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ALERTS

McDonald's Held Not To Be A Joint Employer Of Franchisee's California Employees

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In a welcome development for the franchising industry, a federal appeals court recently held that McDonald's cannot be held liable as a joint employer of the employees of its franchisees.

In *Salazar v. McDonald's Corp.*, the U.S. Court of Appeals for the Ninth Circuit upheld summary judgment in favor of McDonald's in a case involving a class of nearly 1,400 workers employed by a McDonald's franchisee. The lawsuit asserted a number of wage and hour violations under the California Labor Code, negligence, and relief under the California Private Attorneys General Act (PAGA). The class previously settled with the franchisee, but sought to hold McDonald's responsible as a joint employer. The District Court disagreed, holding that McDonald's was not a joint employer of the franchisee's employees and rejecting the employees' other theories of liability. The employees appealed and the Ninth Circuit affirmed.

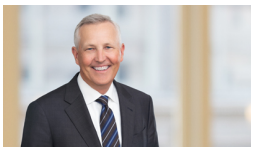
California Law on Joint Employment Liability

The Ninth Circuit based its joint employer analysis on the meaning of "employer" under California law. California Wage Order No. 5-2001, Section 2(H) defines an "employer" as 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." In its 2010 *Martinez v. Combs* decision, the California Supreme Court interpreted Wage Order No. 5-2001 and defined "employ" as:

RELATED PEOPLE

Mark Wallin
Partner
Chicago, Minneapolis, Los Angeles

P 312-214-4591
F 312-759-5646
mark.wallin@btlaw.com



Kenneth J. Yerkes
Partner
Indianapolis

P 317-231-7513
F 317-231-7433
ken.yerkes@btlaw.com

John T.L. Koenig
Partner
Atlanta

P 404-264-4018
F 404-264-4033
john.koenig@btlaw.com

David B. Ritter
Partner
Chicago

P 312-214-4862
F 312-759-5646
david.ritter@btlaw.com

1. to exercise control over the wages, hours or working conditions;
2. to "suffer or permit" to work; or
3. to engage, thereby creating a common law relationship

As the Ninth Circuit explained, in the franchising context, the California Supreme Court held in its 2014 *Patterson v. Domino's Pizza, LLC* decision that "a franchisor 'becomes potentially liable for actions of the franchisee's employees, only if it has retained or assumed a general right of control over factors such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees.'"

McDonald's Is Not A Joint Employer

The Ninth Circuit upheld the District Court's decision that McDonald's is not liable as a joint employer under any of the three *Martinez* theories of liability.

1. McDonald's Does Not "Control"

McDonald's did not retain or exert direct control over the franchisee's workers' wages, hours, or working conditions. The Ninth Circuit concluded that any direct control that McDonald's asserted was geared toward quality control and brand standards, and franchisors "need the freedom to 'impose[] comprehensive and meticulous standards for marketing [their] trademarked brand and operating [their] franchises in a uniform way.'"

2. McDonald's Does Not "Suffer Or Permit"

McDonald's did not "suffer or permit" the franchisee's employees to work. Although McDonald's required the franchisee to use its point of sale and in-store processor (ISP) computer systems to open and close the franchise location, the franchisee voluntarily used the ISP system for scheduling, timekeeping and determining regular and overtime pay through applications that came with the ISP software. The employees claimed the ISP system's settings caused many workers to miss out on breaks and overtime pay and that McDonald's could have prevented the alleged wage and hour violations by its ISP system's settings. The court rejected this argument, finding that the employees wrongly focused on responsibility for the alleged wage violations, when the correct question under California law is responsibility for the employment of the workers. Here, McDonald's had no control over its franchisee's employees.

The Ninth Circuit also concluded the California Supreme Court's recent *Dynamex Operations, Inc. v. Superior Court of Los Angeles* decision did not apply because no argument had been advanced that the workers were independent contractors. All parties agreed that the plaintiffs were employees of the franchisee and the question was whether they were also McDonald's employees under a joint employer theory.

3. McDonald's Is Also Not a Common Law Employer

McDonald's also was held not to be an employer of its franchisees' workers under California common law. The common law test focuses on whether the putative employer "has the right to control the manner and means of accomplishing the result desired." Relying heavily on *Patterson*, the Ninth Circuit explained that in the franchise business model, a franchisor must retain or assume a "general right of control over factors

Mark S. Kittaka
Partner
Fort Wayne, Columbus

P 260-425-4616
F 260-424-8316
mark.kittaka@btlaw.com

Robert W. Sikkel
Of Counsel (Retired)

P 616-742-3978
robert.sikkel@btlaw.com

Peter A. Morse, Jr.
Partner
Indianapolis, Washington, D.C.

