

BOSTON COLLEGE INDUSTRIAL AND COMMERCIAL LAW REVIEW

VOLUME XIII

DECEMBER 1971

NUMBER 2

THE LABOR LAW ASPECTS OF FRANCHISING

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"Franchising"¹ as a marketing technique has increased significantly in the past two decades. Used predominantly by the automobile industry in the early part of this century,² franchised outlets now distribute a wide variety of goods and services ranging from soft ice

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¹ The attempts to define "franchising" are unending. In combination, they do indicate the outer boundaries of the territory surveyed in this article. For example: "[T]he definition [of franchising] has broadened to include 'any contract under which independent retailers or wholesalers are organized to act in concert with each other or with manufacturers to distribute given products or services.' Typically, the franchisee agrees to operate his business within certain prescribed limitations and in keeping with agreed-on buying and merchandising programs." Hall, *Franchising—New Scope for an Old Technique*, 42 *Harv. Bus. Rev.* 60, 62 (Jan.-Feb. 1964).

"At one extreme . . . [franchising] is a simple grant from one party to another to sell the granting party's goods. At the other extreme, a franchise relationship is a comprehensive business arrangement in which the franchisor licenses his trade name and trademark; [sic] imparts, in confidence, his know-how, and on a continuing basis, provides guidance and details concerning the precise manner in which the franchisee must operate his establishment." Report of Ad Hoc Committee on Franchising, in *The Franchising Sourcebook* 561, 564 (J. McCord ed. 1970) [hereinafter cited as *Report of Ad Hoc Committee*]. In the bill proposed by Senator Hart to confer rights on franchisees, a "franchise" was defined as "a contract, agreement, or understanding between two persons that involves a continuing commercial relationship between them and that grants to one person, . . . 'the franchisee', the right to offer, sell, and distribute goods, services or commodities manufactured, processed, distributed or (in the case of services) organized and directed by the other person, . . . called 'the franchisor' . . ." Hearings on S. 2507 and S. 2321 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess., 5 (1967) [hereinafter cited as 1967 Hearings].

Others define a franchise as "a grant by a manufacturer to a distributor to deal in the manufacturer's goods, usually within a designated territory and through a written document." *Id.* at 131. Still another definition is that a franchise is "a license with ownership rights . . . intended to be a permanent arrangement." *Id.* at 153. It may well be true that "[t]he term 'franchise' as used in the business world, has been applied so indiscriminately, and to such diverse business arrangements, as to defy consistent definition." *Id.*

² See C. Hewitt, *Automobile Franchise Agreements* (1956), for a thorough history and analysis of the use of franchising in the automobile industry.

cream to executive recruitment.³ While precise statistics are unavailable, it has been estimated that franchises account for ten percent of the gross national product and twenty-five percent of all retail sales.⁴ Although franchising has been enthusiastically acclaimed by the business community,⁵ its increased use has spawned a plethora of legal problems. Questions have been raised concerning the legality of certain of its aspects in light of antitrust laws,⁶ securities regulations,⁷

³ See Lewis and Hancock, *The Franchise System of Distribution* 85-87 (Univ. of Minnesota 1963), reprinted in *Hearings on S. Res. 40 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 89th Cong., 1st Sess., pt. 1, 279, 371-73 (1965) [hereinafter cited as *Lewis and Hancock, 1965 Hearings*].

⁴ 1967 *Hearings*, supra note 1, at 1. These statistics, used by Senator Hart, as well as virtually all other figures and percentages quoted to celebrate or condemn franchising, apparently represent educated guesses: the reader is rarely guided to a primary source by their users. For example, Jerome Fels, Associate Editor of the *International Franchise Association Legal Bulletin*, has suggested that the number of franchise outlets in this country exceeds 450,000. In support of his figures, he cited an article by Zeidman, *Antitrust Aspects of Franchising*, 45 Mich. St. B.J. 27 (1966). Zeidman was then general counsel to the Small Business Administration. Fels, *Franchising; Legal Problems and the Business Framework of Reference—An Overview*, in *The Franchising Sourcebook* 1, 2, note 3 (J. McCord ed. 1970) [hereinafter cited as *Fels*].

Another source cited by Fels, the editors of *Modern Franchising*, reported in 1968 that an unnamed director of "a substantial franchising organization" had stated in a seminar that "[f]ranchising is a \$70 billion business" that it was responsible for 25% of all retail sales through more than 500,000 dealers, and was growing at the rate of \$15 billion a year. *Id.* at 2 note 4. Other commentators, however, without revealing their sources, note that \$50 billion represents sales by automobile dealers and gasoline service station operators. Report of Ad Hoc Committee, supra note 1, at 565-66. See also Lewis and Hancock, 1965 *Hearings*, supra note 3, at 373, for detailed figures on the volume of business generated by franchised car dealers and gasoline service station operators.

The major problem faced by both popular commentators and scholars lies in the impreciseness of the term "franchising." See note 1 supra. For a discussion of the general problems involved in gathering accurate statistics, see Bond, *Franchise Statistics: Their Uses and Abuses*, in *Franchising Today* 44 (C. Vaughn ed. 1969).

⁵ "The dynamic growth of franchising during the last two decades is ample testimony to its legitimacy. . . . Not only has franchising proved to be a superior method to distribute goods and services, it has also proven to be the last frontier of the small businessman." Remarks of Robert M. Rosenberg, President of Dunkin' Donuts of America, Inc., 1967 *Hearings*, supra note 1, at 177. "Thus, franchising will truly emerge as the model citizen in what has been described by John Kenneth Galbraith as the 'new industrial state.'" Statement of Jerome Shuman, associate professor, Howard Univ. Law School, *id.* at 356. See also Lewis and Hancock, 1965 *Hearings*, supra note 3, at 371-78.

⁶ The antitrust problems generated by franchising are several. The territorial restrictions frequently included in franchise agreements, whereby a franchisee is licensed as the exclusive dealer in a given geographical market, at the same time being prohibited from intruding into other franchisees' territories, have been considered by the Supreme Court in two important cases: *White Motor Co. v. United States*, 372 U.S. 253 (1963), and *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967). In *White* the Court indicated that it would apply the "rule of reason" to determine the legality of territorial restrictions in a vertical arrangement under Section 1 of the Sherman Act. 372 U.S. at 263. In *Schwinn* the Court held that Schwinn's territorial and customer restraints were "unreasonable without more" because of their adverse effect on competition. 388 U.S. at 379. However, while holding that post-sale restraints will almost invariably be found illegal in the ordinary purchase-sale distribution scheme, the Court did indicate that restrictions

are permissible where the manufacturer or seller retains ownership of the goods consigned to his distributors. *Id.* at 382.

Customer restrictions, through which the franchisor often carves out institutional consumers from the franchisees' geographical entitlement for his own exploitation and profit, were also involved in *White* and *Schwinn* and were condemned by the Court in *Schwinn*. *Id.* at 379.

Horizontal territorial allocations made through the instrumentality of a trademark licensor were struck down by the Court in *United States v. Sealy, Inc.*, 388 U.S. 350 (1967), where the allocations were part of horizontal price fixing agreements. But it should be noted that neither *Schwinn* nor *Sealy* condemned the ordinary quality-control restriction placed by trademark licensors on licensees to protect the marks. This is an important point because many franchising arrangements involve trademark and service mark licensing. See Report of Ad Hoc Committee, *supra* note 1, at 588; see also McCarthy, *Trademark Franchising and Antitrust: The Trouble with Tie-Ins*, 58 Calif. L. Rev. 1085 (1970).

A combination between a newspaper company and its dealers to fix maximum prices was held illegal per se in *Albrecht v. Herald Co.*, 390 U.S. 145 (1968). See also *Temperato v. Horstman*, 321 S.W.2d 657 (1959), where an agreement between a franchisor and franchisee giving the franchisor the authority to set retail prices was held violative of Missouri antitrust law.

Cases involving tying arrangements in the franchise context have been rare since, under franchise contracts, products are usually sold as part of a total package. See, e.g., *Susser v. Carvel Corp.*, 332 F.2d 505 (2d. Cir. 1964), cert. denied, 381 U.S. 125 (1965). Although the court of appeals rested its holding that the defendants had violated neither § 3 of the Clayton Act nor § 1 of the Sherman Act by requiring franchisees to purchase ice cream mix and supplies from designated sources on the absence of proof of market dominance, the district court had indicated that the designation of sources was imposed on the franchisees solely to protect the good will and trademark of Carvel. *Susser v. Carvel Corp.*, 206 F. Supp. 636, 645 (S.D.N.Y. 1962). But cf. *Fortner Enterprises, Inc. v. United States Steel Corp.*, 394 U.S. 495 (1969); see also *Siegel v. Chicken Delight, Inc.*, 311 F. Supp. 847 (N.D. Cal. 1970) where the court found that an arrangement requiring franchisees to buy packaging items, cookers and fryers, and certain mix preparations from the franchisor was a tying agreement in violation of Section 1 of the Sherman Act. The court accepted the possibility that the tying might be necessary to protect the good will of the trademark, but the jury found, in a special verdict, that the particular requirement had not been justified by the franchisor. It should also be noted that in *Siegel* the franchisor himself sold the franchisees the tied supplies, while in *Susser* the franchisor merely designated acceptable sources of supply.

Problems involving exclusive selling, exclusive buying, territorial restrictions and quality controls have also arisen under the Federal Trade Commission Act. For an excellent general discussion of legal problems faced by franchisors and franchisees under the Act, see Report of Ad Hoc Committee, *supra* note 1.

Specific antitrust issues arising with respect to pricing and promotional activities of franchisors, as well as the dangers of dual distribution used by some franchisors, are discussed in the context of the Robinson-Patman Act in McCord, *Applicability of the Price and Promotional Provisions of Robinson-Patman and the Antitrust Implications of Dual Distribution in the Franchising Context*, *The Franchising Sourcebook* 471 (J. McCord ed. 1970).

On the general antitrust issues raised by franchising, see Jones, *The Growth and Importance of Franchising and the Role of Law*, 12 *Antitrust Bull.* 717 (1967); Keck, *Alternative Distribution Techniques—Franchising, Consignment, Agency, and Licensing*, 13 *Antitrust Bull.* 177 (1968); McLaren, *Marketing Limitations on Independent Distributors and Dealers—Prices, Territories, Customers, and Handling of Competitive Products*, 13 *Antitrust Bull.* 161 (1968).

⁷ The first question that arises under the Securities Act of 1933, 15 U.S.C. §§ 77a et seq. (1970), is whether a franchise is a "security." Only a few decisions have discussed this issue and none of them has squarely answered it. See *SEC v. W. J. Howey Co.*, 328 U.S.

the Lanham Act,⁸ the Uniform Commercial Code,⁹ state agency laws¹⁰ and the federal tax code.¹¹ These issues have received the careful attention of lawyers and scholars and the scrutiny of congressional committees.¹²

Relatively little attention, however, has been directed to legal issues raised by franchising and related distribution systems under federal labor law. This lack of interest is probably attributable to the relatively limited number of cases that squarely present labor law

293 (1946); Tucker Corp., 26 S.E.C. 249 (1947); *Belhumeur v. Dawson*, 229 F. Supp. 78 (D. Mont. 1964); see also Coleman, A Franchise Agreement: Not a "Security" Under the Securities Act of 1933, 22 Bus. Law. 493 (1967); Goodwin, Franchising in the Economy: The Franchise Agreement as a Security Under Securities Acts, Including 10b-5 Considerations, 24 Bus. Law. 1311 (1969).

The more worrisome problem for the franchisor is his potential liability under the vastly expanded antifraud provisions of 10b-5 for the misrepresentations of his security-issuing franchisee. See *id.* at 1321-24. No case has yet raised this issue. For a discussion of possible problems arising under one state's "blue sky" laws, see Note, Franchise Regulation Under the California Corporate Securities Law, 5 San Diego L. Rev. 140 (1968).

⁸ 15 U.S.C. §§ 1051 et seq. (1970); see, e.g., *McDonald's Corp. v. Moore*, 363 F.2d 435 (5th Cir. 1966); *Burger King of Florida, Inc. v. Brewer*, 244 F. Supp. 293 (W.D. Tenn. 1965); Treese, Trademark Licensing and Vertical Restraints in Franchising Arrangements, 116 U. Pa. L. Rev. 435 (1968).

⁹ Hewitt, Termination of Dealer Franchises and the Code—Mixing Classified and Coordinated Uncertainty with Conflict, 22 Bus. Law. 1075 (1967). See also Note, Article Two of the Uniform Commercial Code and Franchise Distribution Agreements, 1969 Duke L.J. 959 (1969).

¹⁰ A representative sampling of the problems that may arise regarding contract and tort liability under state statutes and common law is presented in the "Arthur Murray" series of cases: *People v. Arthur Murray, Inc.*, 238 Cal. App. 2d 333, 47 Cal. Rptr. 700 (1965); *Beck v. Arthur Murray, Inc.*, 245 Cal. App. 2d 976, 54 Cal. Rptr. 328 (1966); *Nichols v. Arthur Murray, Inc.*, 248 Cal. App. 2d 610, 56 Cal. Rptr. 728 (1967); *Porter v. Arthur Murray, Inc.*, 249 Cal. App. 2d 410, 57 Cal. Rptr. 554 (1967). The California courts have used several theories to find an agency relationship in order to determine the liability of the franchisor for the contractual obligations of franchisees under California's Dance Act: the ostensible agency relationship created by a failure to disclaim an agency relationship (*Beck*), the aiding and abetting by the franchisor of the franchisee's illegal acts (*People*), and the de facto controls retained by a franchisor as an undisclosed principal of the franchisee (*Nichols* and *Porter*).

¹¹ The issue of a franchisor's legal relationship with his franchisee arises in connection with the Internal Revenue Code in determining whether a franchisee is an employee of the franchisor for the Federal Insurance Contributions Act, Int. Rev. Code of 1954 §§ 3101 et seq.; the Federal Unemployment Tax Act, Int. Rev. Code of 1954 §§ 3301 et seq.; and the withholding provisions, Int. Rev. Code of 1954 §§ 3401 et seq. See also the detailed regulations dealing with specific classes of employees, Treas. Reg. § 31.401(c) (1957), and employers, Treas. Reg. § 31.3401(d), (1957), for purposes of the withholding provisions. The basic test is stated in Treas. Reg. § 31.3401(c)-1(b) (1957) as follows:

Generally the relationship of employer and employee exists when the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work but also as to the details and means by which the result is accomplished. . . . [I]t is not necessary that the employer actually direct or control the manner in which the services are performed; it is sufficient if he has the right to do so.

¹² *Lewis and Hancock*, 1965 Hearings, *supra* note 3; 1967 Hearings, *supra* note 1.

problems arising from "true franchising."¹³ To some extent the paucity of litigation is due to the failure of the National Labor Relations Board (NLRB) and the courts to recognize franchising as a distinct type of business association. Consequently, many cases actually involving franchising are not differentiated from those involving other business associations.

This is not to say, however, that a wide range of labor issues has not arisen in the field of franchising. On the contrary, the problems arising in this type of business activity have run the gamut of ordinary labor law issues. Franchisors have refused to recognize unions,¹⁴ violated employees' rights,¹⁵ discriminatorily terminated employees¹⁶ and failed to bargain in good faith.¹⁷ Not surprisingly, they have in turn been picketed¹⁸ and struck.¹⁹

However, it is not the purpose of this article to discuss the problems which franchisors have in common with other employers; rather, its main concern is to consider those labor law issues which have significant implications in the franchising field. Particular emphasis will be placed on the question of the applicability of the National Labor Relations Act (NLRA) to the franchise relationship.

The thesis of the article is that although the NLRA is properly applicable to the franchise relationship, in many instances, the concepts of Agency law upon which the NLRB primarily relies to determine its jurisdiction over various types of franchises do not adequately reflect the economic realities of modern franchising relationships. A more realistic approach would require the Board to measure the legal significance of the franchisor-franchisee relationship in economic terms. The determination of whether a franchisee is an employee of the franchisor should be made on the basis of the franchisee's capital investment and on his freedom to assign his investment interest for a profit, rather than on the quantum of managerial control retained by the franchisor. The question of whether a franchisor is the joint employer of the franchisee's employees should turn on the continuing financial involvement

¹³ "True franchising" is a phrase usually reserved for those arrangements which involve the licensing by a franchisor of a total marketing system, including the product or service, to a franchisee. The "true franchise" system is represented by "fast food" enterprises such as McDonald's Hamburgers, Howard Johnson restaurants, Chicken Delight, Dunkin' Donuts, and Dairy Queen.

¹⁴ *U-Tote M of Oklahoma, Inc.*, 172 N.L.R.B. No. 21, 68 L.R.R.M. 1393 (1968).

¹⁵ *Id.*

¹⁶ *Manley Transfer Co., Inc.*, 164 N.L.R.B. No. 21, 65 L.R.R.M. 1194 (1967) *enfd* 390 F.2d 777 (8th Cir. 1968).

¹⁷ *Ramanda Inns, Inc.*, 171 N.L.R.B. No. 115, 68 L.R.R.M. 1209 (1968).

¹⁸ *Seven-Up Bottling Co. v. Soft Drink Distributors Ass'n*, 73 L.R.R.M. 2158 (N.Y. Sup. Ct. 1969).

¹⁹ *Carpenters, Local 2265 (Carpet Center, Inc.)*, 170 N.L.R.B. No. 93, 67 L.R.R.M. 1557 (1968).

of the franchisor and the power he has to protect this interest by direct or indirect means, rather than on the franchisor's right to control the labor relations of the franchisee.

I. THE FRANCHISE ARRANGEMENT

Franchising is not an industry; it is a multi-level marketing technique employed by many different businesses, each with unique technology, marketing opportunities and problems.²⁰ While the reasons for its usage vary considerably, franchising is most often adopted by companies interested in increasing sales but lacking the capital and sales outlets to attempt a major program of growth and expansion.²¹ Through the use of franchising, the expansion-minded enterprise can both enlarge its capital base—by charging initial franchising fees—and increase its sales income—by providing an additional outlet for its goods or services—while at the same time ensuring close, enthusiastic supervision of the retail outlet by profit-motivated franchisees. Thus, the franchise technique affords a possible cure for the problems which frequently plague small business enterprises—inadequate capitalization and poor middle-management personnel.²²

The heart of the franchise method of distribution is the symbiotic relationship between the franchisor and franchisee. The franchisee's investment in the franchise is a salient characteristic of this relationship.²³ As his investment increases, the franchisee more closely resembles an independent businessman and the franchise arrangement, a vendor-vendee relationship. But the franchisee is not merely a ven-

²⁰ Statement of Robert Rosenberg, President of Dunkin' Donuts of America, Inc., 1967 Hearings, *supra* note 1, at 177.

