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INTERNATIONAL FRANCHISING IN THE DAWN OF A NEW AGE

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NEWS FROM AROUND THE WORLD:

REPORT FROM THE UNITED STATES

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The Pendulum Swings in the US

As 2021 began, substantial and significant changes were underway and accelerating in the United States. First and foremost, the November 2020 election ushered a new administration into Washington, along with working Democratic majorities in both the U.S. House of Representatives and the U.S. Senate. But the pendulum did not start to swing then, and likely will not end with this Administration either.

Changes in U.S. administrations have taken place after every presidential succession back to the election of 1796, when John Adams was elected to serve as the 2nd President of the United States, following the two terms of President George Washington. The presidential transition that took place after the November 2020 election was, by any account, the most fraught and unusual in American history. As a result, the changes that typically occur when a new administration takes office were in some cases delayed and, as of the writing of this report, may not have even begun.[1] Moreover, the slow pace of having the U.S. Senate review and confirm appointees is a drag on the pace with which the Biden Administration, like previous administrations, has been able to get up and running. This is a matter of no small concern, as noted in an article written before the 2020 election by the Chairs of the independent and bipartisan 9/11 Commission, who wrote that the George W. Bush administration, like its predecessors, "did not have its full national security team on the job until at least six months after it took office. Since a catastrophic attack can occur with little or no notice as we experienced on [September 11, 2001], we concluded that the government must seek to minimize disruption of national security policymaking during the change of administrations."[2] So having the full government up and running has implications for national security as well as economic and commercial considerations.

Political changes often follow (as much as lead) cultural shifts, In the last few decades, there has been a major swing in terms of how society interacts with, and sees, some business-related issues. For example, information technology and related commercial advances – such as the emergence of global information technology platforms and biotechnology – have in many cases outpaced legal scrutiny. In some measure, data protection laws have emerged as a partial response to these and other developments in culture and society. But other changes are certain to follow, including for example, antitrust analysis. In antitrust enforcement – the pendulum appears to be swinging away from the Chicago School of Economic theory toward more engaged and active state attorneys general.[3] With the new Administration, the pendulum swing may also impact the Justice Department and the Federal Trade Commission, the two federal agencies primarily charged with antitrust law enforcement.

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[1] Shannon Carroll, "The Biden Administration Faces Obstacles Getting Key Officials in Place Despite a Well-Organized Transition," Center for Presidential Transition (Apr. 30, 2021) (https://presidentialtransition.org/blog/the-biden-administration-faces-obstacles-getting-key-officials-in-place/) ("[O]nly 44 of 220 appointments submitted to the Senate were confirmed by the [Biden Administration's] 100th day. This compares to the 67 appointees confirmed by the 100th day during President Barack Obama's administration, still a small number given the size of our government and importance of many of the unfilled positions.").

[2] Thomas Kean and Lee Hamilton, "The Impact of the 9/11 Commission on Current Presidential Transition Planning," Center for Presidential Transition (Sept. 11, 2020) (https://presidentialtransition.org/blog/9-11-commission-on-transition-planning/).

[3] See, e.g., Gavin Evans, "More Than 40 Attorneys General Want Facebook to Scrap Instagram for Kids," Yahoo! News (May 10, 2021) (https://news.yahoo.com/more-40-attorney-generals-want-213320281.html).

1. The Pendulum Starts to Swing

1.1 Misclassification Cases

In the period from 2009-12, the rollout of 4G telecommunication brought with it faster and more reliable wireless connectivity. With that came commercial developments, such as "mobile apps," which are for many users a staple of modern life. Among the innovative technologies that ensued were things like ride-calling services such as "Uber" and "Lyft" as well as offshoots, such as "Uber Eats," "DoorDash," "Postmates," and countless other developments. Tomes will be written on the utility, folly, potential, and unfortunate consequences of these applications, for example, their impact on restaurant economics and consumer expectations. For the purpose of this report, however, the focus is on the workers that served the consumer-driven demand for the services that these operators offered. As just one example, a person seeking to augment their income could sign up to become an "Uber" driver. Although the terms and conditions of how someone might work in the "Uber" ecosystem might differ from how they would work in the "Lyft" model, the basic arrangement remained the same: the person was considered an "independent contractor" who would be able to accept work from the "Uber" or "Lyft" platform, provide transportation using their own vehicle to the consumer who sought the ride-hailing service, and the driver would be paid from the proceeds of the payment card transaction that the company facilitated, usually with no cash changing hands. The fleet of drivers, operating their own cars, became known as "gig workers," and their relationship to these companies has become a focal point in many controversies.

