

***Written Testimony of Andrew F. Puzder,
CEO of CKE Restaurants Holdings, Inc.
On Why the NLRB Adopting a New Joint Employer Standard Would Be Bad for
Workers, Employers, Franchising and the Economy
Before the House Education and the Workforce Committee's Subcommittee on
Health, Employment, Labor, and Pensions***

I. Introduction

I want to thank Chairman Roe and the members of the Health, Employment, Labor and Pensions Subcommittee for giving me the opportunity discuss what workers and employers should expect from the National Labor Relations Board (“NLRB”). The NLRB’s recent invitation for parties and amici to brief the issue of whether it should adhere to its existing joint employer standard or adopt a new standard is of particular concern to this nation’s franchise community, including our company, CKR Restaurant Holdings, Inc. (“CKR”), which franchises the Carl’s Jr. and Hardee’s quick service restaurant brands.

Our concern is that the NLRB will adopt a standard that views franchisees’ employees as employees of the franchisor. Such a standard could completely disrupt the franchisor/franchisee relationship if it were to make franchisors liable for their franchisees’ employment practices despite the fact that franchisors have no control over such practices.

The NLRB’s current standard has been in place for over 30 years. During that time the franchise business model has proven enormously successful at enabling individuals to own and operate their own businesses, creating substantial economic growth and jobs. The franchise model has also provided countless entrepreneurial opportunities for women, minorities, and veterans. If the NLRB were to change that standard so as to hold franchisors responsible as joint employers with their franchisees, it would significantly and negatively impact both the franchise business model and the small businessmen and businesswomen who have invested their time, energy and money in the hopes of becoming successful franchisees, including those who have done so as part of CKE’s restaurant franchise system.

As CEO of CKE, I'm hopeful my testimony will help open a dialogue between legislators, regulators and the business community on this issue because it is absolutely critical for everyone in this room to understand the potential adverse effects such a changed standard would have. As such, I would like to start with a general comment about the value of franchising and how it works.

The franchisor/franchisee relationship is built on a division of roles and responsibilities. The franchisor owns, represents and licenses the brand, and the franchisee owns and operates one or more locations as a licensee. Businessmen and businesswomen from diverse financial and cultural backgrounds invest money in America's franchised businesses, including CKE's, because they believe they can succeed using their individual business acumen and capital combined with our brand, even in competition with large national chains. Franchisees are the quintessential independent entrepreneurs. They create direct and indirect jobs while generating tax revenues and improving both our nation's economy and their local communities.

While as a franchisor CKE is contractually empowered to protect its brands and to do so on behalf of all of its franchisees, those contractual provisions are limited and do not extend to every phase of the business. We set standards our franchisees need to meet in order to protect the integrity of our brands and ensure consistency throughout our system, but our franchisees run their businesses. Among other things, our franchisees choose their restaurant's location, determine how much they will pay for the location, invest their own capital in facilities and equipment, choose the prices they charge for products and manage every aspect of their restaurants day to day operations.

With respect to employees, the franchisees independently choose the people they hire, the wages and benefits they pay, the training such employees undergo, the specific labor practices they utilize, the method by which those employees are monitored and evaluated and the circumstances under which they are promoted, disciplined or fired.

As with most franchisors, CKE receives a onetime fee per restaurant (generally \$25,000) and a royalty (generally 4% of sales) to compensate it for the services it provides, for the use of its trademarks and for protecting the value of

those trademarks. CKE does not receive a share of its franchisees' profits. As such, franchisors benefit from a percentage of each franchised restaurant's top line sales. The franchisees, on the other hand, benefit from their restaurants' bottom line profits. Franchisees are responsible for their employees as they are the ones who directly benefit from an efficient and well managed staff. As they are the ones who benefit, the franchisees are also the ones who assume the risks associated with having and managing employees. It simply would be untenable for a franchisor to be deemed a joint employer.