²¹ Lewis and Hancock, 1965 Hearings, *supra* note 3, at 300.

²² *Id.* at 300-01. "Generally, the failure of a small business in the early stages is attributable to poor location, inadequate financing, poor products, inadequate sales representations, and other technical problems. However, as the firm expands, the major problem of survival is management ineptitude. . . ." Basil, *Managerial Problems of the Enterprise*, A Symposium on Small Business, 18 Vand. L. Rev. 1733, 1745-46 (1965).

²³ The amounts invested by franchisees vary considerably, depending upon the type of product or service distributed, the location, the potential sales volume and the success of related franchisees. Lewis and Hancock state that the capital requirements of franchisees vary from less than \$1,000 to over \$100,000, and can even vary considerably within the same franchise organization "depending on the scale of operations which the franchisee wishes to establish." Lewis and Hancock, 1965 Hearings, *supra* note 3, at 307. See also 1967 Hearings, *supra* note 1: Robert Half Personnel Agencies—total cost of \$7,500, initial payment of \$2,500, *id.* at 154; Dunkin' Donuts—total investment of \$13,000, *id.* at 178.

The amount of control over the investment will also vary according to the particular franchise agreement. For example, some agreements allow the franchisor to terminate on 30 days' notice and "become the absolute owner" of the tangible property used in the franchise. Lewis and Hancock, 1965 Hearings, *supra* note 3, at 351. Other agreements provide for cancellation on cause and require repayment for the depreciated value of all equipment taken. *Id.* at 350. The agreements also have different approaches to the alienability of franchisees' interests, varying from outright prohibitions of any assignment, to a requirement that the franchisee obtain the franchisor's prior agreement. *Id.* at 349.

dor for the goods or services provided by the franchisor; he implements a whole integrated system designed to market successfully the franchisor's products or services. Consequently, the franchisor insists upon a continuing managerial relationship to ensure that his system of doing business is effectively executed by the franchisee.²⁴ As the degree of his managerial control increases, the franchisee begins to resemble an employee and the franchise arrangement, an employment relationship. This combination of franchisor control and franchisee investment is the distinctive characteristic of the franchise relationship. The degree to which each of these factors is present in a particular franchise depends largely upon the needs and desires of the franchisor; these needs and desires are in turn reflected in the terms of the franchise agreement. Since these terms also provide, in part, the factual basis which determines the applicability of the NLRA, an examination of the formation of the franchise and the franchise agreement will assist in the succeeding analysis of labor law problems.

The initial step in the creation of a franchise is the perfection of a "distribution package" by a manufacturer or wholesaler, either through trial and error or through collaboration with a consulting team. After the distribution package is developed, suitable candidates are recruited and selected as franchisees and an agreement is negotiated detailing the mutual rights and obligations of the parties. The negotiations are dominated by the franchisor; typically, the prospective franchisee has no alternative but to accept or reject the proposed franchise contract. Although the franchisee is free to consult an attorney, the latter is rarely in a position to negotiate substantial changes in the agreement and usually can do little more than explain the legal implications of the contract. Most franchisors realize that it would create a dangerous precedent to fashion their agreements to the individual needs and talents of each franchisee.²⁵

²⁴ A typical franchise agreement provides that:

Licensee shall not dispense, sell or offer for sale in his store at said location, under the trade name "Dari-Delite," or related trade-marks, or otherwise, any item or product that does not conform to such standards and specifications of proportions, appearance, quality, coloring, flavoring or other ingredients or characteristics as from time to time may be prescribed by Dari in writing or otherwise to Licensee. . . . Licensee shall purchase all fixtures, equipment, foods, beverages and supplies . . . from such suppliers as are designated by Dari from time to time to be qualified suppliers for all Dari-Delite operations in the same general area in which Licensee is located.

Lewis and Hancock, 1965 Hearings, *supra* note 3, at 322-23.

²⁵ C. Rosenfield, *Organizing and Advising Small Florida Businesses*, ch. 22 (Florida Practice Manual No. 10, 1969) [hereinafter cited as Rosenfield]. "The terms and conditions of the franchise agreement are inviolate. The franchise company cannot make changes or concessions for one dealer and not for others. . . . The stringent adherence to a single contract is . . . an indication of the strength and philosophy of the franchisor. Weakness

The standard franchise agreement covers a variety of matters, but the important clauses of the contract which structure the franchise relationship may be summarized and described as follows:

(1) *Property rights in the franchise.*—One or more clauses describe the terms upon which various kinds of tangible and intangible property involved in the enterprise are licensed, leased, sold or consigned to the franchisee.²⁶

(2) *Duration of the contract.*—The contract may run from one month to twenty years, although most contracts extend for a period of one year with an option to renew. The shorter period is preferred by franchisors because it allows an adjustment of fees, charges and royalties according to varying market conditions.²⁷

(3) *Territorial restrictions.*—In some industries and geographical areas, the assurance of an exclusive territory is an effective, perhaps necessary, inducement to persuade the franchisee to risk what is, for him, a substantial investment. The right to operate without competition in a given territory invariably involves a corresponding obligation to respect the exclusive territories assigned to other franchisees. Territorial restrictions also allow the franchisor to achieve maximum market saturation for his product.²⁸ In the case of "single

through change indicates a company who will submit to later acts of coercion by its dealers." *Id.* at § 22.27.

²⁶ In the "Mister Donut" Dealer Franchise Agreement, for example, clause 1 states: "The Company hereby grants unto the Dealer and the Dealer hereby accepts a franchise as a Mister Donut dealer at the Dealer's premises . . . with the right to use . . . the Company's trade names, trade-marks, insignias and the design and color scheme of Mister Donut Shops and their accessories, together with the Company's doughnut and other formulae, and the Company's production, advertising and merchandising methods . . ."

Clause 15 provides: "Upon the termination of this agreement for any cause, the Dealer shall immediately discontinue the use of all trade names, trademarks, signs, structures and forms of advertising indicative of Mr. Donut, its symbols or trademarks or its business or products." H. Kursh, *The Franchise Boom*, 207-08, 213 (1962).

Most franchise agreements between parties in the service sponsor-retailer category contain similar clauses. See, for example, the numerous franchise agreements in Lewis and Hancock, 1965 Hearings, *supra* note 3, at 401-55. Some franchise agreements make the franchisee a lessee of the premises, subject to eviction upon termination of the franchise; see Rosenfield, *supra* note 25, § 22.45.

Since the Supreme Court's decision in *United States v. Arnold, Schwinn & Co.*, 388 U.S. 365 (1967), more franchisors may be desirous of retaining title to merchandise distributed through the franchisee in order to avoid possible antitrust violations.

²⁷ See Rosenfield, *supra* note 25, § 22.30.

²⁸ See, e.g., the territorial assignment clause used by Whitehill Systems, Inc., with one of its dealers:

The DISTRIBUTOR'S territory shall be confined to:

Fairfield county in its entirety within the State of Connecticut. Plus, all that area within the County of Westchester, lying east of Route 22, commencing at the Bronx County line and running in a northerly direction to the Putnam County line within the State of New York.

Lewis and Hancock, 1965 Hearings, *supra* note 3, at 419.

... The problem of writing exclusive territorial grants into franchise agreements raises

distributor" franchises, the franchisor's power over territory is expressed in terms of his authority to control the location and size of a geographic segment or route. The power may include the right to reevaluate periodically the franchisee's routes and to require the franchisee to purchase additional equipment or else face a reduction in the route.²⁹

(4) *Financial obligations of the franchisee.*—The franchisee is required to pay franchise fees,³⁰ royalty payments—generally expressed as a percentage of gross sales,³¹ minimal supply orders—usually requiring the franchisee to make a certain quantum of purchases at fixed or unilaterally determined prices,³² rental payments, property and liability insurance premiums³³ and fees for continuing services provided by the franchisor, such as bookkeeping and advertising.³⁴

(5) *Standards for the conduct of the franchise.*—Prescribed standards may be set forth in the agreement, but more often they are incorporated by reference into a "policy manual" published by the franchisor.³⁵ The manual may be general, perhaps containing useful suggestions for the general operation of the business; on the other hand, it may be meticulous in detail, describing every operation and process involved in the conduct of the franchise.³⁶ The standards covered in the policy manual often include such diverse matters as the hours of required operation³⁷ and the proportions to be used in preparing batter for broiled chicken.³⁸ The agreement

delicate legal problems for the franchisor. Fortunately there is no dearth of literature on the practical and legal problems generated by territorial restraints. Most of the literature is a gloss on the Supreme Court's decisions in the *White*, *Schwinn* and *Sealy* cases, note 6 supra.

²⁹ See, e.g., *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966), where the franchisor not only assigned an original route but also retained the right to reevaluate the route after two years and to require the franchisee to purchase another truck or to reduce the route.

³⁰ Van Cise, *A Franchise Contract*, in *The Franchising Sourcebook* 95, 100-01 (J. McCord ed. 1970) [hereinafter cited as *Van Cise*].

³¹ *Id.* at 108-09.

³² *Lewis and Hancock*, 1965 Hearings, supra note 3, at 417. See also *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966), where the franchisor required the franchisee to purchase a certain number of gallons of ice cream mix each year, to prod the franchisee to maximize sales.

³³ *The Dog House, Inc., Operator's Agreement*, §§ 8 and 9, *Lewis and Hancock*, 1965 Hearings, supra note 3, at 409.

³⁴ *Duraclean Dealership Franchise Agreement* § 8, *Lewis and Hancock*, 1965 Hearings, supra note 3, at 423. See also *Southland Corp.*, 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582-83 (1968).

³⁵ *Van Cise*, supra note 30, at 103.

³⁶ *Id.* See also *Southland Corp.*, 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582, 1583 (1968).

³⁷ *Lewis and Hancock*, 1965 Hearings, supra note 3, at 321.

³⁸ *Id.* at 322.

may also require the franchisee to purchase his supplies from specified sources. The designation of supply sources reflects the franchisor's interest in ensuring quality control of the product sold under his trademark. A product of consistent quality is necessary for the protection of the investment in the franchise system, and a monitoring of this quality is necessary both to preserve trademark rights and to avoid charges of deceptive trade practices.³⁹

(6) *Rights of assignment.*—The franchisor will usually restrict the franchisee's right of assignment, often retaining a right of first refusal on any bona fide offer, as well as requiring prior approval of a prospective assignee. Provision may also be made for a sale or buy-back in the event the franchisee dies during the agreement.⁴⁰ The restrictions on assignment are usually justified by the franchisor's continuing financial interest in the enterprise. Furthermore, to the extent that the consuming public relies on the quality symbolized by the licensed trademark, other franchisees of the same product lines need to be protected against the possibility of an assignment of a franchise to an unqualified franchisee.

(7) *Termination.*—Most franchise agreements permit the franchisor to terminate the agreement if the franchisee defaults on any payment due, or breaches any other provision of the agreement.⁴¹ Occasionally, a franchisee will be given a corresponding right in the event of the franchisor's breach.⁴² A substantial percentage of franchise contracts permits either party to terminate the relationship for any reason after thirty days' notice;⁴³ a smaller percentage provides a method for computing the value of the franchisee's interest in the event the agreement is terminated.⁴⁴

Clearly, the specific terms of a franchise agreement determine,

³⁹ *Dawn Donut Co. v. Hart's Food Stores, Inc.*, 267 F.2d 358 (2d Cir. 1959): See sources cited in note 8 *supra*.

⁴⁰ *Van Cise*, *supra* note 30, at 110-12. A typical clause reads as follows:

This Agreement is personal to Licensee and none of Licensee's interest herein nor rights hereunder may be transferred, conveyed or assigned by Licensee whether by operation of law or otherwise; provided that if Licensee shall at any time desire to sell Licensee's Vehicle Renting Business, Licensee may, with the prior written consent of Hertz, assign to the purchaser of such Vehicle Renting Business all of the interest of Licensee in and under this Agreement. Hertz expressly agrees that it will not unreasonably withhold such consent.

Lewis and Hancock, 1965 Hearings, *supra* note 3, at 349.

⁴¹ See "Dealer Lease" between Shell Oil Co. and R.A. Davies, ¶ 9, 1967 Hearings, *supra* note 1, at 61.

⁴² *Van Cise*, *supra* note 30, at 113. The author notes, however, that the franchisee is often required to obtain a substitute franchisee or to covenant not to reenter a comparable business during a reasonable period of time.

⁴³ See *Midas, Inc. Franchise* ¶ 5(a), *Lewis and Hancock*, 1965 Hearings, *supra* note 3, at 405.

⁴⁴ See *Snap-On Tools Corp. Dealer Agreement* ¶ 10-13, *Lewis and Hancock*, 1965 Hearings, *supra* note 3, at 458-59.

to a large extent, the degree of control imposed by the franchisor and the amount of investment required of the franchisee. As the contract terms and financial arrangements vary according to the unique requirements of different franchise programs, so does the power relationship between the franchisor and the franchisee. Given the infinite variations possible on the theme of multiple-level distribution devices, it is not surprising that commentators have found it difficult to place franchising on the spectrum of traditional market relationships—to distinguish it from the ordinary vendor-vendee relationship at the one end, and the employer-employee relationship at the other.⁴⁵

The difficulty of classifying franchise relationships is well illustrated by the fast-food industry. This industry has combined traditional methods of doing business into a unique pattern that cannot adequately be described by traditional terminology. Although there is mutual investment of capital and joint responsibility for the operation of the outlet, the franchisor and franchisee are not technically "joint venturers";⁴⁶ nor is the franchisee merely an exclusive distributor of the franchisor-seller, since the franchisor distributes a way of doing business as much as he does a product.⁴⁷ Neither is the franchisee simply a trademark licensee—although the licensing of a trademark is an important feature of franchising in the fast-food industry—since the franchisor is involved in the enterprise to an extent greater than is necessary to police the use of his trademark.⁴⁸ Given the sometimes substantial financial investment of the franchisee, and his own employment of employees, the relationship is not quite that of employer-employee.⁴⁹ Thus, while a franchise arrangement

⁴⁵ See note 1, *supra*.

⁴⁶ The joint venture connotes a "more equal" partnership than that created by the usual franchise agreement. In some situations the franchisee might bring sufficient capital and expertise to the business to justify viewing him as a joint venturer. However, the franchisee usually does not bring a proven competency, but rather, a capacity for learning which is utilized by the franchisor.

⁴⁷ "The sound franchisor grants a franchisee contractually limited use of a proven trademark, good will and know-how, including use of trade secrets and copyrights, access to a pre-sold market developed by him for an established business, product and/or service, system-wide promotion, proven standardized operating procedures, product and service research and mass purchasing power." Fels, *supra* note 4, at 4.

⁴⁸ The Lanham Act, 15 U.S.C. §§ 1051 et seq. (1970), provides for cancellation of a trademark if the owner abandons it. "Abandoned" is defined to include any act or omission by the registrant which causes the trademark to lose its significance as an indication of origin. 15 U.S.C. § 1127(b) (1970). Although § 1055 of the Act protects use of the trademark by "related companies," which would certainly include franchisees, see *Turner v. HMH Publishing Co., Inc.*, 380 F.2d 224 (5th Cir. 1967), cert. denied, 389 U.S. 1006 (1967), the statute provides that the registration may be cancelled if the owner fails to police the use of his mark. 15 U.S.C. § 1064(e) (1970). See *Dawn Donut Co., Inc. v. Hart's Food Stores Inc.*, 267 F.2d 358 (2d Cir. 1959). It is certainly not necessary, however, to maintain the close supervision and economic control characteristic of franchisors' relationships with franchisees in order to protect a trademark.

⁴⁹ See generally, Part II, *infra*.

may be similar to one or more traditional business associations, neither its eclectic nature nor its economic imperatives can be accurately described by traditional concepts.

Nonetheless, since many franchisees are so closely controlled by their dominant franchisors that the relationship strongly resembles the traditional employment relationship, it is not surprising that the franchisees who bear the strongest resemblance to the conventional employee—the single distributors—are often the subject of union organizational drives. Even where franchisees invest a significant amount of capital and employ large numbers of employees—for example, in fast-food outlets, car rental agencies, bottling plants or personnel agencies—the contractual lines of control held by the franchisor are often so taut that it is difficult to distinguish the franchisee from an employee-supervisor; or, assuming he is not a supervisor, to account for the franchisor's very active management role. Because franchising permits almost as much control as does the employment relationship, employers often adopt franchising in order to retain the advantages but to escape the obligations of an employment relationship. Thus, the inherent characteristics of the franchise arrangement which account for its appeal as a method of distribution are also the sources of labor law issues.

The threshold question, which will be discussed in Part II, is whether, and in what way, the National Labor Relations Board will assert jurisdiction⁶⁰ over the parties to the franchise agreement. The answer to that question will depend upon how the Board characterizes the relationship between the franchisor, the franchisee and, where applicable, the franchisee's employees. The Board has available a number of options, depending upon its interpretation of the franchise agreement: 1) where the issue involves a single distributor franchisee, the franchisee may be defined either as an independent contractor—

⁶⁰ "Jurisdiction" is used here in the sense of the Board's statutory authority to subject one or all of the parties involved in a particular franchise to the substantive provisions of the Act—i.e., to permit certain persons defined as "employees" to vote in a Board supervised representation election, or to issue a complaint alleging an unfair labor practice against a person defined as an employer. The power involved would be analogous to the "in personam" jurisdiction of a state or federal court.

The Board's jurisdiction may also be defined in terms of the limitations placed on its power by its enabling legislation, the commerce clause of the United States Constitution. The Board can only assert power over persons or disputes involved in interstate commerce.

Finally, the Board's jurisdiction may be viewed in terms of its "monetary jurisdiction"—the self-imposed limitations on its "commerce power" which require that different classes of enterprises satisfy different "jurisdictional yardsticks" before the Board will assert power over them. See A. Cox and D. Bok, *Cases and Materials on Labor Law* 1167-68 (7th ed. 1969) for a summary statement of the "yardsticks."