Whether gig workers are treated as independent contractors or as employees has been the subject of many lawsuits and even legislation. These cases often involve allegations of "misclassification" – that is, misclassifying an employee as an independent contractor.[4] One of the most prominent U.S. cases in this area was Dynamex Operations W. v. Superior Ct.[5]

In Dynamex, the California Supreme Court unanimously held that the "ABC" test should be applied to determine whether delivery drivers were employees or independent contractors. Because of the breadth of the misclassification reasoning involved in Dynamex, there has been a concern that franchisors and franchisees would become ensnared in the same legal reasoning, and that franchisees would be deemed to be "misclassified" as independent contractors (aka, "franchisees").[6]

In 2021, the California Supreme Court again reviewed its Dynamex decision. This time, the issue was framed as a question raised by the U.S. Court of Appeals for the Ninth Circuit, which asked the state supreme court to advise whether its 2018 Dynamex decision applied retroactively. The California Supreme Court unanimously concluded yes, noting that "the well-established general principle affirming the retroactive application of judicial decisions interpreting legislative measures supports the retroactive application of *Dynamex*."[7]

In Massachusetts, 7-Eleven, Inc. defeated a claim that it had misclassified its franchisees as independent contractors. The court there focused on the clear standard under the FTC Franchise Rule

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[4] See David Weil, "Lots of Employees Get Misclassified as Contractors. Here's Why It Matters," Harvard Business Review (Jul. 6, 2017) (https://hbr.org/2017/07/lots-of-employees-get-misclassified-as-contractors-heres-why-it-matters).

[5] 4 Cal. 5th 903, 416 P.3d 1 (2018).

[6] In an earlier case, a federal trial court found that under Massachusetts law, franchisees in that state were misclassified as independent contractors. Awuah v. Coverall N. Am., Inc., 707 F. Supp. 2d 80, 85 (D. Mass. 2010). (However, see the Patel v. 7-Eleven, Inc. decision, noted supra.)

[7] Vazquez v. Jan-Pro Franchising Int'l, Inc., 10 Cal. 5th 944, 952, 478 P.3d 1207, 1211–12 (2021).

regulating the relationship between franchisees and franchisors, noting that "[t]he franchise-specific regulatory regime of the FTC governs over the general independent contractor test in Massachusetts. … Accordingly, the Massachusetts [independent contractor law] does not apply to 7-Eleven in these circumstances."[8]

In late 2018, legislation was introduced in California to codify Dynamex. That bill, which became known as "AB-5," passed and were signed into law on September 18, 2019.[9] Notably, although the California Supreme Court's decision in Dynamex was deemed to apply retroactively, a federal court ruled in 2021 that AB-5, the legislation codifying that case, did not apply retroactively.[10]

In 2020, California voters considered a ballot initiative that would exempt ride-sharing services such as "Uber" and "Lyft" from having to comply with AB-5. The ride-sharing companies spent $185 million on their campaign to pass Prop 22,[11] which the voters adopted with roughly 58% of the vote.[12] Ironically, the law – intended by the legislature to corral what it saw as excesses by ride-sharing gig companies– now no longer applies to those gig companies, but may be broad enough to ensnare franchisors.[13]

Not to be left out, the U.S. Department of Labor is also pursuing actions under misclassification theories.[14]

Finally, the "PRO Act," pending in the U.S. Congress, would enshrine the "ABC" test into the National Labor Relations Act.[15]

1.2 Joint Employment

The theory of "joint employment" is a close cousin of vicarious liability. Under this theory, a party (such as a franchisor) is potentially deemed to be the second (or joint) employer of another party's staff (e.g., a franchisee). The standard for determining when two or more parties jointly employ an individual

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8 Patel v. 7-Eleven, Inc., 485 F. Supp. 3d 299, 310 (D. Mass. 2020).

9 AB-5 Worker status: employees and independent contractors; California Legislative Information website (https://leginfo.legislature.ca.gov/faces/billHistoryClient.xhtml?bill_id=201920200AB5).

10 Haitayan v. 7-Eleven, Inc., No. CV 17-7454 DSF (ASX), 2021 WL 757024, at *5 (C.D. Cal. Feb. 8, 2021) ("AB 5 is not retroactive and, therefore, applies only to work performed after January 1, 2020, when the statute went into effect.").