P 317-231-7794
F 317-231-7433
pete.morse@btlaw.com

Scott J. Witlin
Partner
Los Angeles

P 310-284-3777
F 310-284-3894
scott.witlin@btlaw.com

such as hiring, direction, supervision, discipline, discharge, and relevant day-to-day aspects of the workplace behavior of the franchisee's employees" to meet the California common law employer test. According to the court, "McDonald's exercise of control over the means and manner of work performed at its franchises is geared specifically toward quality control and maintenance of brand standards." Recognizing the need for franchisors to maintain quality control and maintenance of brand standards, the Ninth Circuit held that McDonald's did not satisfy the California common law test.

Ostensible Agency Theory Is Unavailable Against Franchisors

The Ninth Circuit also rejected the employees' argument that McDonald's was liable for the alleged wage violations under an "ostensible agency" theory. The definition of "employer" under California Wage Order No. 5-2001 includes "an agent" who "employs or exercises control over the wages, hours, or working conditions" of the workers. The Ninth Circuit concluded that McDonald's "does none of those things," and that "McDonald's cannot be held liable for those violations under an ostensible agency theory."

Negligence and PAGA

Continuing its total repudiation of the employees' theories of liability against McDonald's, the Ninth Circuit dismissed the plaintiffs' negligence and PAGA claims. The negligence claim was barred by the California Labor Code because it was based on the same facts as the wage and hour claims, and the employees suffered no damages independent of the statutory violations. The employees also could not prove that McDonald's owed any duty to them. Under California law, a franchisor is vicariously liable only if it has retained general control over the relevant day-to-day operations of the franchisee, and McDonald's simply had no supervisory duties with respect to its franchisee.

Finally, the Ninth Circuit found that because no employment relationship existed, the plaintiffs could not assert a PAGA claim against McDonald's and thus affirmed the District Court's decision to strike the plaintiffs' PAGA claims and deny class certification.

Takeaways

Salazar is a very important decision for franchisors, franchisees, and the franchising business model as a whole. The Ninth Circuit, applying California law, recognized and validated the significance of franchisor quality controls and brand standards, confirming that franchisors can exert control over their trademarks and brand without the risk of unlimited liability inherent in joint employment. Relying on *Patterson*, the court explained:

Franchisors like McDonald's need the freedom to "impose[] comprehensive and meticulous standards for marketing [their] trademarked brand and operating [their] franchises in a uniform way." McDonald's involvement in its franchises and with workers at the franchises is central to modern franchising and to the company's ability to

Janilyn Brouwer Daub
Partner
South Bend, Elkhart

P 574-237-1139
F 574-237-1125
janilyn.daub@btlaw.com

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maintain brand standards, but does not represent control over wages, hours, or working conditions.

The extent of *Salazar's* full impact remains to be seen. While the *Salazar* decision dealt with California Labor Code violations, the court's logic at least arguably applies equally to claims under other state laws, as well as the Fair Labor Standards Act (FLSA). Moreover, the law recently enacted by the California Legislature, AB 5, may impact the question of franchisor liability and franchisors may want to review its implications with trusted counsel.

To obtain more information, please contact the Barnes & Thornburg attorney with whom you work, or Peter J. Wozniak at 312-214-2113 or peter.wozniak@btlaw.com or Mark W. Wallin at 312-214-4591 or mark.wallin@btlaw.com, both of the Labor and Employment Department, or Marlén Cortez Morris at 312-214-8808 or mcortez@btlaw.com, of the Franchising and Distribution Group.

You can also contact the chair of the Franchising and Distribution Group, Rebekah Prince at 310-284-3831 or rebekah.prince@btlaw.com, or another member of the Labor and Employment Department:

Kenneth J. Yerkes, Chair
317-231-7513

John T.L. Koenig, Atlanta
404-264-4018

David B. Ritter, Chicago
312-214-4862

Mark S. Kittaka, Fort Wayne
260-425-4616

Robert W. Sikkel, Grand Rapids
616-742-3978

Peter A. Morse, Indianapolis
317-231-7794

Scott J. Witlin, Los Angeles
310-284-3777

Janilyn Brouwer Daub, South Bend/Elkhart
574-237-1130