When used in this article, the term "jurisdiction" will ordinarily refer to the "in personam" jurisdiction of the Board as described above. The term "monetary jurisdiction" will be used to describe the limitations imposed by the jurisdictional yardsticks.

thus defeating the Board's jurisdiction—or as an employee of the franchisor; 2) where the issue involves a franchisee who employs additional personnel, he may be characterized as a supervisory-employee of the franchisor, a joint employer with the franchisor, or an independent contractor.

The "option" selected by the Board—that is, the manner in which it characterizes the relationship of the parties to the franchise agreement in the course of its jurisdictional determination—will, to a great extent, determine the resolution of various substantive labor issues relevant to the franchise association. The significant implications of the Board's jurisdictional determinations will be discussed in Part III.

II. APPLICABILITY OF THE NLRA TO THE FRANCHISE ARRANGEMENT

A. *Jurisdiction of the NLRB: General Considerations*

In the preamble to the National Labor Relations Act,⁵¹ Congress observed that "[t]he denial by some employers of the right of employees to organize and the refusal by some employers to accept the procedure of collective bargaining" had led to industrial strife.⁵² In addition, Congress found that "[t]he inequality of bargaining power between employees who do not possess full freedom of association or actual liberty of contract, and employers who are organized in the corporate or other forms of ownership association" had depressed wage rates and prevented "the stabilization of competitive wage rates . . . within and between industries."⁵³ To eliminate these obstructions to commerce, Congress declared a national policy in favor of collective bargaining by protecting the workers' rights to self-organization and collective bargaining through representatives of their own choosing.⁵⁴

Although the political and economic objectives of the Act are impressively broad, the powers of the National Labor Relations Board are limited. The substantive terms of the Act grant the Board both the jurisdiction to determine representation questions involving the claim of a labor organization that it represents a majority of the employees of an employer, and the power to adjudicate and remedy unfair labor practice charges against employers or the representatives of employees.⁵⁵ The Board's jurisdiction, therefore, encompasses, and

⁵¹ 29 U.S.C. §§ 151 et seq. (1970).

⁵² 29 U.S.C. § 151 (1970).

⁵³ 29 U.S.C. § 151 (1970).

⁵⁴ 29 U.S.C. §§ 151, 157 (1970).

⁵⁵ The Board's jurisdiction over representation questions is conferred by § 9(c)(1), which authorizes the Board to investigate representation petitions, provides for appropriate

is limited to, problems emanating from the employment relationship. Interestingly enough, the Act does not comprehensively define either "employer" or "employee." Section 2 indicates that agents of employers are employers, and that certain classes of employers are to be excluded from the Act;⁵⁶ but the meaning of "employer" is assumed. In defining "employee," the NLRA carefully preserves the status of "employee" for individuals who have ceased work in connection with a labor dispute, but excludes certain classes of employees, as well as independent contractors, from the definition.⁵⁷ This inclusion-exclusion description, however, assumes agreement on the meaning of the term "employee."

Faced with congressional silence as to the precise meaning of these important terms, the Board early referred to a variety of sources, including common law agency principles, for definitions of the terms "employer" and "employee."⁵⁸ The common law speaks in terms of master-servant and independent contractor rather than in terms of employer-employee. The master-servant relationship has long been considered analogous to the employer-employee relationship; but whether an independent contractor should be considered an employee under the Act was problematic.⁵⁹ A servant, in common law parlance, is an agent "whose physical conduct in the performance of [services for which he is employed] is controlled or is subject to the

hearings and "direct[s] an election by secret ballot . . ." 29 U.S.C. § 159(c)(1) (1970). Jurisdiction over unfair labor practices, defined by section 8, 29 U.S.C. § 158 (1970), is conferred by section 10, which authorizes the Board to prevent unfair labor practices by investigating charges, issuing complaints, holding hearings, enjoining proscribed conduct and enforcing orders in federal courts of appeal. 29 U.S.C. § 160 (1970).

⁵⁶ 29 U.S.C. § 152(2) (1970).

⁵⁷ 29 U.S.C. § 152(3) (1970).

⁵⁸ The Board used the common law test as one source, see *Seattle Post-Intelligencer*, Dept. of Hearst Pub., Inc., 9 N.L.R.B. No. 119, 3 L.R.R.M. 386 (1938), but did not consider itself bound by common law concepts of the employment relationship; see *United Dredging Co.*, 30 N.L.R.B. No. 118, 8 L.R.R.M. 83 (1941), and defined the statutory term "employee" as including all employees in a legal and conventional sense, unless specifically excluded; see *The Park Floral Co.*, 19 N.L.R.B. No. 44, 5 L.R.R.M. 514, 515 (1940). However, in most of the early cases, the Board relied on the "right to control" test. See, e.g., *James E. Stark Co.*, 33 N.L.R.B. No. 186, 8 L.R.R.M. 315 (1941); *Long Lake Lumber Co.*, 34 N.L.R.B. 700, 9 L.R.R.M. 28 (1941); *S.H. Kress & Co.*, 34 N.L.R.B. 1152, 9 L.R.R.M. 65 (1941). On the basis of this test, the Board often found that the alleged employees were independent contractors. See *Red River Lumber Co.*, 5 N.L.R.B. 663, 2 L.R.R.M. 29 (1938); *Theurer Wagon Works, Inc.*, 18 N.L.R.B. No. 97, 5 L.R.R.M. 450 (1939).

⁵⁹ The problems involved in tracing the outer limits of the employment relationship have arisen in the determination of the applicability of modern social legislation. For example, the Restatement of Agency states: "In all of these acts [Labor Relation Act, Social Security Act, Unemployment Insurance Act, Minimum Wage Act and Fair Labor Practice Act] the terms employer and employee normally refer to the persons dealt with in the Restatement of this Subject under the heading of master and servant." Restatement of Agency, 2d at 3 (1957).

right to control by the master." An independent contractor is one over whom the only control reserved is control of the result sought.⁶⁰

The Board indicated in its early decisions that, in applying the common law formula to an individual case, it would look to the "purpose of the Act"⁶¹ to determine whether certain individuals were members of a group requiring the protection of the Act. In *Hearst Publications, Inc.*,⁶² the Board stated that "the primary consideration in the determination of the applicability of the statutory definition [of employee] is whether effectuation . . . of the Act comprehend[s] securing to the individual the rights guaranteed and protection afforded by the Act."⁶³ The Supreme Court approved and elaborated upon the Board's definitional approach in *NLRB v. Hearst Publications, Inc.*⁶⁴ Justice Rutledge articulated a well-reasoned rationale for the Board's decision in that case:

The mischief at which the Act is aimed and the remedies it offers are not confined exclusively to "employees" within the traditional legal distinctions separating them from "independent contractors." . . . [T]he broad language of the Act's definitions, which in terms reject conventional limitations on such conceptions as "employee," "employer," and "labor disputes," leaves no doubt that its applicability is to be determined broadly . . . by underlying economic facts rather than technically and exclusively by previously established legal classifications.⁶⁵

Congress reacted adversely to the Court's declared independence from common law criteria and amended the definition of "employee" specifically to exclude independent contractors.⁶⁶ It is clear from the congressional history explaining the amendment that the primary purpose of the exclusion was to restrict the Board to the common law agency definition of "employee."⁶⁷ A second purpose, inferable from congressional displeasure with the Board's specific decision in *Hearst*, was to indicate that individuals having the characteristics of "Hearst news vendors" should be defined as independent contractors.⁶⁸ Al-

⁶⁰ Id. at 12.

⁶¹ See *Veta Mines, Inc.*, 36 N.L.R.B. No. 52, 9 L.R.R.M. 151 (1941).

⁶² 28 N.L.R.B. No. 151, 7 L.R.R.M. 163 (1941).

⁶³ Id., 7 L.R.R.M. at 164.

⁶⁴ 322 U.S. 111 (1944).

⁶⁵ 322 U.S. at 126, 129.

⁶⁶ Labor Management Relations Act, 1947, Pub. L. No. 101, § 101-2(3), 61 Stat. 137-38, amending 29 U.S.C. § 152 (1946) (codified at 29 U.S.C. § 141 et seq. (1970)).

⁶⁷ H.R. Conference Rep. No. 510, 80th Cong., 1st Sess. reported in U.S. Code Cong. Serv. 1137-38 (1947); 93 Cong. Rec. 6441-42 (1947) (remarks of Senator Taft).

⁶⁸ The problem of the status of the Hearst newsboys has never been solved to the satisfaction of the Hearst chain. See *San Antonio Light Div., The Hearst Corp.*, 167

though the amendatory language did not necessarily foreclose the Board's use of the "mischief-remedy" test announced in *Hearst*, NLRB decisions subsequent to the Taft-Hartley Act apparently have deferred to the clear purpose of the Amendment. In cases raising the issue, the Board has announced somewhat repetitiously, and always in the same language, that the employer-employee status is determined by reference to the common law master-servant test.⁶⁹

B. *The Franchisee as Employee: Single Distributors*

Within the context of franchising, the status of the parties to a franchise agreement may be determined in either a representation or an unfair labor practice proceeding. In the larger franchise enterprises, the definitional problem usually lies in determining whether the franchisor is unrelated to the franchisee's employees, or whether he is a joint employer of them. In smaller franchise operations such as the single distributor enterprise, the question is whether the franchisee is an independent contractor or an employee of the franchisor. The Board's use of the "right to control" test to characterize the franchise relationship is well illustrated in *Mister Softee of Indiana*,⁷⁰ a fairly typical single distributor case.

In *Mister Softee*, a union filed a representation petition seeking an election among single driver-salesmen (but excluding multiple owner drivers) who distributed soft ice cream under franchise agreements with the alleged employer. Under the agreement the franchisee purchased a truck from the franchisor for use within an exclusive territory, the boundaries of which were unilaterally determined by the franchisor. The franchisor apparently licensed the franchisee to use the trademark "Mister Softee," and also agreed to supply him with the "Mister Softee" mix. In return, the franchisee agreed to devote his full time to the conduct of the business between April 31 and October 1; no specific hours were required. The franchisee was required to purchase 2500 gallons of the franchisor's mix each year at a predetermined price and to buy other unspecified products through the franchisor. The franchisee could charge whatever price he wished

N.L.R.B. No. 99, 66 L.R.R.M. 1131 (1967), and 174 N.L.R.B. No. 97, 70 L.R.R.M. 1252 (1969), where the Board rejected the employer's claim that the vendors were independent contractors. Although the Board has allegedly abandoned the "mischief-remedy" test of Justice Rutledge in favor of the common law "right to control" test, most newsboys are still adjudged employees on the grounds that "[t]here is no room for the exercise of true discretion in the performance of the [deliverer's] work." See *News-Journal Co.*, 180 N.L.R.B. No. 137, 73 L.R.R.M. 1166, 1169 (1970).

⁶⁹ See, e.g., *Borden, Inc.*, 181 N.L.R.B. No. 19, 73 L.R.R.M. 1583 (1970). But cf. *A. Paladini, Inc.*, 168 N.L.R.B. No. 132, 67 L.R.R.M. 1022, 1023 (1967), where the Board cautioned against a "mechanical application of the right to control test."

⁷⁰ 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966).

at retail, but the agreement fixed the wholesale price of the mix. Although the agreement did not cover the point, the franchisees were free to hire their own helpers. The franchisor specifically required that the franchisee "maintain and operate his truck in strict conformance with the plans, procedures, policies, and promotional directives prescribed by the [parent franchisor]."⁷¹ Finally, the franchisee had to obtain the consent of the franchisor before he could assign his franchise interest.⁷²

The franchisor moved to dismiss the petition on the ground that the drivers were not his employees but were independent contractors, excluded by Section 2(2) from the scope of the National Labor Relations Act. In response to the franchisor's motion the Board stated that:

[I]n determining the status of persons alleged to be independent contractors the Act requires application of the "right to control" test. Where the person for whom the services are performed retains the right to control the manner and means by which the result is to be accomplished, the relationship is one of employment; on the other hand, where control is reserved only as to the result sought, the relationship is that of an independent contractor. The resolution of this question depends on the facts of each case, and no one factor is determinative.⁷³

The Board analyzed the franchise arrangement, including the contractual instrument, using the right to control test. After first noting the presence of several factors usually indicative of the vendor-independent contractor relationship—for example, the drivers' ownership of their trucks, their use of employees, and the employer's failure to make the usual payroll deductions—the Board found that the franchisees were employees of the franchisor.⁷⁴ To support this conclusion, the Board cited franchisor control of the size of franchisee territories and the prices and sources of franchisee supplies; the franchisor's right to require operation of the trucks according to unilaterally imposed policies; the restriction on the franchisee's right of assignment; and the fact that all controls and restrictions were enforceable by the franchisor's right to terminate the operation.⁷⁵ Since the salient features of the relationship between Mister Softee and its

⁷¹ *Id.*

⁷² *Id.*

⁷³ *Id.*, 64 L.R.R.M. at 1035.

⁷⁴ *Id.*

⁷⁵ *Id.*

drivers are fairly common in franchise arrangements,⁷⁶ the extent to which the elements of this situation indicate an employment relationship suggests whether subjecting this type of franchise arrangement to the jurisdiction of the National Labor Relations Board is proper.

Franchisors of single distributors invariably insist on controlling the location and size of the franchisee's route or territory. While the route establishes the boundaries of the franchisee's activities, in no way does it determine the manner in which the activity must be carried out. If a purchaser is characterized as an employer merely because he stipulates the scope of the work to be performed, a homeowner who hires a painter to paint his house, but not his garage, or who directs a carpenter to add one room but not two, would become, according to the Board's right to control test, an employer of the painter and carpenter. Such an interpretation suggests misunderstanding of Agency law. The "controls" which determine the work relationship are not the spatial limitations on the area in which work is to be done, but the job specifications which prescribe the manner of performance.

As further evidence of the franchisor's right to control, the Board pointed to the restrictions on the franchisee's right to assign his franchise interest.⁷⁷ Although restrictions on assignment may reflect an unconscionable exercise of raw economic power, a covenant restricting alienability hardly gives the franchisor the right to control the "means of accomplishing the result" for which the franchisee is responsible.

The Board in *Mister Softee* also cited, as proof of the employer's right to control, contract terms which fixed the price of the mix, im-

⁷⁶ The type of "franchise" relationship created in *Mister Softee* has been duplicated in numerous N.L.R.B. cases. In *Frito-Lay, Inc.*, 178 N.L.R.B. No. 92, 72 L.R.R.M. 1177 (1969), for example, a national manufacturer and wholesaler of snack foods franchised individual sales routes to service retail outlets within geographically determined sales districts. Initially hired as employees for a two week training period, the franchisees were eventually assigned a route created unilaterally by the franchisor. They purchased and provided their own trucks as well as the necessary gas, oil, maintenance and repairs. If necessary, franchisees hired their own help, established their own hours and daily schedules, and the time and duration of their vacations. Franchisees were free to sell other products to their customers, provided they satisfactorily serviced customers purchasing the franchisor's products. The franchisees received a commission on sales of 15-20 percent—the difference between the price charged them for the merchandise and the "store-door" price—also set by the franchisor.

In a representation proceeding, the Board held that, despite the drivers' ownership of their trucks and the limited discretion allowed them in servicing their routes, a master-servant relationship was evidenced by the franchisor's control of the location and size of routes, the sales practices of the franchisees, the prices charged for the products, the billing and credit accounts, the assistance rendered the franchisees by the franchisor in soliciting and servicing accounts, and the minimal proprietary interest the franchisees had in their routes.

⁷⁷ *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966).

posed a gallonage requirement and designated dairies from which the franchisees were to buy the mix.⁷⁸ It is difficult to understand why the Board cited the franchisor's power to fix the price of the mix as evidence of his right to control performance; a franchisor fixes such a price in the same way that sellers of any product fix the price of their product. The gallonage requirement and the exclusive list of mix suppliers, however, are related to the issue of the employer's right to control the means used by the franchisee. Similarly, the franchisor's right to require operation of the trucks in conformance with policies of the franchisor, while necessary to protect the value of the trademark and the financial investment of the franchisor, is persuasive evidence that the franchisor is directing, or has the power to direct, the physical activities of the franchisee.

As franchisors have noted in other contexts, however, the task of the franchisee is not merely the sale of the franchisor's products to the public; it is the implementation of a complete system for the successful marketing of the franchisor's products or service.⁷⁹ According to this theory, the Board has invariably confused the means used to accomplish the result with the result itself. Many franchisors rely on secret processes, patented machines or recognizable service patterns to create a factor of good will in the franchise package. Each franchisee is dependent upon the franchisor not only for the trademark, and for patent and management advice, but also for protection against deviations, by other franchisees, from the standards of quality and service necessary to preserve good will.⁸⁰ When viewed as constituent elements of a total "system" of marketing, rather than as badges of franchisor dominance, these controls, which the Board considers indicative of the master-servant relationship, more accurately evidence the interdependence of a franchisor and his franchisees in creating and maintaining a viable enterprise.⁸¹

The argument is certainly imaginative and even plausible in terms of the realities of American business patterns. Given the imaginative flexibility of the business community, it is now quite apparent

⁷⁸ Id., 64 L.R.R.M. at 1035.

⁷⁹ Fels, *Franchising: Legal Problems and the Business Framework of Reference—An Overview*, in *The Franchising Sourcebook* 1-9 (J. McCord ed. 1970) [hereinafter cited as Fels].

⁸⁰ "Without controls to the extent reasonably required to assure a maintenance of uniform standards of the product-service-mix as well as of [sic] the quality of it, the value and reputation of the trademark and the entire system might 'evaporate' because of repeated frustration of reasonable consumer expectations." Id. at 16.