11 Sara O'Brien, "The $185 million campaign to keep Uber and Lyft drivers as contractors in California," CNN (Oct. 8, 2020) (https://www.cnn.com/2020/10/08/tech/proposition-22-california/index.html).

12 Taryn Luna, "California voters approve Prop. 22, allowing Uber and Lyft drivers to remain independent contractors," L.A. Times (Nov. 3, 2020) (https://www.latimes.com/california/story/2020-11-03/2020-california-election-tracking-prop-22).

13 Notably, Dynamex does not apply to joint employment claims. See Cruz v. MM 879, Inc., 2020 WL 6938843, at *3 (E.D. Cal. Nov. 25, 2020) ("it does not appear that the [California] Supreme Court intended for the "ABC" test to be applied in joint employment cases"); and Curry v. Equilon Enterprises, LLC, 23 Cal. App. 5th 289, 314, 233 Cal. Rptr. 3d 295, 314 (2018), as modified on denial of reh'g (May 18, 2018) ("Therefore, it does not appear that the Supreme Court intended for the "ABC" test to be applied in joint employment cases.").

14 Punching In: DOL's Pipeline of Worker Classification Lawsuits, Bloomberg Law (May 10, 2021) (https://news.bloomberglaw.com/daily-labor-report/punching-in-dols-pipeline-of-worker-classification-lawsuits). See also Wage and Hour Div., "Misclassification of Employees as Independent Contractors," U.S. Dept. of Labor (May 2021) (https://www.dol.gov/agencies/whd/flsa/misclassification).

15 Protecting the Right to Organize Act of 2021, H.R. 842, 117th Cong. § 101(b) (2021) (defining the term "employee" to reflect the ABC test).

has been the focus of considerable attention over the last ten years. This report does not seek to define or revisit this controversial set of standards, which may be applied in various settings. These include:

- Federal standards under various labor and HR-related laws (such as the Fair Labor Standards Act, the Occupational Safety and Health Act, the National Labor Relations Act, the Family and Medical Leave Act, the Migrant and Seasonal Agricultural Worker Protection Act, and the Wage and Hour Act).

- Enforcement actions under those laws, including actions by the U.S. Department of Labor and the National Labor Relations Board (NLRB).

- State enforcement actions.

- Private litigation.

Notably, with the change in Administration, there will likely be a renewed attempt to adopt a broader definition of "joint employment" by the Labor Department and the NLRB. Indeed, in March 2021, the Labor Department issued a notice of proposed rulemaking, which proposed to rescind the final "joint employer" rule issued in 2020 during the Trump Administration.[16] The Trump-era joint employer rule, issued in January 2020 to take effect on March 16, 2020,[17] adopted a four-part test to determine whether a party was a joint-employer with another:

"Those four factors are whether the other person:

(i) Hires or fires the employee;

(ii) Supervises and controls the employee's work schedule or conditions of employment to a substantial degree;

(iii) Determines the employee's rate and method of payment; and

(iv) Maintains the employee's employment records."[18]

In 2020, 18 U.S. states sued the Labor Secretary (then, Eugene Scalia) alleging that when the U.S. Department of Labor issued the 2020 joint employer rule, it failed to comply with the Administrative Procedure Act. The International Franchise Association, among others, was granted the right to participate in the case as an intervenor on the side of the Labor Department. In September 2020, the court agreed with the states and determined that the Labor Department was "arbitrary and capricious" in adopting the 2020 rule, and the court enjoined application of most portions of that rule.[19] That decision is now on appeal to the U.S. Court of Appeals for the Second Circuit.

The "PRO Act," pending in the U.S. Congress, would add an expansive view of the joint employment standard to the National Labor Relations Act. The PRO Act passed the House of

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16 86 Fed. Reg. 14038 (Mar. 12, 2021).
17 85 Fed. Reg. 2820 (Jan. 16, 2020).
18 Id. at 2858-59 (to be codified as 29 C.F.R. § 791.2(a)(1)).
19 New York v. Scalia, 490 F. Supp. 3d 748, 796 (S.D.N.Y. 2020).

Representatives on March 9, 2021 and is now pending before the Senate,[20] and would define "joint employer" thusly:

> "Two or more persons shall be employers with respect to an employee if each such person codetermines or shares control over the employee's essential terms and conditions of employment. In determining whether such control exists, the Board or a court of competent jurisdiction shall consider as relevant direct control and indirect control over such terms and conditions, reserved authority to control such terms and conditions, and control over such terms and conditions exercised by a person in fact: Provided, That nothing herein precludes a finding that indirect or reserved control standing alone can be sufficient given specific facts and circumstances."[21]

2. Enforcement

2.1 The Federal Trade Commission

Several significant developments marked the last year for the Federal Trade Commission.