Each of the 42 states in which our franchisees operate has its own particular labor laws with which such franchisees must comply. The franchisor's royalties are contractual as part of a franchise agreement that generally has a 20 year term. Neither the initial franchise fee nor the franchisor's royalty were intended to cover nor do they cover the costs of managing employee related risks. To impose such risk on franchisors would materially alter the existing franchisor/franchisee relationship to the detriment of both parties and materially damage the current very successful franchise business model.

Franchisees run their own businesses and each franchisee is in charge of the profitability of his or her restaurant, *not the franchisor*. The value of the franchise model is that it allows individual entrepreneurs to use their business judgment to run small businesses that utilize national or regional brands. A joint employee liability standard could destroy that model.

Let me describe our business and the importance of the franchise system to that business.

II. Company Description and Job Creation Impact

CKE Restaurants Holdings, Inc. is a quick service restaurant company that, through its subsidiaries, owns or franchises nearly 3,500 restaurants in 42 states and 31 foreign countries and territories. We are headquartered in Carpinteria, California with regional headquarters in Anaheim California, and St. Louis, Missouri. Carl N. Karcher, an Ohio native with an 8th grade education, and his

wife Margaret, a California native, started our Company in 1941 with a hot dog cart in South Central Los Angeles.

We now employ over 22,270 people in the United States. Our domestic franchisees employ approximately an additional 50,000 people. As such, we account for over 70,000 jobs in the United States.

Our Company owns and operates 883 of our 3,487 restaurants. Our franchisees own and operate the remaining 2,604 restaurants of which 2,008 are in the United States. Our Company-owned restaurants average over \$1.3 million in sales per year. Each restaurant employs about 25 people and has one General Manager.

We provide significant employment opportunities for minorities. Today, 62% of our Company employees are minorities. We also provide significant employment opportunities for women. Currently, 62% of our employees are women. We're proud of the Company's diversity.

Of CKE's over 22,270 employees, 2,936, or 13%, earn the federal minimum wage. Of these 2,936 minimum wage employees, 1,851, or 63%, are between the ages of 18 and 21 (basically high school or college age). As such, 5% of our total employee base is over 21 years of age and earning the federal minimum wage. The average hourly rate for all restaurant level employees is \$8.96. Last year, CKE spent \$329 million on restaurant level labor or about 28% of total company owned restaurant sales.

Our General Managers are 62% minorities and 66% women. They are 41 years old on average. However, their ages range from 19 to 64. Several of our Executive Vice Presidents and Senior Vice Presidents started as restaurant employees and learned the business as restaurant General Managers.

Our franchisees, who are generally small business owners and entrepreneurs themselves, often started out as General Managers in our restaurants or our competitors' restaurants. Many run family businesses that have passed from one

generation to the next. We have 226 franchisees nationwide. A few of our franchisees own a hundred or more restaurants, but most of our franchisees own 20 or less. These franchisees exemplify the American entrepreneurial spirit on which we built our Company and they instill that spirit in their 50,000 employees and managers.

While we and our franchisees directly account for over 70,000 jobs in the United States, our Company's impact on the Nation's employment rate goes well beyond the number of people we directly employ. The hundreds of millions of dollars we and our franchisees spend on capital projects, services and supplies throughout the United States create thousands of additional jobs and generate broader economic growth. This is the power of a franchising model that has existed for years under the NLRB's current standard.

III. The Franchise Relationship

At its simplest, franchising is a mechanism through which the franchisor licenses the use of its trademarks, goods and services to other individuals and businesses (the franchisee) to enable the franchisee to independently own and operate its own business. In the context of restaurant franchising, the franchisor in effect provides a business format for the development, establishment and operation of restaurants, using uniform and unique building designs, restaurant layouts, trade dress (including specially designed décor and furnishings), recipes and menu items, cooking techniques, training systems, regional or national advertising and the like. This business format, which is unique to each franchisor, is sometimes referred to as that franchisor's "System."