⁸¹ "Many of franchising's legal problems are peculiarly 'franchising' problems because, inherent in them, are the controls commonly employed by the system; and because the resolution of the problems with system survival will require acceptance of franchising for what is—*sui generis*—a separate modern business form used by mutually interdependent businessmen bound in a contractual continuing relationship." Id. at 19.

that the old categories of business associations, and the distinctions between them, are often purely legal: the corporate form, once a symbol for aggregates of capital, is now used by corner grocery stores; the partnership form, generally associated with small tradesmen, is often used by giant oil companies. An employee salesman may have more freedom in scheduling his work day and in negotiating with customers than does an independent retail clothing store which sells the lines of a few large manufacturers. Similarly, the master-servant-independent contractor distinction is an anachronism. Images of independent, medieval guild craftsmen and memories of self-reliant Yankee store-keepers are conjured up when the Board speaks—as it recently did—of the independent contractor not only as a person free from close control by his principal but also as a person who has the “opportunity to make decisions which will affect his profit and loss.”⁸² The degree of freedom which the employee or the “independent” businessman enjoys in making managerial decisions more often reflects the nature of the enterprise than the status of the individual. As franchisors have long realized, and franchisees have learned, the freedom to make managerial decisions is frequently nothing more than the freedom to fail.⁸³

It would be idle to generalize about the various types of restraints under which retail dealers operate.⁸⁴ Few retailers fit the

⁸² A. Paladini, Inc., 168 N.L.R.B. No. 132, 67 L.R.R.M. 1022, 1023 (1967).

⁸³ According to Robert Rosenberg, President of Dunkin' Dounts of America, Inc.: In today's highly sophisticated business society, one out of every two independent businesses started each year fail. Out of every 10 new independent restaurants that open their doors for business today, 5 will close within 1 year and 8 out of the 10 will be out of business within 5 years. Compare these facts, if you will, with a fatality rate of just under 5 percent for businessmen operating under a franchise banner.

Hearings on S. 2507 and S. 2321 Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary, 90th Cong., 1st Sess., at 177 (1967).

⁸⁴ For an excellent survey of the myriad restraints under which retail businessmen operate, see S. Hollander, *Restraints Upon Retail Competition* (Marketing and Transportation Paper No. 14, Bureau of Business and Economic Research, Graduate School of Business Administration, Michigan State Univ., 1965). The author, while acknowledging that the franchise system of distribution “provides for the maximum degree of control, short of outright ownership, *id.* at 20, also points out that “some aspects of . . . franchising . . . have contributed to the vitality and diversity of the marketing system” in contrast to “the manufacturer-dealer arrangements in some industries [which] have made the retailers captives to their suppliers' price policies and distribution practices.” *Id.* at 2.

In speaking of suppliers' restraints, the author notes that:

To a great extent, the supplier's influence will vary with the retailer's need for his wares and the supplier's need for specific types of behavior at the retail level. The strength of the consumer demand for the manufacturer's or wholesaler's brand, and the importance of his products in the retailer's sales and profit mix will often determine how much direction the supplier can exert. Similarly, the degree to which retail salesmanship, demonstration, or service is required will often determine the controls the supplier wants to exert. . . . If the supplier's

purist model used by the Board to measure the "independent businessman." Some retailers have a greater degree of freedom to make decisions "affecting profit and loss," but since many employees enjoy the same freedom, often to a greater extent than traditional independent retailers, the test is an ineffective method of distinguishing them. If the Board is to be responsive to contemporary marketing realities, it might better search for identifying characteristics of the independent contractor in terms of the actual objectives sought by the small businessman-franchisee rather than relying entirely on the freedom from control requirement of Agency law. Franchisees seek primarily a property interest which will make them independent of the wage system. The difference between the employee and the small independent businessman lies in the equity investment of the latter and in his ability to redeem and perhaps reap a profit on the investment.

According to this approach, the franchisee who invests a significant amount of money in the enterprise, and who retains the right to sell or recoup his investment, would be defined as an independent contractor, despite the usual tight lines of control tying him to the franchisor. Conversely, the allegedly independent franchisee having no investment and a minimal proprietary interest would be viewed as an employee, despite the absence of contractual controls in the franchise agreement. "Investments" consisting of the purchase of a delivery truck or inventory financed by the franchisor through long-term credit would be viewed critically by the Board. In order to acquire a property interest setting him off from the traditional employee, the franchisee should have a substantial financial interest in the enterprise, which can be transferred or assigned. In addition, the franchisee's interest should be acknowledged in the agreement. Where the franchisor has the right to terminate that interest at his discretion on thirty days' notice, the value of the franchisee's proprietary interest should be discounted accordingly.

In terms of the "ownership test" the distributors in *Mister Softee* were obviously employees: their investment consisted of an obligation to pay off the cost of the trucks; their proprietary interest in the enterprise was nonexistent. Franchisors in this type of case will find it difficult to convince the Board that their franchisees are independent contractors in the sense of our definition. This difficulty, however, is not artificially created by legal constructs; rather, it is a reflection of market realities.

offerings cover most or all of the dealer's line, the degree of supervision may be almost as great as under outright ownership.

Id. at 19.

Perhaps the suggested approach to the problem of distinguishing the employee from the independent contractor does not appear to adhere to the definitional mandate of Congress. However, the number of factors used to analyze the employment relationship under common law permits such flexibility that the Board has, in fact if not in theory, been given carte blanche to sort out the employee-independent contractor conundrum.⁸⁵ It is not suggested that the Board should distort prior formulations of the common law test; rather, the point is that the Board should make the test more realistic and useful by looking to the proprietary interest retained by the franchisee.

There is evidence that the Board has been influenced by the arguments of franchisors and the economic facts of modern franchising although it has apparently felt constrained to phrase these influences in terms of the right to control test. In *A. Paladini, Inc.*,⁸⁶ the captains of fleet-owned fishing boats had the kind of discretion which the Board has determined essential for a finding of independent contractor status. They selected their own crews, determined the wages to be paid, personally selected appropriate fishing spots, and negotiated the price which the company would pay for the catch. The captains obviously had the right to make decisions affecting their profit and losses. Nonetheless, the Board found that the captains were employee-supervisors rather than independent contractors. In reaching this decision, the Board cautioned against a "mechanical application of the right to control test" and indicated that the test must be applied "in light of the economic realities of the particular situation."⁸⁷ Although the Board stated that one of the factors to consider was the opportunity to make decisions affecting profit and loss, the Board seemed to have been more influenced by the fact that the captains had made no financial investment (the company owned the boats and equipment) and had assumed no financial risks.⁸⁸

While the Board has apparently taken a step in the right direction with its sub-silentio modification of the common law test, Chairman Miller has argued for a return to the "mechanical" test in his dissents to several recent decisions.⁸⁹ It is still unclear whether the courts of appeal will accept this new approach. For example, in *Carnation Co.*,⁹⁰ the company began negotiating individual distributorship agreements

⁸⁵ The Board has attempted to make the right to control test a more realistic measure of employment status through use of the "opportunities to affect profit and loss" test and through its willingness to consider indirect and subtle controls over the franchisee.

⁸⁶ 168 N.L.R.B. No. 132, 67 L.R.R.M. 1022 (1967).

⁸⁷ *Id.*, 67 L.R.R.M. at 1023.

⁸⁸ *Id.*

⁸⁹ See *Farmers Insurance Group*, 187 N.L.R.B. No. 123, 76 L.R.R.M. 1133, 1138-39 (1971); *Deaton, Inc.*, 187 N.L.R.B. No. 102, 76 L.R.R.M. 1129, 1131-33 (1971).

⁹⁰ 172 N.L.R.B. No. 215, 69 L.R.R.M. 1127 (1968).

with its employee-drivers at a time when the drivers were represented by a union. Under the proposed franchise arrangement, the drivers were to purchase their trucks and equipment from Carnation under conditional sales contracts, payable in monthly installments. To secure these contracts, each distributor was required to assign his accounts receivable to Carnation and to execute a trust agreement which established a joint bank account. All proceeds were to be deposited in the joint bank account, from which funds could be withdrawn only over the joint signatures of the distributor and a Carnation representative.⁹¹ Carnation forbade the sale of competitive products, required the distributor to maintain company-installed advertising at his own expense, indicated how the truck was to be painted, provided for cancellation by either party on thirty days' notice, and allowed cancellation by Carnation on one day's notice if the distributor breached the agreement. In the event Carnation terminated for breach by the distributor, it would acquire title to any of the distributor's trucks upon which a balance was owing without having to account for the distributor's equity.⁹² The distributors were free to set their own hours of work and sequence of deliveries and to wear their own clothes. They were required to pay their own license fees and taxes, to obtain health and liability insurance at their own expense, and to buy their own gasoline and garage services.⁹³

In response to union charges that the company had violated Sections 8(a)(1) and 8(a)(5) of the NLRA, the Board found that, despite the franchise agreement signed by approximately one-third of the drivers, the latter were still employees under the Act. Accordingly, the Board set aside the franchise agreement. The Ninth Circuit Court of Appeals denied enforcement of the Board's order and held that the driver-distributors had been effectively transformed into independent contractors.⁹⁴ Without inquiring into the number of ways there are to deliver milk, the court concluded that *except for* the economic controls, "found in a variety of 'franchise' arrangements oriented toward brand-name protection and market penetration," Carnation made no attempt to control the way its drivers carried out their deliveries.⁹⁵

The court apparently saw a significant difference between the employees' former status as employee-drivers and their later status as franchisees. In fact, however, the possibility of greater profit is offset by the franchisees' obligation to pay for their trucks, insurance, gas,

⁹¹ *Id.*, 69 L.R.R.M. at 1128.

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Carnation Co. v. NLRB*, 429 F.2d 1130 (9th Cir. 1970).

⁹⁵ *Id.* at 1134.

oil, repairs and advertising maintenance. Furthermore, they have neither a proprietary interest in the route nor, initially, an investment in the enterprise. Yet, as a result of the court's decision,⁹⁶ they no longer enjoy the benefits of union representation or the various protections of the National Labor Relations Act. This decision clearly conflicts with the result that would have been reached using the "ownership" test. It is arguable that the "franchisees" are now less "independent" than they had been under the collective bargaining agreement. Such a result demands a closer examination of investment factors.

C. *The Franchisee as Employer: Multidistributors*

The discussion has thus far focused upon the franchisee as an employee, as typified by the single distributor. Often, however, a franchisee will hire a significant number of employees to assist him in running a large scale enterprise. The problems of characterizing the

⁹⁶ *Id.* Appellate courts have responded in much the same way to similar decisions by the Board. In *Meyer Dairy, Inc. v. NLRB*, 429 F.2d 697 (10th Cir. 1970), the NLRB characterized the members of the Meyer Dairy Distributors Association as employees of Meyer Dairy, rejecting the employer's contention that the distributors were independent contractors, and ordered a representation election in which the union received a majority of the ballots cast. The employer refused to bargain and was found in violation of § 8(a)(5) by the Board. The court of appeals refused to enforce the Board's order on the ground that the Board was erroneous in finding that the milkmen were employees.

The Board had examined the contractual and de facto relationship between the distributors and the Dairy, and had found that the allegedly independent contractors owned no proprietary interest, operated under oral leases and were subject to the close supervision of the employer. In addition, the Board noted that the employer furnished the franchised distributor with company-bought trucks and parts, and provided for repair work in a company-owned garage. The contract stated that the distributors had to "meet the standards as established by the [company] . . . consistent with standards of . . . individuals engaged in similar dairy products business in [certain] particulars." There followed six specific areas in which the franchisee was required to conform his work practices to requirements of the franchisor. *Id.* at 702.

However, upon review, the court found that there were no elements of agency present. Apparently, the court meant that it found no elements of a master-servant relationship, since the distributors, even if independent contractors, were certainly agents of the company. The court went on to conclude that the distributors were "holders of franchises . . . free from business control of Meyer except that they are required to meet [certain] standards . . ." *Id.*

Such a reaction by appellate courts may be explained, in part, by the Board's vacillation in the driver-distributor cases. Although theoretically applying the same right of control test, the Board consistently found, during the 1950's, that driver-distributors were independent contractors. See, e.g., *Shamrock Dairy, Inc.*, 124 N.L.R.B. No. 63, 44 L.R.R.M. 1407 (1959), and 119 N.L.R.B. No. 134, 41 L.R.R.M. 1216 (1957) *aff'd sub. nom.* *International Brotherhood of Teamsters, Local Union No. 310 v. NLRB*, 280 F.2d 665 (D.C. Cir.), cert. denied 364 U.S. 892 (1960); and *Pure Seal Dairy Co.*, 135 N.L.R.B. No. 12, 49 L.R.R.M. 1434 (1962). During the era of the Kennedy-Johnson Board, the NLRB, without explicitly overruling its prior decisions, generally found that driver-distributors, operating pursuant to franchise arrangements little different from the arrangements of Shamrock Dairy or Pure Seal, were employees.

three party relationship (franchisor-franchisee-franchisee's employees) in determining the jurisdictional question are somewhat more complex than those encountered in the single distributor context. In addition to characterizing the franchise arrangement in terms of statutory formulae already discussed, the NLRB must define the interrelationships among the three interest groups. Using the right to control test as the guiding principle, the Board has at various times determined franchisees to be (1) independent contractor-employers, (2) joint employers with the franchisor, (3) employees of the franchisor, or (4) supervisory employees of the franchisor.

The jurisdictional issue in controversies involving franchisee-employers may arise as a result of union attempts to organize either the franchisees or the franchisees' employees. In either case, the essential question is whether or not the franchisor will be characterized as an employer of the interest group which the union seeks to represent. If the franchisee's employees are being organized, the union will of course contend that the franchisor and the franchisee are joint employers or that the franchisor is the employer with the franchisee his supervisory employee; the point is to ensure that the franchisor is included in the employment relationship. If the franchisee is the sole employer, the enterprise will probably not satisfy the Board's minimum jurisdiction requirements and the representation petition will be dismissed.⁹⁷ If the franchisees are being organized, the union must convince the board that the franchisees are employees, but not supervisory employees, since the latter are not protected by the NLRA.⁹⁸ The franchisor would of course argue that the franchisees are independent contractors or, if they are employees, that they are supervisory employees. An illustrative case, *Southland Corp.*,⁹⁹ raises most of these issues.

In *Southland*, a union petitioned for an election in a unit composed of employees of Speedee Mart, a franchised outlet operated by Wallace S. George, Sr., under an agreement with the Southland Corporation. The agreement resembled the standard arrangement, with modifications appropriate to the enterprise. After surveying prospective sites, Southland had acquired a site, constructed a store, supplied fixtures and completely stocked the store with grocery merchandise. Southland then franchised the "system" to George. Under the terms of the franchise agreement, George leased the store and fixtures and

⁹⁷ See text accompanying note 102 infra.

⁹⁸ Under § 14(a) of the Act, a supervisor may become a member of a labor organization, but no employer subject to the Act is required "to deem . . . supervisors as employees for the purpose of any law . . . relating to collective bargaining." 29 U.S.C. § 164(a) (1970).

⁹⁹ 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582 (1968).

obtained a license to use the "7-Eleven" trademark and operational system. The system consisted of a continuing provision of services, including a bookkeeping service whereby the franchisee deposited daily all cash sales proceeds into Southland's account. From this account, Southland paid the franchisee's bills, made out the salary checks for George's employees and processed and paid the invoices submitted by George's suppliers. The franchisor furnished George with a policy manual which described in detail virtually every action to be taken by the franchisee in the conduct of his store. Southland also provided retail price recommendations and a list of authorized vendors from whom George could purchase his supplies. Finally, Southland retained the right to terminate the agreement without cause on thirty days' notice.¹⁰⁰

The petitioning union averred that Southland was the employer and George its supervisor. In the alternative, the union contended that George and Southland were joint employers.¹⁰¹ Southland, on the other hand, claimed that George was an independent contractor. The Board evaluated these contentions in light of the control factors present in the franchise arrangement and concluded that George was an independent contractor and the sole employer of the store's employees. Since George's annual retail sales were less than the Board's minimum retail jurisdictional standards, the Board dismissed the petition.¹⁰²

In reaching this conclusion, the Board looked behind the agreement and its purported reservation of a right to control in the hands of the franchisor.¹⁰³ The Board disposed of the Southland Policy Manual by noting that the record indicated that neither George nor the franchisor had considered it anything more than a guide.¹⁰⁴ The periodic price recommendations were viewed as "merely suggestions,"¹⁰⁵ and the list of authorized vendors as only recommendations.¹⁰⁶ The Board pointed out that George had set his prices above or below the recommended schedule, and had purchased supplies from vendors not on the approved list. Finally, the Board rejected the union's contention that the power to cancel the franchise gave the franchisor a "club" that could be used to achieve compliance with his demands.¹⁰⁷

The Board's application of the right to control test had differed

¹⁰⁰ *Id.*, 67 L.R.R.M. at 1582-84.

¹⁰¹ *Id.*, 67 L.R.R.M. at 1582.

¹⁰² *Id.*, 67 L.R.R.M. at 1584.

¹⁰³ *Id.*, 67 L.R.R.M. at 1583-84.

¹⁰⁴ *Id.*, 67 L.R.R.M. at 1583.

¹⁰⁵ *Id.*

¹⁰⁶ *Id.*, 67 L.R.R.M. at 1584.

¹⁰⁷ *Id.*

significantly in *Mister Softee*, where the franchisees did not employ additional help.¹⁰⁸ In that case, the Board emphasized the elements in the relationship giving the franchisor the *right* to control, including those required by state law, to support its finding of an employer-employee relationship. Specifically, the Board examined the franchise agreement and pointed to the franchisor's right to inspect the franchisee's truck, his control over the route size, his exclusive dealing requirement, his unlimited right to prescribe plans, procedures and policies, and finally, his right to terminate the agreement.¹⁰⁹ In *Southland*, on the other hand, the Board seemed to give considerable weight to the control *actually exercised* by the franchisor.

While this difference in treatment appears unjustified, it comports with the "ownership" test suggested above.¹¹⁰ In *Mister Softee* the franchisee's only investment was the cost of the truck, which he was required to purchase and finance through the franchisor.¹¹¹ In *Southland* the franchisee initially invested \$4,000 against the inventory price of \$10,500 required by the franchisor, and at the time of the union's petition he had a total equity of \$15,000 in the store.¹¹² If, as has been suggested,¹¹³ the restrictions on the manner in which the enterprise is conducted are less important in determining employee status than the power contractually retained or in fact possessed by the franchisor to disenfranchise the franchisee, the monetary investment or accrual of equity interest must operate as a significant check on the franchisor's power to terminate the relationship. Under most franchise agreements, where the franchisee not only buys the truck or fixtures and the good will of a fixed location, but also purchases an "interest" in the entire system as well, the franchisor is obligated to buy out the franchisee's proprietary interest at termination. Thus, the right of Southland to terminate arbitrarily the franchise held by George had to be discounted by the cost of exercising the right—the repayment of the \$15,000 equity interest. In contrast, the franchisee in *Mister Softee* apparently possessed no interest in his route other than the excess of his truck's value over finance payments made to the franchisor. There was no financial disadvantage to the franchisor in arbitrarily terminating the franchise.

