What McDonald's can teach us about franchisor liability

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Consider the following scenario: a franchisee had breached its obligations to its employees under workplace laws, primarily through not providing breaks or paying overtime as required.

- There was some evidence to suggest the franchisor was aware of this.
- The franchisor, through the franchise agreement, had control over many aspects of the franchisee's operations.
- The franchisor provided training to managers and required that at least one franchisor-trained manager be on duty for each shift.
- All the employment functions (hiring, firing, payment of wages etc) were conducted by the franchisee.
- The franchisee voluntarily used a pay-roll system developed by the franchisor. It appears that many of the violations occurred because the pay-roll system was not properly configured to allow break times and calculate overtime as required by applicable workplace law.
- The franchisor represented to the franchisee that the pay-roll system was compliant and encouraged the franchisee not to change any settings.

In these circumstances, should the franchisor be liable for the failure of the franchisee to pay its employees their legal entitlements?

Snapshot

- The issue of whether companies such as franchisors should be responsible for the workplace law breaches of other employees is a hot topic.
- Australian law deals with this issue mainly through accessorial liability and new vulnerable employee provisions.
- A similar function is served in the United States through the doctrine of joint employment.

Anyone following the news over the last few years would be aware that these are issues of considerable public, parliamentary and regulatory attention. This attention was particularly focussed on 7-Eleven (see Fair Work Ombudsman, *A Report of the Fair Work Ombudsman's Inquiry into 7-Eleven: Identifying and Addressing the Drivers of Non-Compliance in the 7-Eleven Network*, Commonwealth of Australia, Canberra, April 2016).

However, the above scenario is not based on 7-Eleven but on the recent decision of the United States Court of Appeals for the Ninth Circuit in *Salazar v McDonald's Corp,* 9th Cir. No. 17-15673, Oct 1 2019 ('**Salazar**'). This decision considered what liability McDonald's might have under Californian labour legislation for its franchisee's breach of the obligations to its employees to pay or provide overtime premiums, meal and other rest breaks (the proceedings against the franchisee had been settled). The liability of McDonalds was asserted to have arisen on the basis that McDonald's was a joint employer, with the franchisee, of those employees.

Does the doctrine of joint employment offer a further or different avenue to impose liability on companies for the contraventions of other employers than those provided by Australian law?

Accessorial liability and vulnerable workers under the *FW Act*

The circumstances in which a company (or an individual) should be responsible for the wages and other entitlements of employees of another employer has been considered by the courts under the accessorial liability provisions of the *Fair Work Act 2009* s 550 ('***FW Act***') (see Webster J & Winterburn A, 'Accessories Personally Liable for Unpaid Employee Entitlements', 26 *Law Society of NSW Journal*, September 2016, 82-83; Fredericks G, 'Not Just An Innocent Bystander: Accessorial liability of third parties under the *Fair Work Act*', 27 *Law Society of NSW Journal*, October 2016, 78-79).

Following the 7-Eleven and other controversies, these provisions were strengthened, or taken a step further, in 2017 as part of the 'vulnerable employees' amendments to the *FW Act* (see De Flamingh J, 'Parliament Moves to Protect Vulnerable Workers', 38 *Law Society of New South Wales Journal*, October 2017, 75-77). Importantly, while much of the focus on, and the motivation for, the amendments was with respect to franchisor responsibility for actions of their franchisees, the provisions are not limited to this. The provisions extend to holding companies and subsidiaries, as well as to officers of franchisors and holding companies.

The accessorial liability provisions have been in the *FW Act* for some time and have been applied in a wide range of circumstances, for example:

- where a contractor entered into arrangements with a subcontractor to provide services where the contractor knew the subcontractor could not provide those services as contracted and make a profit unless it underpaid its employees (see *Fair Work Ombudsmen v South Jin Pty Ltd* [2015] FCA 1456 ('***South Jin***')); and
- where an accountant/bookkeeper accounting firm knew of the contraventions by its client, failed to take appropriate action and facilitated the contravention (*Fair Work Ombudsman v Blue Impression Pty Ltd & Ors* [2017] FCCA 810; *EZY Accounting 123 Pty Ltd v Fair Work Ombudsman* [2018] FCAFC 134 ('***Blue Impression***')).

These provisions, on their face, appear to require a degree of pro-activity on the part of companies in ensuring their franchisees and subsidiaries comply with workplace law. If the company genuinely does not know of the contravention it will (generally speaking) not be accessorily liable, even if the company reasonably should have known. This is different from a situation where a company had some suspicion or some understanding of the contravention but took steps to avoid knowing more. This is more likely to be accessorial liability.