CKE, like other franchisors, has expended significant time, expertise and money over the years to develop a distinctive System, and continues to invest its resources to keep the System relevant in today's market. It would be extremely difficult for an individual or group of individuals to develop and maintain their own restaurant System, placing their dream of owning their own business out of reach. Moreover, developing a new System in the competitive restaurant industry is highly risky. The ability to franchise enables entrepreneurs who want to own

their own business to enter this highly competitive market backed by the strength of an established and proven restaurant System, thus significantly reducing both the cost and risk of being an entrepreneur. As consideration for providing would-be entrepreneurs with a System, the franchisor receives a royalty. In our industry, the royalty rate usually ranges from 4% to 5% of sales. We do not receive a share of the franchisees' profits.

We believe the desire to be an entrepreneur and the minimization of risk franchising makes possible are the primary reasons business format franchising has experienced such explosive growth in the last couple of decades. As of 2012, there were nearly 750,000 franchise establishments in the United States. IHS Global Insight, [*Franchise Business Economic Outlook for 2013*](#), at 1, 7 (December 2012). These establishments employ about 8.1 million people and have an economic output of \$769 billion. *Id.* Franchise establishments account for roughly 3.4% of the country's gross domestic product. *Id.* at 2.

However, the economic impact of franchised businesses goes beyond the establishments themselves. After accounting for factors such as products and services purchased by franchised outlets and the personal purchases of franchise owners and employees, PriceWaterhouseCoopers estimated that, in 2005, the total impact of franchising, including its spillover effects, was to add 21 million jobs (or 15.3% of all private-sector jobs) and \$660.9 billion of payroll (12.5% of all private-sector payroll) to the American economy. PriceWaterhouseCoopers, [*The Economic Impact of Franchised Businesses Vol. II: Results for 2005*](#), at 7.

In CKE's System, we further encourage the entrepreneurial spirit that made this country strong by respecting the business experience of our franchisees and working with them to build a stronger System. While at the end of the day, as Franchisor we have to set the standards and make the rules that will define our brands, we practice an independent exchange of ideas and open discussion with our franchisees on every topic of importance to them, ranging from products to marketing to IT issues. Indeed, some of our popular and successful products were introduced to us by our franchisees. Our franchisees are not a division, subsidiary or alter ego of CKE, but are truly independent small businessmen and businesswomen who know how to drive their own business and do not hesitate to

speak their minds. We believe that the open exchange of ideas fostered by the franchise model is healthy for us and our franchisees.

As I mentioned, franchising benefits the economy as a whole. Franchising multiplies the resources that would be available to us alone, thus resulting in faster growth. This means more construction, more demand for the supplies and services used in our business, more opportunities for the lending community, more demand for real estate, resulting in more job creation and more local, state and federal tax revenue. Successful franchising is good for small businesses and good for our economy.

The key to operating a successful franchise System is to maintain standards and maintain brand uniformity throughout the System, while ensuring that the franchisee can still run his or her business. In order to maintain brand uniformity and to protect the value of its trademarks by which that System is known, the franchisor of a business format or System must control certain aspects of that System. For example, the franchisor must be able to control what products franchisees offer under its trademark, the quality of those products and how those products are prepared and presented.

The franchisor must be able to set standards dictating the appearance of the restaurants, including remodel requirements, and the format of guest service. The franchisor may approve suppliers and other vendors. In most Systems, including ours, the franchisor controls or approves advertising (although the franchisee generally controls local marketing), and will have the right to approve or disapprove the closure of a restaurant before expiration of the franchise term, or the transfer of the franchise rights to another individual or business entity.

Control in these areas of brand protection, however, is limited and does not minimize the fact that the franchisee is very much the owner of its business, and controls the profitability of its restaurants. While the franchisee must meet System standards and pay a royalty and certain other fees to the franchisor, if the franchisee's business is successful, net profits from the business are his or hers to keep. On the other hand, the risk of financial loss from unsuccessful performance is also on the franchisee, just like any other small business.