Another factor which may have influenced the Board in its resolution of the independent contractor-employee issue was the fact that

¹⁰⁸ For a discussion of the Board's treatment of the franchise arrangements in *Mister Softee*, see pp. 230-33 *supra*.

¹⁰⁹ *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034, 1035 (1966).

¹¹⁰ See pp. 234-36 *supra*.

¹¹¹ *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966).

¹¹² *Southland Corp.*, 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582 (1968).

¹¹³ See p. 235 *supra*.

George himself was not actively involved in manning the store, but had delegated management responsibilities to his son, and had hired additional help.¹¹⁴ Consequently, the union claimed that George was a supervisory employee of Southland.¹¹⁵ The implications of finding George a supervisor are most important. In *Mister Softee* the franchisees were called employees and thereby given the opportunity to combine in bargaining with the franchisor. If George and similar franchisees are defined not merely as employees, but as supervisory employees, they lose the possible advantages of employer status, without obtaining the off-setting benefits of employee rights. More specifically, their bargaining position vis-à-vis the franchisor is weakened and their power over their "employees" is diluted. Yet, since supervisors are specifically excluded from provisions of the NLRA, such a finding would award no compensatory protection to the franchisees. Thus, to define George as a supervisory employee would have been an undesirable solution to the problem.

However, the union suggested another conceptualization of the relationship which would have better served the objectives of the NLRA—that George and Southland were joint employers of the unit employees.¹¹⁶ The "joint employer" characterization, however, was also rejected by the Board. The decision indicated that the critical factor used in determining whether a joint employer relationship exists "is the control which one party exercises over the labor relations policy of the other."¹¹⁷ Again, the test looks to the right to control, not exclusively to the exercise of control, possessed under the agreement. The Board found that Southland possessed neither actual nor potential control over the labor relations of George with his employees. It pointed first to the language of the franchise agreement giving George unfettered control over "any and all labor relations." In addition, since the record disclosed no evidence that Southland had ever sought to influence George's labor relations policies, the Board found that George was the sole employer of his employees. In response to the union's claim that Southland indirectly controlled the number of employees, their wages and their hours¹¹⁸ through Article 14 of the franchise agreement—providing that to the extent the franchisee's payroll exceeded eight percent of net sales, the owner's draw could be reduced by the amount of such excesses—the Board noted that the clause did not *require* George to reduce the number of hours or wages of his em-

¹¹⁴ Southland Corp., 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582, 1583 (1968).

¹¹⁵ Id., 67 L.R.R.M. at 1582.

¹¹⁶ Id.

¹¹⁷ Id., 67 L.R.R.M. at 1584.

¹¹⁸ Id.

ployees.¹¹⁹ The Board added that the effect of the clause on George's labor policies, assuming causal connection, was too remote and conjectural to be considered in determining possible control by Southland.

The Board accurately articulated the joint employer rule, but applied it too narrowly. The conceptual justification for the rule derives from the nature of collective bargaining. The original purpose of the NLRA was to encourage organization of employees so as to permit meaningful negotiations between the employer and his employees—that is, between the person who determines the allocation of the enterprise's resources and profits and the persons whose wages, hours and conditions of employment are affected by the allocation. At the very least, collective bargaining requires that the union actually represent the desires and needs of employees and that management represent the power that determines the lot of the employees.¹²⁰ If George's employees are limited to bargaining with George, they will not be bargaining with the ultimate source of power over their wages and conditions of employment.

The presence of direct controls is important in analyzing Southland's control, but their absence is not conclusive proof of the franchisee's independence. In *Southland*, for example, the franchisor exercised considerable control over financial policies of the franchisee. Southland unilaterally established the inventory price and determined the amount of the down-payment. The balance was to be paid by the franchisee from the amount remaining after the franchisor deducted his fifty-five percent share of adjusted gross sales. The franchisee could "draw" only part of his share of the sale proceeds, the remainder being applied to reduction of his debt with Southland. If his payroll costs exceeded the greater of eight percent of sales for the preceding week or \$200, the owner's weekly draw might be reduced by the amount of such excess. The union pointed to these restrictions as evidence of indirect control exercised by Southland over George's labor policies.¹²¹

The Board seemed to have been overly concerned with the question of the franchisor's potential for indirect control in the previously summarized Article 14.¹²² It is not, however, the possibility of indirect control of labor relations, but the necessity for partial control of a franchisee's labor policy which is inherent in a franchise relation-

¹¹⁹ *Id.*

¹²⁰ "[V]oluntarism, as the basis for successful labor management relations . . . plays . . . an important role in collective bargaining, regardless of whether the spur is a narrow or an enlightened self interest. From this approach certain conclusions may be drawn: The parties must have authority, within their jurisdiction to speak for their principals . . ." M. Forkosch, *A Treatise on Labor Law* 852 (2d ed. 1965).

¹²¹ *Southland Corp.*, 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582, 1584 (1968).

¹²² See text accompanying notes 118-19 *supra*.

ship. George's retail franchise is more than an outlet for Southland's products. It is the Southland business. To the extent that George's poor personnel practices, employee inefficiency or labor disputes diminish gross sales or interrupt the franchise operation, the franchisor's continuing financial interest (fifty-five percent of gross sales) suffers.

The Board noted that, with one exception, Southland had not exercised or attempted to exercise any influence over the labor relations policies of George.¹²³ But this fact could equally have been evidence of George's facility in handling employees, or, on the other hand, proof of Southland's lack of interest or power. While no intelligent employer interferes with a subordinate's successful management of personnel, it is naive to suggest that a franchisor having absolute power to terminate the relationship on thirty days' notice would tolerate a franchisee's inept personnel practices. The decision of the Board should not turn on either the apparent success of a brief franchise relationship, or on the self-serving language of the contract. The first factor is subject to chance, the second to the deft stroke of a lawyer's pen.

In analogous situations, the Board has been more perceptive in interpreting the right to control test. The joint employer doctrine has been interpreted liberally, for example, to tie department store owners to employment relationships with departmental lessees.¹²⁴ Although

¹²³ Southland Corp., 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582, 1584 (1968).

¹²⁴ Despite occasional decisions to the contrary, the Board has established a strong presumption that licensors and licensees in discount department stores are joint employers of employees of the licensee. See *Thriftown, Inc.*, 161 N.L.R.B. No. 42, 63 L.R.R.M. 1298 (1966); *K-Mart*, 162 N.L.R.B. No. 41, 64 L.R.R.M. 1045 (1966); *Jewel Tea Corp.*, 162 N.L.R.B. No. 44, 64 L.R.R.M. 1054 (1966); *United Mercantile, Inc.*, 171 N.L.R.B. No. 103, 68 L.R.R.M. 1173 (1968). Cf. *Zayre Corp.*, 170 N.L.R.B. No. 190, 68 L.R.R.M. 1002 (1968). For a thorough summary of the Board's approach in the discount department store cases before and after *Thriftown*, see *Gallenkamp Stores Co. v. NLRB*, 402 F.2d 525, 69 L.R.R.M. 2024 (9th Cir. 1968).

The Board's rationale for the rule derives from its perception of the "entrepreneurial context" in which the license arrangements are utilized: "Given this business arrangement, it is apparent that any disruption of operations, including that resulting from a labor dispute involving an operator [of a licensed department], will almost necessarily adversely affect the operation of the entire store." *Thriftown*, supra, 63 L.R.R.M. at 1300. Although the rule appears to represent a departure from the criterion ordinarily used to measure joint employer status—common control of labor relations—the Board later observed that: "While we would not postulate the existence of a joint-employer relationship merely on the basis of such a need—[of the licensor to control the labor relations of its licensees—] we will make such a finding where the license arrangements objectively demonstrate a response to that need." *United Mercantile, Inc.*, supra, 68 L.R.R.M. at 1175. It is apparent, however, that once the Board perceives a "need" for the licensor to control, the Board will find that need reflected in the license arrangement regardless of the terms of the license. See *Red-More Corp.*, 169 N.L.R.B. No. 63, 67 L.R.R.M. 1203 (1968).

The Board, however, has been reluctant to disturb unit determinations made prior

the test used to determine joint employer status in such cases is theoretically the same as that used by the Board in *Southland*, these cases examine the strength of the franchisor's right to control in terms of all the ties he maintains with the franchisees, not just in terms of the direct control he maintains over labor relations.¹²⁵ This approach could be used more openly and with greater precision if the Board changed the test of joint employer status from one of weighing the right of the stronger party to control labor relations practices to one of evaluating the mutual concern of two or more parties in the working conditions of a given unit of employees. If both the franchisor and franchisee have a continuing financial interest in an enterprise, and possess the power to protect it by either indirect or direct measures, a presumption should arise that they are joint employers for purposes of the National Labor Relations Act.

The considerations invoked by the "mutual interest" test are more pertinent to the ultimate question of who comprise the necessary parties for successful collective bargaining. Under most franchise agreements, including *Southland's*, the franchisor exercises significant control over the financial structure and rate of profit of the individual franchisee. It is doubtful that most franchisee-employers could make decisions regarding demands for significant changes in wages and working conditions without first consulting the franchisor. Since an absent franchisor would nevertheless be a brooding presence at the bargaining table, the bargaining process would be expedited if he appeared there himself.

Of course, the franchisor will invariably object to any legal interpretation of his contract which characterizes him as a joint employer. His power over the franchisee and the conduct of collective bargaining is economic rather than legal in origin. He does not need an official title to deal with the union through a franchisee. In addition, as Part III will suggest,¹²⁶ the conferral of joint employer status may have disadvantageous consequences for the franchisor.

D. *Combined Units: Franchisee-Employers and Franchisee-Employees*

Additional problems are presented when a franchisor has some franchisees who are merely employees—single distributors—and others who are themselves employers—multidistributors. The touchstone of statutory status is the contractual power to control modes of

to *Thriftown*, where the Board ordinarily did not define licensors and licensees as joint-employers. See, e.g., *Esgro Valley, Inc.*, 169 N.L.R.B. No. 13, 67 L.R.R.M. 1116 (1968).

¹²⁵ See note 124 *supra*.

¹²⁶ See pp. 260-65 *infra*.

performance. Since the franchisor will probably use the same contractual instrument throughout the enterprise, and therefore will have the same quantum of power over each, both single and multi-distributors will be subject to the same kinds of franchisor controls. Thus if single distributors are defined as employees, it will be difficult for the Board, using the traditional right to control test, to justify a different label for the multidistributors. Assuming that multidistributors, as well as single distributors, qualify as employees, are multidistributors more appropriately subcategorized as employee-supervisors? If multidistributors were classified as supervisors, they would not be eligible to vote in a representation election, nor would they be entitled to the other protections provided by the Act.¹²⁷

The Board's response to questions concerning the statutory status of multidistributors in this context has been somewhat vague and generally inconsistent. In some cases the Board has dismissed the contention that the franchisees are supervisors on grounds that their employees are not employees of the franchisor.¹²⁸ In other cases, the Board has defined multidistributors as employee-supervisors.¹²⁹ More often the Board has, in effect, ignored the issue by excluding multidistributors from an appropriate unit of single distributors.¹³⁰

¹²⁷ See note 98 *supra*.

¹²⁸ See, e.g., *Quality Hay Co.*, 173 N.L.R.B. No. 172, 69 L.R.R.M. 1521 (1968).

¹²⁹ See, e.g., *S & W Motor Lines*, 179 N.L.R.B. No. 136, 72 L.R.R.M. 1510 (1969) where multiple owner-drivers of freight trucks were defined as supervisors. Of course the drivers under them, and controlled and paid by them, had first been defined as the employees of the employer.

A typical employment structure in the trucking industry was described by the Fifth Circuit Court of Appeals in *NLRB v. Deaton Truck Line, Inc.*, 389 F.2d 163, 165, 67 L.R.R.M. 2632, 2633 (5th Cir. 1968):

[T]he owner and driver relationships . . . may be classified as follows: (1) Deaton employees who drive Deaton owned trucks; (2) Owner-drivers who own a single truck which they drive and lease to Deaton; (3) Multiple-Owner-drivers who lease several trucks to Deaton, drive one of them and select drivers for the others from among drivers approved by Deaton; (4) Non-driving owners and (5) Non-Owner drivers who drive trucks owned by either a multiple-owned-driver or by a non-driving owner . . . who has leased trucks to Deaton.

The Deaton employees, single owner-drivers and non-owner-drivers, were classified as employees and multiple owner-drivers were classified as supervisors. Non-driver owners were not defined as employees. *Id.* at 167, 67 L.R.R.M. at 2635 n. 12.

For the complete history of the lengthy dispute over the employment status of owner-operator truck drivers used by Deaton, see *Teamsters, Local 612 v. Deaton Truck Line, Inc.*, 307 F.2d 748 (5th Cir. 1962); *Deaton Truck Line, Inc. v. Teamsters Local 612*, 314 F.2d 418 (5th Cir. 1962); *Deaton Truck Line, Inc. v. NLRB*, 337 F.2d 697 (5th Cir. 1964); *NLRB v. Deaton Truck Line, Inc.*, 389 F.2d 163, (5th Cir. 1968).

¹³⁰ See, e.g., *Mister Softee of Indiana*, 162 N.L.R.B. No. 22, 64 L.R.R.M. 1034 (1966) and *Frito-Lay, Inc.*, 178 N.L.R.B. No. 92, 72 L.R.R.M. 1177 (1969). Presumably the multidistributors are excluded because they did not share a community of interests with the single distributors.

The Board has also excluded various classes of employees on "policy grounds." For example, the Board has excluded two types of managerial employees: those so closely

Various arguments may be posited for or against a particular decision or its theory, but none of the usual responses adequately describes the intricate net of relationships that characterize the franchise arrangement. A decision that multidistributors are nonsupervisory employees might protect the interests of the multidistributors, but this protection is achieved at the expense of the subemployees: a finding that the multidistributor is not a supervisor implies that the multidistributor's employees are not employed by the franchisor.¹³¹ The subemployees are therefore excluded from the unit although their interests may be identical to those of the single distributors.

A decision that the multidistributor is a supervisor permits inclusion of the subemployees, but would exclude the multidistributor himself. However, the usual reason for excluding supervisory personnel from units of employees—that, theoretically, the interests and loyalties of supervisors run to management—is not persuasive when used to justify the exclusion of multidistributors. The employees of the multidistributor are usually hired by, paid by, and directly responsible to the multidistributor. They might be characterized as employees of the franchisor because he authorizes and indirectly controls their employment, but the relationship is at best the conclusion of a legal syllogism. Secondly, the franchisee who has employees is no more or less tied to the franchisor than is the single distributor. Unlike the ordinary supervisor, he is not compensated for supervising employees, nor does he represent the franchisor to the subemployees. His compensation, like that of the single distributor,

related to or aligned with management as to raise the possibility of a conflict of interest on the part of the employee; and those who formulate, determine or affect employer policy. See *Retail Clerks Local 880 v. NLRB*, 366 F.2d 642, 644-46 (D.C. Cir. 1966), cert. denied, 386 U.S. 1017 (1967). For a discussion of the Board's rationale, see *Westinghouse Electric Corp. v. NLRB*, 398 F.2d 669, 670-71 (6th Cir. 1968); for an illustration of how the test is used in a situation analogous to a franchise situation, see *Illinois State Journal-Register, Inc. v. NLRB*, 412 F.2d 37 (7th Cir. 1969). See also *Sida of Hawaii, Inc.*, 191 N.L.R.B. No. 46, 77 L.R.R.M. 1376 (1971) where 115 taxi cab drivers who owned stock in the employer were excluded from a unit of 250 drivers on the ground that "[the stockholder-drivers] have an effective voice in determining policy as well as the terms and conditions of employment through their selection of the [employer's] directors."

It is apparent that if a franchisee did not have sufficient supervisory authority to be counted a supervisor, he would often be treated as a managerial employee "aligned" with management. In either case, he would be excluded from the union.

¹³¹ The result is not required since it would be possible for the Board to find that both the multidistributor and his employees are employees of the franchisor. But this finding would often strain the facts since the multidistributor often hires, pays and supervises the subemployees without the franchisor even knowing of their existence. If the multidistributor can be characterized as a supervisor, then the hiring of the subemployees can be accounted for as an exercise of supervisory authority impliedly granted by the franchisor. However, if the multidistributor is not defined as a supervisor, but as an employee, the legal nexus necessary to tie the subemployees to the franchisor is lost. See *Quality Hay Co.*, 173 N.L.R.B. No. 172, 69 L.R.R.M. 1521 (1968).

depends upon the terms of the franchise agreement and his own personal efforts.

The third option available to the Board—that of excluding multidistributors or their employees from the unit—can be a satisfactory solution if it is used judiciously. The Board might determine, for example, that either the multidistributor's financial investment or his essentially managerial role makes it inappropriate to include him in a unit of single distributors. The employees of the multidistributor, depending on the nature of their tasks and on the amount of control exercised over them by the franchisor, could conceivably be included in a unit otherwise comprised of single distributors.

On the other hand, the Board will frequently allow the parties to define a unit by private agreement. Although the Board maintains ultimate control over the composition of the unit, in practice, the decision of the parties will rarely be challenged. Consequently, the multidistributor may be included in the unit if the union regards him as a competitive threat to the employment opportunities of the single distributors. Similarly, he might be excluded if the union or the franchisor were unsure of the outcome of a representation election.

The preferable solution, in doubtful cases, would be to allow multidistributors to indicate in the familiar "Globe" election¹³² whether or not they wish to be represented by the union. The Globe election procedure allows employees to determine whether they wish to be included in a specified unit and, if they do, whether they wish to be represented by the union(s) on the ballot. It ensures, to some extent, that the franchisees and their employees, who do not comfortably fit any of the statutory categories, will not be manipulated for the benefit of the other parties. Undoubtedly, some awkward situations might arise, especially where, for example, single distributors, multidistributors and employees of multidistributors all choose representation by the same union. Although, theoretically, the union would face a conflict of interest in representing both the multidistributors and their employees, the decision by both to join the same

¹³² A "Globe" election takes its name from *Globe Machine and Stamping Co.*, 3 N.L.R.B. No. 25, 1A L.R.R.M. 122 (1937). Under procedures first established by this case, when a group of employees might properly constitute a separate unit or form part of a larger unit, the Board permits the desires of the employee to be the determining factor. Separate elections are conducted among the groups, and the determination of the unit or units is withheld pending the results of the elections. Those groups which do not elect the union constitute separate units, while those groups voting for representation by the union are placed in the larger unit.