However, the vulnerable employee provisions are intended to have the effect that franchisors and holding companies (and their officers) can be liable for certain contraventions by, respectively, their franchisees and subsidiaries, of certain civil remedy provisions where they knew, *or should reasonably have known,* the contraventions would occur, or a contravention of the same or similar character would occur, unless they took reasonable steps to prevent the contravention (see Fair Work Amendment (Protecting Vulnerable Workers) Bill 2017 Explanatory Memorandum at i to ii).

Accordingly, an attempt by a company to avoid knowledge of, or to distance itself from, an employer's actions in a situation where it could have done something, may avoid a finding of accessorial liability but is likely to increase the prospects they will be liable under the vulnerable employee provisions. Indeed, a number of the factors set out in the introduction to this article would likely be regarded as pointing to, although not determinative of, such liability.

Despite this potential expansion of liability, there are still areas in which the vulnerable employee provisions will not apply. For example, the contractor-subcontractor or service provider relationships considered in the *South Jin* and *Blue Impression* matters are unlikely to be caught by these provisions. Further instances of the 'gap' may include labour hire companies and service providers.

Assuming this gap should be filled (which is likely to be a matter of some controversy), a further mechanism for imposing direct liability may be through the concept of joint employment. That is where, for example, both the franchisor and the franchisee are the employer of the employees and therefore have joint and several obligations to the employees.

The doctrine of joint employment

The issue of whether the doctrine of joint employment exists in Australian law has not been authoritatively determined by an Australian court (*Coghill v Indochine Resources Pty Ltd* [2015] FCA 377 at [27] ('***Indochine***')). While the issue may still be regarded as being open, it appears that there is some doubt as to whether joint employment can exist in Australian law (*FP Group Pty Ltd v Tooheys Pty Ltd* [2013] FWCFB 9605; *Indochine* at [30]).

However, the doctrine is an established part of US law, both at a state and federal level. The doctrine is derived from various statutes and operates differently according to the terms of each statute and how those statutes have been interpreted by State and Circuit Courts.

Salazar v McDonald's Corp

In *Salazar*, the statutory provision in question defined an employer to be someone '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.' (California Wage Order No. 5-2001, section 2(H)). In considering this definition the California Supreme Court has provided three bases on which a person can be found to employ someone '(a) to exercise control over the wages, hours or working conditions, or (b) to suffer or permit to work, or (c) to engage, thereby creating a common law relationship.' (*Salazar* slip op. at 10).

However, despite the factors set out in the introduction to this article, the 9th Circuit, by majority, held that McDonald's was not the joint employer (claims based on agency and tort were also dismissed) as McDonalds did not control the hiring and firing, wages, hours or material working conditions of the employees (*Salazar* slip op. 11-12, 14 and 15) and that any direct control of the employees was done for the purpose of brand management and quality control (*Salazar* slip op. at 12). Accordingly, the fact that McDonalds may have become aware of the violations did not come into play as the relevant test under Californian law required a focus on the formation of the employment relationship and the direct control of that relationship.

Conversely, had McDonalds been an employer then it seems likely that issues such as knowledge of the contravention would be irrelevant as they would have an obligation to pay or provide benefits regardless of whether they were aware of that obligation or whether it was being met. Indeed, this does present the conundrum that if McDonalds had exerted greater control in order to prevent contraventions, it may have faced a greater

risk of being held to be a joint employer. Further, the result for McDonalds may well have been different under other statutes or if considered by other State or Circuit courts.

While the use of the doctrine of joint employment may have some attraction to those wishing to fill the 'gap' there are a number of issues which must be considered before adopting this, for example:

- How broadly or narrowly should 'joint employment' be defined? If it is defined too broadly, it may have the effect of increasing the uncertainty, risk and cost of day to day corporate transactions and relationships. Indeed, at present the scope of this doctrine under federal US law is the subject of review by the National Labor Relations Board as it seeks to narrow its current relatively broad definition. As may be expected, this proposal is a matter of some controversy.
- Will it be joint employment for all purposes or for limited purposes (for example only for unfair dismissal proceedings)?
- If it applies for, say, the payment of wages, will the employee first have to attempt to claim the money from the 'primary' employer, will they have to commence proceedings against both employers or can they elect?
- How will it affect other employer obligations, such as workplace health and safety obligations?
- If the two joint employers are covered by different industrial awards, how will this issue be determined?
- Will the employees have the usual implied contractual obligations to both employers?
- If the doctrine is applied more narrowly on a statute by statute basis, will this increase uncertainty on the part of employers as to their obligations?

The decision in *Salazar* (and other US jurisprudence on joint employment) do show possible alternatives to accessorial liability and the vulnerable employee provisions.

However, it is something that should be approached with some caution and with a very close focus on how it may operate in practice. **LSJ**