When developing a new restaurant in the CKE System, the franchisee must obtain its own financing, select its own sites, acquire the property or enter into its own lease based on the terms they negotiate, and will enter into its own construction contracts. In our System, franchisees set the prices for the products they sell their customers, and choose their local store marketing. The franchisee is responsible for knowing local requirements for licensing, permits, fees, health department regulations, zoning and the like.

Similarly, while we have the right to approve suppliers and other vendors, our franchisees must enter into their own contracts with approved suppliers and vendors. Each franchisee's loan or payment terms are based on that franchisee's financial strength and credit, not the credit of CKE. In the event of a default under their loan or under any construction, supply or service contract, or a failure to meet local requirements, the franchisee alone is responsible, not CKE. CKE is not a party to those contracts, and the lenders, landlords, suppliers and vendors understand that the franchisee alone is the party they must look to in the event of a breach.

Similarly, the franchisee alone is responsible for who is hired in their restaurants, how they make their hiring decision, the number of employees, the wages they pay, the benefits they provide and whether an employee should be promoted, fired or suspended. While the Franchisee's Operating Principal (an equity owner responsible for operations) must be acceptable to us and meet our training qualifications, our Franchise Agreements specifically state:

Franchisee shall hire all employees of the Franchised Restaurant and be exclusively responsible for the terms of their employment and compensation, and for the proper training of such employees in the operation of the Franchised Restaurant, in human resources and customer relations. Franchisee shall establish at the Franchised Restaurant a training program for all employees that meets the standards prescribed by [Franchisor].

Indeed, we see great variation among our franchisees in this area. As we do not set the requirements for or manage the number of employees a franchisee hires

or the percentage of sales they invest in labor, there is significant variability between franchisees based on their individual employment practices. Franchisees may hire as many as 60 employees per restaurant (particularly for openings), while others hire as few as 15. We believe the average is around 25. Spending on labor (as a percentage of sales), including managers, shift leaders, and hourly employees, could range from as low as 23% to as high as 34%. These are numbers that our franchisees manage.

As the franchisor, we set the performance standard in terms of product quality, appearance of the restaurant, and guest experience. However, it is up to the franchisee to hire, train and motivate their employees to meet those standards, and to discharge employees who fail to perform to the franchisee's expectations. If the franchisee is failing to meet standards, we will send the franchisee an assessment outlining the deficiencies or, if severe enough, issue an operational default notice. *But we will not dictate to the franchisee how to manage its employees to meet those standards.* As the owner of its business, that is the franchisee's exclusive domain because it is the franchisee that is a party to the employment relationship, not CKE.

Accordingly, the franchisee alone must be responsible if it violates any laws or regulations governing employment relationships, just as it alone is responsible if it were to default on its loans, leases or on its contracts for goods or services.

Through our franchise agreements, we have contractually agreed on the nature of our relationship with our franchisees:

No agency, employment, or partnership is created or implied by the terms of this Agreement, and Franchisee is not and shall not hold itself out as agent, legal representative, partner, subsidiary, joint venturer or employee of [Franchisor] or its affiliates. . . . Franchisee is an independent contractor and is solely responsible for all aspects of the development and operation of the Franchised Restaurant Without limiting the generality of the foregoing, Franchisee acknowledges that [Franchisor] has no responsibility to ensure that the Franchised Restaurant is developed and operated in

compliance with all applicable laws, ordinances and regulations and that [Franchisor] shall have no liability in the event the development or operation of the Franchised Restaurant violates any law, ordinance or regulation. . . . Franchisee shall post a sign in a conspicuous location in the Franchised Restaurant which will contain Franchisee's name and state that the Franchised Restaurant is independently owned and operated by Franchisee under a franchise agreement with [Franchisor].