Although the "Globe" election is usually used to allow craft employees to opt for representation by a craft union rather than by an industrial union, it could also be adopted to permit franchisees and their employees to opt out of union representation altogether.

union would probably indicate that the franchisor is in control of all subordinate parties to the franchise relationship.

III. IMPLICATIONS OF APPLYING THE NLRA TO THE FRANCHISE ARRANGEMENT

The consequences of an affirmative jurisdictional finding by the NLRB will depend upon several interrelated factors, including the context in which the issue is raised, the type of franchise involved, and the substantive issues raised and resolved in the course of the proceeding. The assumption of jurisdiction over the franchise relationship and the subsequent application of various provisions of the NLRA to the activities of the parties will often determine the legitimacy or usefulness of the franchise technique. Even when not invoked, federal labor laws exert a subtle influence on the power relationship between franchisors and franchisees. Thus, the possibility that the NLRB will assert jurisdiction, and the consequences of such an assertion, should be important considerations in the franchisor's initial decision to use franchising as a method of distribution. This section analyzes the implications of an assertion of jurisdiction in the execution, implementation, administration and termination of the franchise relationship.

A. *The Initiation of a Franchise Program*

A manufacturer, distributor or wholesaler who decides to initiate a franchise system will ordinarily seek to maximize his control of the system by reserving a right to control the activities of individual franchisees. Generally, the franchisor will impose upon the franchisee a one-sided contractual agreement which does little more than identify the franchisor's rights and the franchisee's responsibilities, and provide penalties for failure to discharge such responsibilities.¹⁸⁸ If the franchisor uses his superior knowledge and financial power to force the franchisee into an unfavorable, perhaps unconscionable, bargaining position, the franchisee may find little relief in the civil courts. However, by maximizing his advantage, the franchisor risks the possibility that the franchisee will seek to remedy his poor bargaining position through collective action and makes it more likely that the NLRB will find that the franchisees are employees.

The franchisor can attempt to minimize the likelihood of franchisee union activity by negotiating a reasonable agreement and by administering a fair program. He can also lessen the likelihood that the Board will take jurisdiction of a representation petition by avoiding unnecessarily stringent control provisions in the agreement and in the administration of the program. Although the Board is more

¹⁸⁸ See pp. 221-24 *supra*.

interested in the realities of the parties' economic relationship than in the verbal niceties of their contractual instrument, the "right to control" is still the official test used to determine the relationship between the franchisor and franchisee.¹³⁴ The franchisor should, therefore, decide whether close contractual or de facto controls are sufficiently important to warrant the risks they entail.

A decision by the Board that the franchisees are employees does not necessarily have immediate consequences. Such a decision, made in the course of a representation proceeding, will achieve three results. First, the decision resolves the jurisdictional issue—the Board will take jurisdiction of a representation petition involving the franchisee-employees. Second, the decision, in effect, determines the appropriate unit for bargaining. If the franchisee-distributors are employees, they are appropriate members of a single unit, although, as noted previously, multidistributors may be excluded from the unit either by the Board or pursuant to the parties' stipulation. Finally, the decision gives franchisee-employees the right to decide whether they wish to be represented by a union. It is, of course, entirely possible that the franchisees may reject the petitioning union(s) in a secret ballot election. In that event, the franchise arrangement would be administered as it was prior to the Board's intervention. Although characterized as employees, the franchisees, by voting against unionization, would thus elect to be treated as independent contractors.

If the franchisees were to elect union representation, that decision would certainly alter, and perhaps destroy, the franchise relationship. The collective bargaining representative may choose to ignore the franchise agreements, which would now be classified as individual employment contracts, and insist on a standard agreement in lieu of the franchise contracts.¹³⁵ Such a course of action by a union would go far toward destroying the substance, as well as the trappings, of the franchise relationship. Alternatively, the union might bargain for the incorporation of the franchise contracts into a more inclusive collective bargaining contract, thereby preserving the structure of the franchise arrangement while strengthening the bargaining position of the individual franchisees.¹³⁶ The strategy of the union will depend in part on the terms of the agreement. If they are particularly unfavorable to the franchisee, their preservation might be undesirable. If the

¹³⁴ See the discussion of *Carnation Co.*, 172 N.L.R.B. No. 215, 69 L.R.R.M. 1127 (1968) at pp. 236-38 *supra*.

¹³⁵ See *J. I. Case Co. v. NLRB*, 321 U.S. 332 (1944).

¹³⁶ See *Chicago Tri-Cities Motor Freight, Inc.*, 168 N.L.R.B. No. 86, 67 L.R.R.M. 1190 (1967), where the lease agreements between the employer and owner-operators provided for cancellation upon 30 days' written notice by either party. Under the terms of the union contract, however, an owner whose lease was cancelled continued to be employed as a driver.

structure of the agreement is considered sound, the union might bargain for its incorporation and seek to make advantageous changes in its substantive provisions.

If a franchisor desired to initiate a more extensive franchise program, requiring substantial capital investment by the franchisee and the use of employees, the problem would involve different kinds of labor law issues with concomitant changes in the impact a Board decision would have upon the franchise relationship. Despite such differences, however, some similarities to the case of the single distributor-franchisee remain. For example, the franchisor of an extensive program is as interested in maintaining strong lines of control to each franchised outlet as is the franchisor of single distributorships. The contracts used will often contain similar provisions, although the exercise of the franchisor's retained power will differ. In the case of a single distributor, the franchisor is concerned with maintaining reasonable production levels, whereas the franchisor of a larger enterprise, while interested in production levels, must achieve those by training the franchisee as a manager rather than as a producer. The kinds of controls exercised in the larger franchise enterprise tend, therefore, to concern managerial responsibilities. For example, the franchisor will be interested in the accounting techniques, inventory control and personnel practices of the franchisee. In a service enterprise he will be particularly interested in ensuring that the franchisee will hire, train and retain courteous and efficient employees.

Unlike the franchisor of single distributors, the franchisor in the larger enterprise need not be concerned with the possibility that his franchisees will attempt to form a union, or that the Board will classify him as the employer of those franchisees. Any attempt by the franchisees of large outlets to form a labor organization would be viewed with suspicion by the Antitrust Division of the Department of Justice and the Federal Trade Commission.¹⁸⁷ In any event, the

¹⁸⁷ In *Bambury Fashions, Inc.*, 179 N.L.R.B. No. 75, 72 L.R.R.M. 1350 (1969), the National Association of Women's and Children's Apparel Salesman (NAWCAS) filed a petition seeking a representation election among traveling salesmen of women's and children's apparel. The Board dismissed the petition on the grounds that, although some of the 12,500 salesmen that NAWCAS sought to represent were employees of apparel manufacturers, most were "independent contractors" since the salesmen were "granted the right to control the means by which the manufacturer's line of apparel is sold within a defined territory, and the manufacturer retains the right to control only the result." *Id.* at 1353. Consequently, the NAWCAS was disqualified from representing the employee-salesmen when its membership included competing employer-independent contractors.

The Board noted that the representation petition had been filed by NAWCAS "in order to avoid prosecution by the Federal Trade Commission in a restraint of trade complaint proceeding." *Id.* at 1350. "[A] hearing examiner of that agency issued an initial decision, on April 18, 1968, that NAWCAS and its agents, in a number of the practices they follow and rules and regulations they impose on their members in connection with trade show activities, have engaged in illegal restraints of trade." *Id.* at 1353.

Board has not permitted the larger franchisees to utilize the Act's protections in order to bargain collectively with their franchisors. The franchisor might, however, be defined as a joint employer of the franchisees' employees if they seek to organize or engage in concerted activities. To the extent that the franchisor retains a right to control the labor relation practices of his franchisees or, in fact, does exercise such control, the greater is the risk that the Board will tie the franchisor to the franchisees' employees. There is also a strong suggestion in the reported cases that the probability of the Board's finding a joint employer status increases in proportion to the amount of generalized control that can be or is exercised by the franchisor.¹³⁸

A finding that the franchisor is a joint employer of the franchisee's employees, when made in the course of a representation proceeding, will have one immediate legal consequence: the decision will ensure that the employer's enterprise will satisfy the "jurisdictional yardsticks" which limit the Board's jurisdiction. Since the franchisor's sales or revenue figures will be added to those of the franchisee, it is unlikely that the joint enterprise will fail to reach the minimal amounts set by the Board. On the other hand, an adverse decision on the

The Federal Trade Commission has jurisdiction under Section 5 of the Federal Trade Commission Act, 15 U.S.C. § 45 (1970), to enforce both the Sherman Act, 15 U.S.C. § 1 et seq. (1970), and the Clayton Act, 15 U.S.C. § 12 et seq. (1970). Section 6 of the Clayton Act exempts "labor organizations" from the antitrust laws. If the NAWCAS were defined as a labor organization, it would be exempt from the "restraint of trade" prohibitions of Section 1 of the Sherman Act. But it is doubtful that the FTC or the courts would be bound by the Board's definition of a labor organization or by its characterization of an employment relationship. In *Columbia River Packers v. Hinton*, 315 U.S. 143 (1942), fishermen, who leased boats and sold their catch to processors, formed a union which bargained collectively with the processors to fix the price. Members sold only to processors who had union contracts, and processors under contract bought only from union members. One processor who refused to contract with the union was boycotted. He sought an injunction under the Sherman Act. The Court held that this was not a labor dispute within the Norris-LaGuardia Act but was a dispute between businessmen over the sale of a commodity. There was, therefore, no employer-employee relationship, but a combination in restraint of trade. Although the union had not been certified by the Board, it is clear that, at best, such a decision would have been only persuasive evidence, not a *res judicata* finding. (For a highly critical analysis of *Hinton* see Gottesman, *Restraint of Trade—Employees or Enterprisers?*, 15 U. Chi. L. Rev. 638 (1948).) Similarly, the Board will accept the ruling of a sister agency on the employment relationship as persuasive, but not binding. In *Yellow Cab Co.*, 179 N.L.R.B. No. 148, 72 L.R.R.M. 1514 (1969), where the employment relationship was at issue, the Board noted that the employer had "moved the Board to reopen the hearing for the purpose of adducing evidence that the Internal Revenue Service has recently rendered an administrative decision holding that the [taxi] drivers are independent contractors and not employees Although we consider such a decision to be relevant, . . . we respectfully decline to follow it" *Id.* at 1516 n. 5.

¹³⁸ See *Red-More Corp.*, 164 N.L.R.B. No. 93, 65 L.R.R.M. 1155 (1967), *aff'd*, 169 N.L.R.B. No. 63, 67 L.R.R.M. 1203 (1968), *enf'd*, 418 F.2d 890 (9th Cir. 1969).

joint employer issue, as in *Southland*,¹³⁹ will often require Board dismissal of the representation petition on the jurisdictional ground. The franchisor, therefore, will usually attempt to prove that he is not a joint employer with his franchisee.

A union seeking to represent the franchisees' employees will certainly attempt to include the franchisor as a joint employer. If the union cannot establish a joint employer relationship, it will argue in the alternative that the franchisor is the sole employer and that the franchisee is his supervisory-employee. From the union's point of view it would be irrelevant whether the Board asserted jurisdiction on the basis of the joint employer or supervisor relationship. In terms of the relationship between franchisor and franchisee, the consequences of defining the franchisee as a supervisor have been previously discussed.¹⁴⁰ In either event, the enterprise would become subject to the NLRA.

A finding of joint employer status would have no immediate consequences. The employees of the franchisee would be given the opportunity to choose or reject a collective bargaining representative. If the employees chose a collective bargaining representative, the franchisor might find it necessary to supervise carefully the personnel practices of his franchisee, especially his relationship with the union. This is true for several reasons. First, the franchisor is more likely to have the experience, expertise and personnel required to negotiate and administer a collective bargaining agreement. Second, the franchisor will be interested in proper dealings with the union to ensure, on the one hand, that unnecessary work stoppages are avoided and, on the other hand, that costly wage increases are resisted. Third, the joint employer is jointly and severally liable for any financial liabilities incurred as a result of the unfair labor practices of his co-employer.¹⁴¹ Finally, and most importantly, the franchisor realizes that any union problems arising in one franchise outlet might endanger the franchisor's business in other outlets.

In sum, when a businessman decides to use franchising, whether by recruiting single distributors with their meager investment or by training potential entrepreneurs who invest substantially in the enterprise, his choice of contract language and his control of the franchisee may well justify an assertion of jurisdiction by the NLRB. The effects

¹³⁹ 170 N.L.R.B. No. 159, 67 L.R.R.M. 1582 (1968); see pp. 239-45 *supra*.

¹⁴⁰ See note 98 and accompanying text *supra*.

¹⁴¹ See *NLRB v. Frontier Guard Patrol, Inc.*, 399 F.2d 716 (10th Cir. 1968) for an excellent analysis of the rationale and use of the joint employer doctrine in unfair labor practice proceedings.

of the Board's decision will vary according to the type of franchise involved.

B. Adoption of Franchising by an Ongoing Enterprise

Where an employer distributes products or services directly through employees, he may decide to convert to a franchising system of distribution using one of two methods. He may terminate his employment relationship with the employees and franchise either individual former employees or new purchasers; or he may divide his enterprise into geographical segments and assign franchise territories to individual or corporate entrepreneurs, who in turn would sell franchises to individual franchisees. In either case, he may very well encounter serious problems under provisions of the National Labor Relations Act, especially Sections 8(a)(1), 8(a)(3) and 8(a)(5).

Sections 8(a)(1)¹⁴² and 8(a)(3)¹⁴³ forbid an employer to interfere with the organizational activities of employees by threats, coercion or actual discrimination with respect to hiring or tenure of employment. It is an unfair labor practice, therefore, for employers to coerce their employees in an attempt to dissuade them from forming, joining or assisting labor organizations. Similarly, it is an unfair practice for employers to terminate, transfer, demote, or decrease the compensation of employees as retaliation for union activities. Section 8(a)(5)¹⁴⁴ requires employers to bargain in good faith with respect to hours, wages and other terms and conditions of employment. In addition, the Board often insists that an employer negotiate certain decisions with a union during the term of an existing agreement, including decisions to relocate the enterprise, subcontract out tasks, or terminate the enterprise. An employer who decides to franchise an enterprise which is unionized, or who initiates franchising during a union organizational campaign, may well become enmeshed in unfair labor practice litigation involving charges of violations of sections 8(a)(1), (3) or (5). The response of the Board to these charges will, in part, depend upon its initial characterization of the franchise relationship. The Board's resolution of the issues arising from the charges could well have an important impact on the quality of the franchise relationship.

Before considering the genuinely perplexing problems that arise when franchising is utilized as a legitimate response to problems encountered in product distribution, we must first consider issues arising from a deliberate use of franchising to frustrate employees'

¹⁴² 29 U.S.C. § 158(a)(1) (1970).

¹⁴³ 29 U.S.C. § 158(a)(3) (1970).

¹⁴⁴ 29 U.S.C. § 158(a)(5) (1970).

rights. The Board has not hesitated to expose as a sham a franchise program obviously designed to prevent current employees from engaging in organizational activities.¹⁴⁵ Although the motive of the employer in initiating a franchise program is not always clear, where the initiation of a union organizational campaign and the decision to franchise coincide, a strong presumption is raised that the franchising program is an illegal response to the organizational attempt. The "sale" of franchises to former employees via long-term credit obligations is strong evidence that an employer has violated section 8(a)(1).

Yet, in cases where the motives for franchising are mixed or unclear, the Board has found it difficult to convince reviewing courts that the initiation of franchising by an ongoing enterprise necessarily violates sections 8(a)(1), 8(a)(3) or 8(a)(5). In *Carnation Co.*,¹⁴⁶ for example, the company had employed over one hundred route drivers to distribute its dairy products; the drivers were represented by a Teamster local. Two months after negotiating a new contract, the company began negotiating individual distributorship agreements with its employee-drivers. The union charged the employer with violations of sections 8(a)(1) and 8(a)(5). At the time of the hearing, approximately one-third of the drivers had signed the franchise agreements. Four drivers who had elected not to sign the agreements were terminated. The Board found that, despite the franchise agreement, the driver-distributors were still employees covered by the bargaining contract and that Carnation's bargaining with its individual drivers constituted a violation of sections 8(a)(1) and 8(a)(5). In the alternative, the Board found that the employer had violated sections 8(a)(1) and 8(a)(5) by failing to bargain concerning the decision to change the status of the route men.¹⁴⁷

The Ninth Circuit Court of Appeals denied enforcement of the Board's order that the four discharged drivers be reinstated with back pay.¹⁴⁸ The court held that since the driver-distributors had been

¹⁴⁵ In *Borden, Inc.*, 181 N.L.R.B. No. 19, 73 L.R.R.M. 1583 (1970), the Board dealt summarily with the employer's attempt to circumvent his contractual obligations with a certified collective bargaining agent by unilaterally instituting a franchise program. The employer imposed the franchise status on current employees by threatening to sell their routes if they refused to participate in the new program. The Board found a violation of 8(a)(5), noting that the newly formed franchise "represents nothing more than a unique plan by the employer to shift some of its operating costs to the vendor who now more than ever is subservient to the employer's wishes and desires." *Id.* at 1584. In *Borden, Inc.*, 192 N.L.R.B. No. 7, 77 L.R.R.M. 1532 (1971), the Board reaffirmed the above finding in 181 N.L.R.B. No. 19, 73 L.R.R.M. 1583 (1970), reiterating that the employees involved remained employees and did not become independent contractors as contended by the employer. *Id.*

¹⁴⁶ 172 N.L.R.B. No. 215, 69 L.R.R.M. 1127 (1968).

¹⁴⁷ *Id.*, 69 L.R.R.M. at 1128.