First, the FTC is in the process of a periodic review of the Franchise Rule. To that end, the Commission solicited comments and conducted an online workshop on November 10, 2020 to determine "whether there is a continuing need for the Rule; what modifications, if any, should be made to the Rule to increase its benefits to prospective franchisees; and what modifications, if any, should be made to the Rule to account for changes in relevant technology or economic conditions."[22]

Second, in April 2021, the U.S. Supreme Court issued a unanimous ruling in AMG Capital Management, LLC v. Federal Trade Commission that the FTC exceeded its authority under the Federal Trade Commission Act by bringing actions to recover monetary relief under Section 13(b) of the Act.[23] In the aftermath of that decision, the FTC asked Congress to amend the Federal Trade Commission Act to restore its authority to seek consumer redress in the form of monetary relief and restitution for violations of the Act.[24]

Finally, also in April 2021, U.S. Senator Catherine Cortez Masto issued an extensive report in the nature of a white paper.[25] Senator Cortez Masto's report is entitled "Strategies to Improve the Franchise Model: Preventing Unfair and Deceptive Franchise Practices." Among other things, that report recommends changes to how the FTC enforces the Franchise Rule as well as the adoption of additional legislation.

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20 167 Cong. Rec. H1174-75 (Mar. 9, 2021).

21 Protecting the Right to Organize Act of 2021, H.R. 842, 117th Cong. § 101(a) (2021).

22 Federal Trade Commission, 85 Fed. Reg. 55850, 55851 (2020).

23 141 S. Ct. 1341 (2021).

24 See FTC News Release, "FTC Asks Congress to Pass Legislation Reviving the Agency's Authority to Return Money to Consumers Harmed by Law Violations and Keep Illegal Conduct from Reoccurring" (Apr. 27, 2021) (https://www.ftc.gov/news-events/press-releases/2021/04/ftc-asks-congress-pass-legislation-reviving-agencys-authority).

25 Cortez Masto Releases Alarming New Report Detailing Harmful Practices in Franchise Sector, Calls For Transparency and Oversight, Office of Senator Catherine Cortez Masto (Apr. 13, 2021) (https://www.cortezmasto.senate.gov/news/press-releases/cortez-masto-releases-alarming-new-report-detailing-harmful-practices-in-franchise-sector-calls-for-transparency-and-oversight).

3. State Agencies

In February 2021, the California Department of Financial Protection and Innovation issued an administrative order, taking action against the franchisor of the "Burgerim" system and its affiliates. In that action, the state agency alleged that the franchisor engaged in 1,583 violations of the California Franchise Investment Law and assessed administrative penalties of $3,987,500 plus investigative expenses of $18,750.[26] The Department also ordered additional relief. Thus far, it does not appear that the state agency has sought to enforce its administrative order nor is there any confirmation that the franchisor paid the restitution and penalties.

Conclusion

Antitrust enforcement and related issues will become more prevalent as the new Administration has all of its appointees confirmed by the Senate and those individuals get to work. This will likely include closer scrutiny of mergers, analysis of concentration in industries such as online search and content companies (such as *Google* and *Facebook*), biomedical companies (whose ability to impact pharmaceutical prices is an important consideration), and in the healthcare industry.[27]

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[26] In the Matter of Burgerim Group USA, Inc., et al. (Feb. 16, 2021) (https://dfpi.ca.gov/enf-b/burgerim-group-usa-inc/).

[27] However, the FTC still must prove its case. In December 2020, a court ruled that the FTC defined a market too narrowly for the purpose of determining whether the merger of two hospital systems would violate the Clayton Act, and denied a preliminary injunction that would have stopped that merger. Federal Trade Commission v. Thomas Jefferson Univ., No. CV 20-01113, 2020 WL 7227250 (E.D. Pa. Dec. 8, 2020).

Biography

Lee has extensive experience counseling distributors and franchisors, including drafting and negotiating franchise agreements for complex international and domestic transactions and advising clients on all aspects of franchise and distribution law. Lee also counsels clients on the application of technology to franchise and distribution systems. He focuses his attention on matters such as social networking and social media issues, e-commerce, data use and security policies, cybersquatting and domain name disputes, consumer complaint and cybersmear sites, as well as software and hardware licensing. In addition, he serves as an expert witness and also represents clients in matters before the Federal Trade Commission.