In short, franchisees are independent businesses in substance as well as in form. As mentioned earlier, however, because franchisees are licensed to operate as part of a larger System, franchising enables individual entrepreneurs to run small businesses that can compete with national chains. Any change to the NLRB's joint-employer standard that would result in making a franchisor a joint employer with their franchisees without the franchisor directly and immediately controlling the essential terms and conditions of employment, such as, hiring, firing, discipline, supervision and direction, is in direct conflict with the terms of most contractual agreements between a franchisor and its franchisees, and turns the concept of franchising on its head.

IV. Impact of The Joint Employer Standard On Franchising

If the NLRB were to issue a standard which considered franchisors joint employers with their franchisees and liable for the employment decisions of their franchisees, this would inevitably force franchisors to exert control over their franchisees employment decisions. Franchisors would need to review job applicants, review hiring decisions before offers were made, review compensation structure and bonus plans, and so forth.

Moreover, because the employees are integral to the daily operation of the restaurant, the oversight would not stop with hiring decisions and compensation. Franchisors would need to monitor the workplace, so a franchisor would need to be present in the franchised restaurants at a greatly increased frequency. Franchisors

would feel compelled to dictate or even administer employee training for its franchisees at all levels, and increase staffing as deemed necessary. Suddenly, the franchisee would find itself unable to control its labor costs, one of the key controllable expenses. And since the franchisor does not share in the restaurant's profitability, the franchisor may have a very different view of labor dollars that should be spent, taking away the franchisee's ability to control their profit. Franchisees, if they chose to invest in or remain as a part of that structure, would find themselves functioning more as a wholly controlled division of the franchisor, rather than as independent owners and operators.

Of course, all of this additional Franchisor oversight and liability comes with a price. The franchisor would need to add staff to oversee its franchisee's employment decisions and employee training in an effort to reduce the franchisor's exposure. But inevitably, despite increased oversight, at some point the franchisee and franchisor would find themselves defending a claim based on employment decisions made by the franchisee. The current structure of fees and royalties in hundreds of thousands of franchise agreements across this country do not contemplate franchisors assuming such responsibility or expense. Going forward, franchisors will want to be compensated for taking on this potential liability. We would consider a 4% or 5% royalty wholly insufficient for providing a System AND taking on the cost and liability of managing the approximately 50,000 workers our franchisees employ. We assume other franchisors will feel the same.

If franchisors are considered joint-employers with their franchisees, the cost of increased staff and increased risk will most likely translate into franchisors charging higher royalty rates and fees, perhaps significantly higher. Franchisor control over a franchisee's labor force, and the risk and higher royalty rates and fees associated with it, have the potential to chill the desire of franchisors to franchise and of franchisees to acquire a franchise or to develop new units, at a time when the country desperately needs economic growth.

Franchisors do not currently manage employee relations for their franchisees, who are independently owned and operated businesses, and there is no rationale and no public benefit to justify imposing legal responsibility on franchisors for the employment decisions of their franchisees. Indeed, it would be

as illogical as imposing legal liability on a franchisor if their franchisee failed to pay its rent or utilities bills. The risk, on the other hand, is great, in that the cost for entrepreneurs to franchise will increase, and the economic growth that flows from franchising could well be destroyed.

Conclusion

In conclusion, I want to thank you for the opportunity you've given me to talk about why the NLRB, in considering the joint-employer standard, should be careful not to tie franchisors to the decisions franchisees make when it comes to their employee workforce. As I shared with you, not only is this impractical and contrary to hundreds of thousands of existing contractual relationships, but it is also detrimental to the franchise model which gives franchisees the power to make decisions that they consider the most financially prudent. While we set standards that will protect our brands and ensure the quality of our products, we are simply not in the business of franchising to micromanage our franchisees and the way they run their business or manage their employees. Accordingly, we urge you to strongly consider the negative impacts of any NLRB change in the joint employer standard that would be applicable to the private and very successful franchisor/franchisee relationship.

Thank you.