¹⁴⁸ *Carnation Co. v. NLRB*, 429 F.2d 1130, 74 L.R.R.M. 2311 (9th Cir. 1970).

effectively transformed into independent contractors, the company was not under a continuing obligation to observe the collective bargaining agreement.¹⁴⁹ The court remanded the case for further proceedings on the question of whether the franchise program was unilaterally imposed by the employer in violation of section 8(a)(5) and directed the Board to fashion a remedy that would take into account the termination of the employment relationship.¹⁵⁰

The refusal of the court to enforce the Board's order, although understandable because of the Board's previous position in a related matter, raises numerous questions concerning the franchise relationship, the proper application of Agency principles and the proper roles of the Board and appellate courts. Prior to its decision in *Carnation*, the Board had, in effect, permitted Shamrock Dairy, one of the franchisor's competitors in the Phoenix area, to enter into distributorship agreements with its employees during the term of a collective bargaining agreement.¹⁵¹ On the belated advice of counsel, Carnation decided to do the same.¹⁵² Arguably, it was unfair for the Board to change its rules in such a way as to create competitive disadvantages for one employer or one group of employers. However, the Board is, and must be, free to overrule itself. Nonetheless, the appellate court, although recently instructed by the Supreme Court to defer to the Board's expertise in cases involving employee status,¹⁵³ substituted its own interpretation of the facts in the record. Furthermore, the court insisted that its decision was not only faithful to Agency principles, but also more in conformity with the purpose of the Act.¹⁵⁴

The court not only ruled that the employer had successfully transformed its employees into independent contractors; it also indicated that even if the Board had found that Carnation violated section 8(a)(5) by refusing to bargain its decision to franchise, the Board could not remedy the violation by compelling Carnation to distribute its products through employee drivers. On application by the Board for an order modifying the opinion, the court agreed that the Board had the power to order a restoration of the status quo to remedy a violation of section 8(a)(5)—that is, to compel the employer to

¹⁴⁹ Id. at 1135, 74 L.R.R.M. at 2315.

¹⁵⁰ Id. at 1136, 74 L.R.R.M. at 2315.

¹⁵¹ Shamrock Dairy, Inc., 124 N.L.R.B. No. 63, 44 L.R.R.M. 1407 (1959) and 119 N.L.R.B. No. 134, 46 L.R.R.M. 2433 (1957), aff'd sub nom. International Brotherhood of Teamsters, Local 310 v. NLRB, 280 F.2d 665 (D.C. Cir.) cert. denied, 364 U.S. 892 (1960).

¹⁵² Carnation Co. v. NLRB, 429 F.2d 1130, 1132-33, 74 L.R.R.M. 2311, 2313 (9th Cir. 1970).

¹⁵³ NLRB v. United Insurance Co. of America, 390 U.S. 254 (1968).

¹⁵⁴ Carnation Co. v. NLRB, 429 F.2d 1130, 1133-34, 74 L.R.R.M. 2311, 2313-14 (9th Cir. 1970).

observe the union contract while negotiating the franchise program—but the court clearly indicated that it would consider such a remedy to be an abuse of the Board's discretion.¹⁵⁵ On remand, the Board held that the employer had not violated section 8(a)(5). The Board found that the employer had, in fact, initiated discussions concerning possible adoption of a franchise system, and that the union had refused to cooperate. Since the parties had reached an impasse on the issue, the Board concluded that the employer was free to make changes in its distribution system.

The implications of the court's decision are somewhat startling: employers are free to circumvent contractual commitments by "franchising" their distribution system to current employees; and, even though the Board may find a violation of section 8(a)(5), it is powerless to prevent the circumvention. This decision, however, is limited by a unique set of facts. The Board had previously found on a similar record that an employer had not violated the Act by franchising his distribution routes.¹⁵⁶ The decision and order had been enforced. Then, without overruling the prior decision, the Board reached a contrary conclusion with regard to a competitor of the previous employer.¹⁵⁷ Since the Board had acted unfairly, the court's decision was, perhaps, nothing more than judicial reaction to administrative incompetence.

A franchisor is particularly vulnerable to other charges under section 8(a)(5). Assume, for example, that a manufacturer organizes a franchise distribution system using driver-distributors. If he uses a standard franchise agreement, the Board probably would characterize his franchisees as employees in either a representation or unfair labor practice case. The franchisor might hope to avoid unionization by creating a remunerative, well-managed system for the franchisee; more likely, he will give little, if any, consideration to the possibility of unionization. Given the difficulties involved in organizing small numbers of widely dispersed store clerks or drivers, it is unlikely that the service sponsor-retailer will have to face an organization campaign. On the other hand, all franchisee-employees who engage in concerted activity are entitled to the protections of the National Labor Relations Act. If two franchisees approach a franchisor and request or demand a change in the franchise contract, an attempt by the franchisor to penalize the franchisees might violate sections 8(a)(1) and 8(a)(3).¹⁵⁸

¹⁵⁵ *Carnation Co. v. NLRB*, 429 F.2d 1130, 1136, 75 L.R.R.M. 2046 (9th Cir. 1970).

¹⁵⁶ *Shamrock Dairy, Inc.*, 124 N.L.R.B. No. 63, 44 L.R.R.M. 1407 (1959).

¹⁵⁷ See text accompanying notes 151-52 *supra*.

¹⁵⁸ Cf. *Latex Industries, Inc.*, 132 N.L.R.B. No. 3, 48 L.R.R.M. 1310 (1961); *Ryder Tank Lines, Inc.*, 135 N.L.R.B. No. 95, 49 L.R.R.M. 1597 (1962).

Similarly, any other concerted activity related to wages, hours or terms and conditions of employment is protected by section 7.¹⁵⁹

More importantly, once a group of franchisees persuades the NLRB that its members are employees, and elects union representation, the franchisor will be severely circumscribed by section 8(a)(5) in his freedom to modify or terminate franchise agreements. If a union utilizes its right to ignore the individual franchise agreements and bargains without reference to them, or incorporates them by reference into a collective agreement with appropriate modifications, the employer might not be able to terminate or even modify his basic distribution system without first negotiating the decision with the union representative.¹⁶⁰ Assuming the existence of the usual union security

¹⁵⁹ 29 U.S.C. § 157 (1970). The definition of a "protected activity" is often a difficult one; see *NLRB v. Thayer Co.*, 213 F.2d 748, 34 L.R.R.M. 2250 (1st Cir. 1954), for an excellent discussion of the concept in the context of the reinstatement rights of strikers. It is fairly safe to say that if a group of employees acts in concert in an attempt to negotiate or improve wages, hours or conditions of employment, their termination by an employer would be violative of sections 8(a)(1) and 8(a)(3). See, e.g., *Western Contracting Corp. v. NLRB* 322 F.2d 893, 54 L.R.R.M. 2216 (10th Cir. 1963); but cf. *NLRB v. Mt. Clemens Pottery Co.*, 147 F.2d 262, 16 L.R.R.M. 501 (6th Cir. 1945); *NLRB v. Deaton Truck Line, Inc.*, 389 F.2d 163, 67 L.R.R.M. 2632 (5th Cir. 1968). See also, Schatzki, *Some Observations and Suggestions Concerning a Misnomer—"Protected" Concerted Activities*, 47 Texas L. Rev. 378 (1969).

¹⁶⁰ In *Fibreboard Paper Products Corp. v. NLRB*, 379 U.S. 203 (1964), the Court enforced a Board decision ordering an employer to bargain with the representative of unit employees the decision to replace his maintenance employees with those of an independent contractor. Although the majority opinion by Chief Justice Warren and the concurring opinion by Mr. Justice Stewart carefully avoided imposing an obligation to bargain all decisions to subcontract, the Board early interpreted *Fibreboard* as imposing a general duty on employers to bargain decisions to subcontract—see, e.g., *Master Appliance Corp.*, 158 N.L.R.B. No. 96, 62 L.R.R.M. 1170 (1966); *Billups Western Petroleum Co.*, 169 N.L.R.B. No. 147, 67 L.R.R.M. 1323 (1968)—but later required that a decision must have an adverse impact on the employees or unit job opportunities before the bargaining obligation arises. The Board also at first interpreted the decision as requiring the employer to bargain concerning decisions to close its plant, see *Ozark Trailers, Inc.*, 161 N.L.R.B. No. 48, 63 L.R.R.M. 1264, (1966); to remove or relocate, see *Cooper Thermometer Co.*, 160 N.L.R.B. No. 150, 63 L.R.R.M. 1219 (1966); or to make basic structural changes which adversely affect unit employees, see *Cloverleaf Div. of Adams Dairy Co.*, 147 N.L.R.B. No. 133, 56 L.R.R.M. 1321 (1964).

It should be noted that the Board has consistently experienced difficulty in persuading appellate courts to accept its expansionary interpretation of *Fibreboard*. See, e.g., *NLRB v. Acme Industrial Products, Inc.*, 439 F.2d 40 (6th Cir., 1971), where the court rejected the Board's contention that the employer violated section 8(a)(5) by refusing to bargain a decision to relocate one plant's operations, for economic reasons, to another plant; the employer was willing to bargain all other aspects of the move. The court rejected what it perceived as the Board's "too broad a view of the . . . *Fibreboard* [decision]" and distinguished the present case on the ground that the employer stood ready to bargain on all aspects of the decision except the decision itself. *Id.* at 42. See also *NLRB v. Adams Dairy, Inc.*, 350 F.2d 108 (9th Cir. 1965), cert. denied, 382 U.S. 1011 (1966). Nonetheless, the Board has not abandoned its expansionary reading of *Fibreboard* and, as *Adams Dairy* illustrates, the Board would likely apply it to franchise closings. Cf. *Drapery Mfg. Co.*, 170 N.L.R.B. No. 199, 68 L.R.R.M. 1027 (1968).

In a recent decision, the Board indicated that it may be taking a new direction.

provision, the franchisor would also be unable to utilize the one- or thirty-day termination provisions.¹⁶¹

As a joint employer, the franchisor may find similar serious restraints placed upon the management of his franchised units by section 8(a)(5). Under many franchise agreements, the franchisor has the power to terminate the franchise unilaterally. Although franchise agreements can often be interpreted to require some breach of a contractual condition by the franchisee in order to justify a summary termination,¹⁶² the franchisee is rarely in a position to challenge the franchisor's decision. Consequently, the power to terminate the franchise constitutes the franchisor's most powerful weapon to ensure high standards of performance and prompt payment of fees and rents on the part of the franchisee. As a joint employer, the franchisor could still exercise the termination power (assuming there exist no contractual restrictions), but not with the same reckless abandon. If, for example, the franchisor terminated both the franchise enterprise and the franchisee, the Board, using extensions of the "Fibreboard" doctrine, could require the employer to bargain with a union representing the franchise employees.¹⁶³ The franchisor might face additional problems should he decide to make basic structural changes in an ongoing franchise. To the extent these revisions affect the wages, hours, terms and conditions of employment of the franchisee, the franchisor will be compelled to negotiate them not only with the

In *General Motors Corp., GMC Truck & Coach Div.*, 191 N.L.R.B. No. 149, 77 L.R.R.M. 1537 (1971), a majority of the Board held that the employer was not obliged to bargain a decision to sell its Houston Truck Center. A decision to sell, according to the majority, in which a significant investment or withdrawal of capital will affect the scope and ultimate direction of an enterprise, is a matter essentially financial and managerial in nature. Such a decision, the majority stated, lies at the very core of entrepreneurial control and is not the type of subject which Congress intended to encompass within the mandatory subjects of bargaining. Members Fanning and Brown dissented, adhering to the expansionary reading previously given to the *Fibreboard* decision in *Ozark Trailers*, *Cooper Thermometer* and *Adams Dairy*, supra. It is quite apparent that the Nixon Board will, in general, adhere closely to the limiting factors of *Fibreboard*: the only managerial decisions subject to the bargaining obligation are those decisions involving a decision to sub-contract work previously performed by members of the unit, and which will cause members to lose their employment. But see C. A. Scott, 192 N.L.R.B. No. 30, 77 L.R.R.M. 1718 (1971), where the Board recently held that a unilateral decision by the employer to eliminate work in one department of the enterprise put the employer in violation of section 8(a)(5).

¹⁶¹ It is assumed, of course, that the union will restrict the employer's right to discharge employees to situations involving a failure of the employee to discharge his duties, or to situations where the employer must reduce his work force due to a decrease in business. The employer could still discharge the franchisee, but, under the usual union security provision, he would have to state a reason.

¹⁶² Gellhorn, *Limitations on Contract Termination Rights—Franchise Cancellations*, 1967 Duke L.J. 465; Note, *Article Two of the Uniform Commercial Code and Franchise Distribution Agreements*, 1969 Duke L.J. 969.

¹⁶³ See note 160 supra.

franchisee, but also with the employees' collective bargaining representative.¹⁶⁴ If the franchisor were able to substitute a new franchisee without making basic alterations in the structure of the enterprise, the new franchisee might inherit current (unionized) employees with the usual contractual restrictions on their terminations. For a potential franchisee, the combination of a union, a collective bargaining agreement in which he did not participate, and a group of left-over employees might mar the attractiveness of even a financially successful enterprise.

Another important problem for the franchisor centers upon the meaning given the phrases "wages" and "terms and conditions of employment" in the franchise context. Since the franchisee's compensation is usually the difference between the gross cost of the distributed product or service and the retail price, any changes in the price of supplies or services would have to be negotiated because they would affect the compensation or "wages" of the franchisee. The franchisor's right to modify fee payments or royalties would be subject to the same limitations. Although the franchisor could negotiate the right to make these decisions without consulting the union representative, it is rare for the union to surrender control of these crucial decisions to the employer's discretion.¹⁶⁵

C. *The Administration of a Franchise Program: Problems with Picketing and Boycotts*

Prospective franchisors and franchisees should anticipate, during the life of the franchise, the possibility of becoming involved in strike, picketing and boycott activities by labor organizations. These activities may occur in a variety of circumstances and they raise the problem of

¹⁶⁴ In *Dixie Ohio Express Co.*, 167 N.L.R.B. No. 72, 66 L.R.R.M. 1092 (1967), the Board held that an employer was required to bargain a reorganization of his operations involving the loss of unit jobs with the representative of the employees. The Board has also held that, where an employer's contracting-out resulted in a loss of reasonably anticipated work opportunities for unit employees, as in *Shurtenda Steaks, Inc.*, 161 N.L.R.B. No. 88, 63 L.R.R.M. 1407 (1966), or where the subcontracting resulted in a loss of overtime, as in *Cities Service Oil Co.*, 158 N.L.R.B. No. 120, 62 L.R.R.M. 1175 (1966), the employer was under an obligation to bargain the decision. The logical reading of the cases in combination indicates that where an employer's change in operational methods causes some adverse impact on the employees, the decision to implement the change would have to be bargained with the union. Thus, where a franchisor "requests" a franchisee to reduce his hours of operation, to cut labor costs, to change operational methods resulting in few unit jobs or reduced overtime, or to agree to increased franchise fees, royalty payments or product costs, the union might persuade the Board that these organizational or financial adjustments by the joint employer will have an adverse impact on wages or conditions.

¹⁶⁵ *Cox and Dunlop, Regulation of Collective Bargaining by the National Labor Relations Board*, 63 Harv. L. Rev. 389, 407-11 (1950).

how to characterize the franchise relationship so as to determine the applicability of Sections 8(b)(4) and 8(b)(7) of the NLRA.

Section 8(b)(4),¹⁶⁶ which prohibits secondary boycotts, is designed to isolate "neutral" employers and their employees from the disruptive effects of labor disputes between other employers and their employees. A secondary boycott is an attempt by a union to involve and inconvenience neutral employers or employees in order to bring pressure on the "primary employer" with whom the union has its dispute. Thus the section makes it an unfair labor practice for a union to engage in a strike or boycott to compel a *neutral* employer to stop doing business with a primary employer, or to persuade neutral employees to withdraw their services from their employer. The section does not protect employers from the effects of "primary" picketing directed at the employer with whom the union has a dispute, even if the neutral employer is prevented from making pick-ups or deliveries as a result of the picketing.¹⁶⁷ Nor does it protect employers who "ally" themselves with the primary employer by agreeing to handle material which otherwise would have been handled by the striking employers.¹⁶⁸ Finally, the Board has held that employers who are so closely controlled by the primary employer so as to be part of a "single integrated enterprise" cannot claim the protection of 8(b)(4) as "neutral" employers.¹⁶⁹ Section 8(b)(7)¹⁷⁰ restricts organizational picketing—picketing which is designed to secure employer recognition

¹⁶⁶ 29 U.S.C. § 158(b)(4) (1970).

¹⁶⁷ *NLRB v. International Rice Milling Co.*, 341 U.S. 665 (1951). See also the proviso to § 8(b)(4)(B) added by Congress in 1959. The gloss on 8(b)(4) is extensive and short summaries of its varied implications are inevitably misleading. For excellent analysis of the scope and detail of 8(b)(4) see Lesnick, *The Gravamen of the Secondary Boycott*, 62 *Colum. L. Rev.* 1363 (1962); Lesnick, *Job Security and Secondary Boycotts: The Reach of NLRA Sections 8(b)(4) and 8(e)*, 113 *U. Pa. L. Rev.* 1000 (1965).

¹⁶⁸ The "ally doctrine" had its origin in an opinion by Judge Rifkind in *Douds v. Metropolitan Federation of Architects*, Local 231, 75 *F. Supp.* 672 (S.D.N.Y. 1948), and its use by the N.L.R.B. was approved in *NLRB v. Business Machine and Office Appliance Mechanics*, Local 459, 228 *F.2d* 553 (2d Cir. 1955), cert. denied, 351 U.S. 962 (1956). For a critical analysis of the doctrine, see Asher, *Secondary Boycotts—Allied, Neutral and Single Employers*, 52 *Geo. L.J.* 406 (1964).

¹⁶⁹ See note 174 *infra*.

¹⁷⁰ Section 8(b)(7)(C), 29 U.S.C. § 158(b)(7)(C) (1970), prohibits a union from engaging in picketing designed to "persuade" an employer to recognize or bargain with that union when the picketing extends beyond a reasonable period, unless the union files a representation petition prior to the expiration of that period. Upon filing, an expedited election will be conducted by the Board. Where the union fails to file the petition, § 10-1 requires the Regional Director in the appropriate region to secure injunctive relief in a federal district court. See generally, Local 681, *Joint Executive Board of Hotel And Restaurant Employees*, 130 *N.L.R.B. No.* 68, 47 *L.R.R.M.* 1321 (1961), supplemental decision and order, 135 *N.L.R.B. No.* 124, 49 *L.R.R.M.* 1648 (1962), *aff'd sub nom. Smitley v. NLRB*, 327 *F.2d* 351 (9th Cir., 1964).

of the union as the collective bargaining representative of the employees. It is important to note that such picketing is prohibited only when designed to force an employer to recognize the union as the bargaining agent of *his* employees.

