable as a Joint Employer of its Franchisee's Employees

On October 1, 2019, the Ninth Circuit Court of Appeals decided by majority opinion by Circuit Judge Susan Graber, with a partial dissent filed by Chief Circuit Judge Sidney Thomas, *Salazar v. McDonald's Corp.* No. 17- 15673 (9th Cir. 2019), holding franchisor McDonald's was not a joint employer with its franchisee, because McDonald's did not retain control of day-to-day aspects of work at the franchisee's restaurants. The Ninth Circuit further held that any "direct control" asserted by McDonald's over its franchisee were geared toward "quality control" and "brand standards." The Ninth Circuit affirmed summary judgment in favor of McDonald's by a majority decision, holding that all of employees' class action claims alleging overtime, meal, and rest breaks violations and other claims and penalties, including under California's Private Attorneys General Act (PAGA) California Labor Code Section 2699 et.seq.), failed as a matter of California law.

Specifically, the majority opinion in interpreting California law under the "control" definition of employer, held that McDonald's was not a joint employer with its franchisee because McDonald's did not have control over the employees' wages, hours, or working conditions, or control over the day-to-day aspects of work at the franchises. The court noted that pursuant to California Wage Order No. 5-2001, section 2(H) — which governs the housekeeping industry including restaurants, an "employer" is one who directly or indirectly, or through an agent or any other person, employs or exercises control over the wages, hours, or working conditions of any person.

The majority opinion considered and rejected plaintiff's' claims that McDonald's could be a joint employer of franchisee employees under an alternative "suffer or permit" definition of employer. Plaintiffs argue that McDonald's was a joint employer because it "induced" its franchisee to use its in-store processor computer system (ISP), while discouraging changes in that system that would have conformed to the California wage and hour laws-that is, because McDonald's had the ability to prevent wage and hour violations caused by the ISP's system settings yet failed to do so.

The majority opinion rejected plaintiffs' arguments, determining that plaintiffs focus on responsibility for the alleged violations of wage and hour laws was misplaced because the suffer or permit definition pertains to **responsibility for the fact of employment itself**. The differentiating question in the majority opinion was whether under California law McDonald's was one of plaintiffs' employers — not whether McDonald's caused plaintiff employer to violate wage and hour laws "by giving the employer bad tools or bad advice." [In a footnote the court declined to decide whether McDonald's may be liable to its franchisee for any alleged violations.]

In a partial dissenting opinion, Judge Thomas diverged from the decision of the majority and would have determined that McDonald's summary judgment should be denied in that there were genuine issues of material fact because plaintiffs presented evidence that McDonald's ISP — with settings McDonald's prescribed, instructed franchisee to use, and represented would comply with wage and hours laws — was a direct cause of plaintiff lost wages.

What does this mean for California franchisors and franchisees?

A franchisor can still be liable as a "joint employer" if the manner in which it conducts its operations are materially different from the way that McDonald's was determined to conduct its operations, namely if it is determined to have control of day-to-day aspects including hiring, directing, supervision, and/or discipline.

It is less than clear the extent to which franchisors can exercise control over their franchisees for "quality control" and/or "brand management," without overstepping what is still a gray area of

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controlling day-to-day aspects of franchisees' operations.

Franchisors and franchisees that do business in California must be mindful of California's many special and sometimes dramatically different standards and laws for determining employees' rights to be paid overtime and entitlement to meal and rest break claims; and further mindful of the severe penalties, including under PAGA, for noncompliance with California wage and hour laws.

Because California wage and hour laws requirements are so special, franchisors and franchisees must carefully determine whether any computer systems, software, or even applications that employees are increasingly using for scheduling, etc. on their own personal devices, are California law compliant. In California, one size does not fit all when it comes to franchisor provided "tools and advice" compliant with California law.

This case may not be over in that plaintiffs have promised to file a request for *en banc* reconsideration.

In any event, California franchisors and in particular franchisees, may wish to review their compliance with California wage and hour laws and their interactions, including the degree of direct control that franchisors exercise over their franchisees in their day to day operations.