The inherent limitations on the protections offered by these sections have important implications for the franchised enterprise. The possibility that the franchisor or franchisee might be involved in, or be the object of, picketing or boycott activity should be considered carefully in the decision to adopt franchising as a distribution technique. Although no reported cases have raised the issue in the context of franchising, the disposition of charges under section 8(b)(4) frequently turns on the relationship between the primary employer—the employer with whom the union has a dispute—and the allegedly “neutral” or secondary employer. In *Operating Engineers, Local 12*,¹⁷¹ a union threatened to picket a construction site when the employer subcontracted excavation work to two individual nonunion, equipment owner-operators. The trial examiner recommended that the union be found in violation of sections 8(b)(4)(ii)(A) and (B). The Board disagreed, finding that the owner-operators were sufficiently controlled by the employer to qualify as statutory employees. The union was protesting not the employer’s business relationship with nonunion employers, but rather, his employment of nonunion employees. Therefore, the complainant was not a neutral employer for purposes of section 8(b)(4).¹⁷² Since this section prohibits only the picketing of neutral employers, the complaint was dismissed.

The implications for franchising are readily apparent. If the

¹⁷¹ 168 N.L.R.B. No. 112, 67 L.R.R.M. 1019 (1967). See also *Carpenters Local 2265*, 170 N.L.R.B. No. 93, 67 L.R.R.M. 1557 (1968) where a union initiated organizational picketing at job sites in an attempt to organize allegedly independent installers who were installing carpeting on contract with the employer. The employer charged the union with violating § 8(b)(4)(ii)(B) on the theory that the union was coercing the employer to restrain him from doing business with the independent contractor-installers. The Board dismissed the complaint, finding that, since the employer retained the right to control the way the installers performed their tasks, the installers were employees; the picketing was not, therefore, interfering with the employer’s relationships with other businessmen.

The principle is important in the franchising context. Picketing is a potent weapon in attempts to organize employees; if the franchisor could successfully argue that his franchisee-distributors were independent contractors, he could request an injunction against picketing which interfered with his business relationship by alleging a violation of 8(b)(4)(ii)(B). The employer-franchisor could also charge a violation of section 8(b)(7)(C), which prohibits organizational picketing unless the union files a petition for a representation within a reasonable period of time (usually 30 days). However, the charge would impliedly admit that the franchisees were employees, since 8(b)(7) only regulates picketing for organizational purposes. The franchisor might be unwilling to make that concession if he thinks he can persuade the NLRB that his franchisees are independent contractors.

¹⁷² *Operating Engineers, Local 12*, 168 N.L.R.B. No. 112, 67 L.R.R.M. 1019, 1019-20 (1967).

Board finds an employment rather than an independent contractor relationship, the franchisor and franchisee cannot claim that picketing activity directed at the franchisor is directed at a neutral employer. The franchisor would be considered the only, and therefore the primary, employer. Even if the franchisor successfully argues that his franchisees are independent contractors, the union will contend that their participation in the franchise program makes them "allies"¹⁷³ of the franchisor, or part of a "single integrated enterprise,"¹⁷⁴ and that therefore the franchisor is not a neutral employer. Finally, if the franchisor is characterized as the joint employer of the disputant-employees, again, he would not be considered a neutral employer.¹⁷⁵

A union attempting to organize the employees of a franchisee might attempt to picket the franchisor in order to bring additional pressure on the franchisee and his employees. Under section 8(b)(7)(C),¹⁷⁶ organizational picketing may be carried on, but it will be

¹⁷³ Cf. *Douds v. Metropolitan Federation of Architects, Engineers, Chemists and Technicians, Local 231*, 75 F. Supp. 672 (S.D.N.Y. 1948). The ally doctrine was approved and adopted in *NLRB v. Business Machines Local 459*, 228 F.2d 553 (2d Cir. 1955). The Board has declared that the ally doctrine is also applicable if the primary and secondary employers, even though separate legal entities, are under common ownership and if there is, in addition, such actual or active common (as distinguished from merely potential) control as to denote an appreciable integration of operation and management policies. *Drivers, Chauffeurs and Helpers, Local 639*, 158 N.L.R.B. No. 129, 62 L.R.R.M. 1197 (1966).

¹⁷⁴ For a description of the "single integrated enterprise" concept, see *Vulcan Materials Co. v. United Steelworkers of America, Local 2176*, 430 F.2d 446, 74 L.R.R.M. 2818 (5th Cir. 1970). See also *Okeh Caterers*, 179 N.L.R.B. No. 84, 72 L.R.R.M. 1405, 1406 (1969), (where three separately owned corporations indicated one facility as the corporate address, used trucks covered by a common insurance policy, and supervised their employees in common, they were termed a single integrated enterprise and treated as joint employers of lessee drivers for purposes of jurisdictional standards); *Welcome-American Fertilizer Co.*, 169 N.L.R.B. No. 104, 67 L.R.R.M. 1484 (1968), (where a larger company owned all the stock of the smaller company, four of five of the latter's Board of Directors were employees of the former, and the larger company trained employees of the smaller and allowed them to participate in its fringe benefits program, the two constituted a single integrated enterprise for purposes of determining NLRB jurisdiction over an alleged violation of § 8(a)(3) by the smaller company).

The Board has various short hand symbols to describe the single integrated enterprise. For example, in *Mutual Coal Co., Inc.*, 170 N.L.R.B. No. 27, 67 L.R.R.M. 1385 (1968), where sublessees of a coal mine owner were contractually compelled to work under the supervision of lessor's engineers and to deliver all coal mined to the lessor at his price, the Board termed the lessee "an administrative segment" of the lessor. In *Manley Transfer Co., Inc.*, 164 N.L.R.B. No. 21, 65 L.R.R.M. 1194 (1967), the Board termed a subcontractor of the primary contractor a "subordinate instrumentality" of the primary contractor, where the subcontractor and the primary contractor were commonly owned. *Id.* at 1196. In *J. Howard Jenks*, 165 N.L.R.B. No. 1, 65 L.R.R.M. 1228 (1967), the Board held that an employer that had changed its name and corporate form, but had remained under the ownership and control of a former employer found guilty of various unfair labor practices, was the "alter ego" of the first employer.

¹⁷⁵ *Teamsters Local 559*, 172 N.L.R.B. No. 35, 69 L.R.R.M. 1270 (1968).

¹⁷⁶ 29 U.S.C. § 158(b)(7)(C) (1970).

enjoined if the union fails to file a representation petition with a reasonable time (usually thirty days).¹⁷⁷ Although the extent of the picketing permitted by section 8(b)(7)(C) is unclear, it is possible that a union could legitimately picket a joint employer of the target employees, even though the latter were not present at the site of the picketing.¹⁷⁸ Ironically, one union which engaged in the picketing of franchisees defended against a section 8(b)(7)(C) complaint by attempting to prove that the franchisees were independent contractors.¹⁷⁹ If the Board had accepted the union's contention, it would have lacked the jurisdiction to seek an injunction against the picketing. Using the right to control test, however, the Board determined that the franchisees were employees and issued a remedial order.

In attempting to minimize the risks involved in a labor organization's use of permissive picketing and boycotts, a franchisor is apt to be caught in a double bind. If he ensures that his franchisees will be characterized as independent contractors, he will be unable to avail himself of the protection of 8(b)(7).¹⁸⁰ Furthermore, even if the franchisees are characterized as independent contractors, they will probably not be characterized as neutral employers for the purposes of the protective provisions of section 8(b)(4), because they are either allies of the franchisor or part of a single integrated enterprise.¹⁸¹ If, on the other hand, the franchisees are characterized as employees, the franchisor cannot seek to enjoin union activities under section 8(b)(4) since there exists only one primary employer—the franchisor—rather than both primary and neutral employers.¹⁸² A finding that the franchisees and franchisor are joint employers similarly neutralizes

¹⁷⁷ 29 U.S.C. § 158(b)(7)(C) (1970).

¹⁷⁸ See Dunau, *Some Aspects of the Current Interpretation of Section 8(b)(7)*, 52 Geo. L.J. 220 (1964); Note, *Illegal Picketing Under Section 8(b)(7)—A Reexamination*, 68 Colum. L. Rev. 745 (1968).

¹⁷⁹ In *Sheet Metal Workers, Local 283*, 172 N.L.R.B. No. 76, 69 L.R.R.M. 1174 (1968), where the union was attempting to organize installers of air conditioning units, organizational picketing was carried on for more than 30 days without the union filing a representation petition. The union was charged with a violation of § 8(b)(7)(C), which prohibits organizational picketing for more than 30 days unless a representation petition is filed. The union defended against the charge by contending that the installers were *not* employees and that, therefore, the picketing was not organizational picketing forbidden by § 8(b)(7)(C). The Board, however, disagreed, finding that the installers were employees and that the picketing was thus proscribed by § 8(b)(7)(C).

¹⁸⁰ Thus, for example, in *Sheet Metal Workers, Local 283*, *supra* note 179, if the contractor had created indicia of independent contractor status for the installers, he could not have invoked § 8(b)(7)(C).

¹⁸¹ See *supra* note 174 and cases cited therein.

¹⁸² See, e.g., *Local 559, Internat'l Brotherhood of Teamsters*, 172 N.L.R.B. No. 35, 69 L.R.R.M. 1270 (1968), in which the Board held that where a manufacturer distributed his products through a subsidiary which he controlled, a union in dispute with the subsidiary was not prohibited by § 8(b)(4) from picketing the plant of the parent manufacturer, since the two employers were considered one for the purposes of § 8(b)(4).

the franchisor's possible protection against being involved in his franchisee's labor disputes.¹⁸³ The same result would follow if the franchisees were characterized as supervisors. Thus, the franchisor's only protection would be that normally available to an employer whose premises are subject to picketing. The franchisor of either single distributors or large enterprises should not assume that he will receive the added protection afforded to a neutral employer.

D. *Transferring the Franchise: The Problem of the Successor Franchisee*

A distinguishing feature of the franchise relationship is the opportunity it provides the inexperienced entrepreneur to invest in a business enterprise which, with the franchisor's help, he can build and eventually sell at a substantial profit.¹⁸⁴ If the franchisee is a single distributor, and the contract permits, he will encounter no problem with federal labor legislation in disposing of his franchise interest. Where the franchisor and franchisee are joint employers of organized employees, however, the joint employer doctrine may well be used to transfer the contractual and statutory obligations of a franchisee-employer to his successor in interest. The importance of the joint employer doctrine in the franchise context may best be illustrated by comparing two cases dealing with the refusal of a successor employer to bargain with a union recognized by his predecessor.

In *Ramada Inns, Inc.*,¹⁸⁵ the owner of a Ramada franchise contracted with a second franchisee, Ramada Inc., whereby the latter agreed to operate the motel's restaurant. Shortly after beginning to operate the restaurant, Ramada Inc. was presented with a demand for recognition by a union representing a majority of the restaurant employees. The entire franchise was then assumed by a successor who retained the franchise agreement with Ramada Inc. Some six months after the union's original demand, during which time Ramada Inc. had refused to bargain with the union, Ramada Inc. assigned the restaurant franchise to another franchisee named Maalouf. The union made a bargaining demand on Maalouf which he refused. The union then filed a charge under section 8(a)(5).¹⁸⁶

General Counsel issued a complaint against Maalouf on the ground that Ramada Inc. had unlawfully refused to recognize and bargain with the union in response to the original demand, and that as successor to Ramada, Maalouf had an obligation to remedy his predecessor's unfair labor practice. The majority opinion of the Board,

¹⁸³ *Id.*

¹⁸⁴ See pp. 220-21, 235 *supra*.

¹⁸⁵ 171 N.L.R.B. No. 115, 68 L.R.R.M. 1209 (1968).

¹⁸⁶ *Id.*

while conceding that Ramada Inc. had violated section 8(a)(5), stated that: "Ramada's prior unlawful refusal to bargain cannot . . . be attributed to Maalouf. The Board has never held that an unfair labor practice develops [sic] upon a bona fide purchaser of a business simply by reason of successorship. . . ." ¹⁸⁷

There was no suggestion in *Ramada Inns* that the franchisor was the joint employer of the restaurant employees. But if joint employer status had been established, an argument could have been proffered similar to that used by the General Counsel in *Ref-Chem Co.*¹⁸⁸ There the Board found that a series of subcontractors, working under contract with El Paso Corp., were joint employers, with El Paso, of the unit employees. The original subcontractor had negotiated a contract which his successor refused to observe. The Board found that the latter subcontractor had violated section 8(a)(5) by refusing both to recognize the union and to observe the original agreement.¹⁸⁹ The Board's theory was that the obligation to observe the original agreement remained constant in the joint employer, Ref-Chem, and that the agreement had been assumed in turn by each of the subcontractors.¹⁹⁰ Although granting that the evidence established that the subcontractors and El Paso were joint employers, the court of appeals rejected the Board's theory of the case:

[T]he Board did not set out case authority, nor are we furnished with any in this court, sustaining the use of the joint employer doctrine to pass the obligation to bargain from one employer to another by means of their common but successive joint employer, where none of the employers is a successor or *alter ego* of another.¹⁹¹

The qualification offered by the court in the final clause suggests that where successorship in the labor law sense occurs—*i.e.*, when

¹⁸⁷ Id., 68 L.R.R.M. at 1211. Although the Board perhaps had not used the joint employer doctrine to impose an obligation to bargain on a successor employer, the quoted majority statement is inaccurate. In *Perma Vinyl Corp.*, 164 N.L.R.B. No. 119, 65 L.R.R.M. 1168 (1967), the Board held that "[t]o further the public interest involved in effectuating the policies of the Act and achieve the 'objectives of national labor policy, reflected in established principles of federal law,' we are persuaded that one who acquires and operates a business of an employer found guilty of unfair labor practices in basically unchanged form under circumstances which charge him with notice of unfair labor practice charges against his predecessor should be held responsible for remedying his predecessor's unlawful conduct." Id. at 1169. In addition, in *Overnite Transportation Co., Inc.*, 157 N.L.R.B. No. 103, 61 L.R.R.M. 1520 (1966), the Board found a violation of § 8(a)(5) where the successor employer changed the condition of employment without bargaining with the incumbent union.

¹⁸⁸ 169 N.L.R.B. No. 45, 67 L.R.R.M. 1220 (1968).

¹⁸⁹ Id., 67 L.R.R.M. at 1227.

¹⁹⁰ Id., 67 L.R.R.M. at 1226.

¹⁹¹ *Ref-Chem Co. v. NLRB*, 418 F.2d 127, 129 (5th Cir. 1969).

"assets and employees are transferred from one employer to another and the identity of the employing enterprise remains substantially intact,"¹⁰²—the contractual obligations of a franchisee might well be preserved and passed on by a common franchisor-joint employer.

If the successor to a franchisee must undertake an obligation to bargain with an existing unit, or even, perhaps to honor an existing collective bargaining agreement, the value of the franchise will be discounted accordingly. Although successor franchisees should be held to the same obligations as other successor employers, it is doubtful that any useful purpose would be served by imposing additional obligations through an ingenious use of the joint employer doctrine.

CONCLUSION

This article has attempted to demonstrate that franchising is a unique type of business association which does not neatly fit the National Labor Relations Act formulary used to characterize and regulate the interaction between employers and employees. The master-servant—purchaser-independent contractor conceptualization of the employment relationship does not generally reflect market realities and is particularly ill-adapted to the evaluation and classification of the franchise method of distribution. It has been suggested that the functional determinants of the franchise relationship cannot be measured by the common law right to control test. Rather, they should be assessed by the degree of entrepreneurial risk and opportunity involved in a particular franchise. Specifically, the determination of whether a franchisee is an employee of the franchisor should turn on the amount of the franchisee's capital investment in the franchise and on his ability to assign his interest for a profit. Similarly, the characterization of a franchisor as the joint employer of the franchisee's employees should depend upon his continuing financial interest in the franchise and his power to protect this interest by direct and indirect measures rather than by his right to control the labor relations of the franchisee.

To some degree, the National Labor Relations Board has focused on the realities, rather than the rhetoric, of franchising. In some cases the Board has characterized the franchisee as an employee in terms of the economic realities that determine his relationship to the franchisor. It has also, for the most part, tied the franchisor to the franchisee-employer because of the former's general influence over the wages, hours and working conditions of the franchisee's employees. However, the Board's decisions, while sensitive to the economics and politics of franchising, are frequently criticized by the courts for fail-

¹⁰² *Id.* See also *Perma Vinyl Corp.*, 164 N.L.R.B. No. 119, 65 L.R.R.M. 1168 (1967) discussed at note 187 *supra*.

ing to adhere to legislative rules and definitions. It has been suggested that this criticism could, in part, be avoided if the Board were to indicate clearly the principles of law and business realities underlying its decisions.

The necessity for a reevaluation of the criteria used to determine the applicability of the NLRA in the franchising context is evidenced by the considerable impact which an affirmative jurisdictional finding has upon the franchising relationship. The application of the NLRA often determines the legitimacy or utility of franchising as a method of distribution. Franchising programs implemented by an employer to avoid the obligations imposed by the Act have been consistently struck down by the Board. Moreover, franchisees have been required to bargain for structural and other changes affecting their employees with union representatives, and have been held responsible for remedying labor law violations of their predecessors.

On the whole, the law as developed by the NLRB has made franchising a less attractive business form for franchisors than it otherwise might be. The characterization of the franchisor as an employer or joint employer partially vitiates several of the primary purposes of most franchising programs: (1) the elimination of close management supervision, (2) flexibility in dealing with enfranchised distributors, (3) the conservation of economic power vis-à-vis distributors and (4) complete legal divorce from the franchisee. While franchisors and franchisees should legitimately be expected to bear their share of the economic burdens levied by social legislation such as the NLRA, they are both entitled to a more realistic appraisal of their status in terms of the objectives of the Act before these burdens are imposed.

BOSTON COLLEGE INDUSTRIAL AND COMMERCIAL LAW REVIEW

VOLUME XIII

DECEMBER 1971

NUMBER 2

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