The Franchising Solution to the Employee-Independent Contractor Problem

By David Gurnick

Proper classification of workers as employees or independent contractors is frequently litigated. Many employers want to classify workers as independent contractors. This saves employment taxes, workers compensation premiums and employee benefits. But workers treated as independent contractors often seek to be reclassified as employees in order to gain wages, pay for overtime and lost meal and rest breaks, workers compensation, large penalty assessments, and other benefits. Likewise, state agencies often reclassify independent contractors as employees. This gains tax revenues for the state, and more benefits for workers.

California courts use the "control-of-the-work" test to decide if workers are employees or independent contractors. Under this test "the most important factor is the right to control the manner and means of accomplishing the result desired. If the employer has the authority to exercise complete control...an employer-employee relationship exists." *Empire Star Mines v. California Employment Commission* 28 Cal.2d 33 (1946). The state Supreme Court has contrasted workers who were under an employer's control with "entrepreneurs operating independent businesses for their own account." *Borello v. Department of Industrial Relations* 48 Cal.3d 341 (1989).

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The *Borello* Court indicated that entrepreneurs operating as independent businesses are independent contractors. Franchising is a business method recognized to involve independent entrepreneurs operating for their own account. The Court of Appeal has noted that franchisees are "typically small business owners and entrepreneurs;" *1-800-Got-Junk? v. Superior Court* 189 C.A.4th 500 (2010); and that "the right to sell another's goods and possession of entrepreneurial responsibility distinguishes a franchised distributorship from a sales network." *Gentis v. Safeguard Business Systems* 60 C.A.4th 1294 (1998). With this recognition about franchising, some companies can strengthen their position that workers are independent contractors by establishing formal franchisor-franchisee relationships with them.

In the "control" test, courts consider nine other factors in assessing a worker's status as an independent contractor or employee. These are: whether the company can terminate at will; whether the worker is in a distinct business; whether the work is usually done without supervision; the level of skill required; which party supplies the tools and place of work; the length of time services are performed; method of payment, whether for time or by the job; whether the work is part of the principal's regular business; and the parties' intent.

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A FedEx worker delivers packages in San Francisco.

By applying these factors, workers originally treated as independent contractors have been reclassified as employees in several industries, among them residential care workers (*Heritage Residential Care v. Division of Labor Standards Enforcement* 192 C.A.4th 75(2011)); couriers (*Messenger Courier Association of Americas v. Unemployment Insurance Appeals Board* 175 C.A.4th 1074 (2009)); pick-up and delivery drivers (*Air Couriers International v. Employment Development Department* 150 C.A.4th 923 (2007)); FedEx drivers (*Estrada v. FedEx Ground Package System* 154 C.A.4th 1 (2007); television writers (*Tieberg v. Unemployment Insurance Appeals Board* 2 Cal.3d 943 (1970); and even race horse jockeys (*Isenberg v. Employment Stabilization Commission* 30 Cal.2d 34 (1947)).

In contrast, when the control test and its factors are applied in franchise relationships, the independent contractor classification usually applies. Franchise agreements are typically for a term of three to 10 years, rarely being terminable at will. Franchisees often operate independent businesses, at physical locations that franchisees lease for their own use, using equipment and tools that franchisees acquire and own. As independent owners, franchisees operate without day-to-day supervision that characterizes employer oversight of employees. Franchisees require varying degrees of entrepreneurial skill, depending on the industry. The public, not the franchisor, pays for goods and services from retail franchisees. Worker franchisees are typically paid by the job, as opposed to an hourly or time-based wage. Most often, franchisors view their franchisees, and franchisees view themselves, as independent businesses, operating with a profit motive, and bearing a risk of loss. Almost uniformly, franchise agreements state the parties' intent to be independent contractors.

This month, a federal court in California demonstrated that franchise relationships tend to indicate parties are independent contractors. Janitorial franchisees sought class certification for claims that their franchisor misclassified them to evade paying wages and job benefits. Plaintiffs claimed the franchisor's "common policies and practices so tightly control[led] the franchisees' actions as to create an employer-employee relationship." The franchisor argued its policies "show[ed] nothing more than that which makes the owners franchisees." The court agreed with the franchisor: "Once it sets aside the policies required to protect Jani-King's service mark and goodwill, the Court finds very little — if any — common evidence tending to prove an employer-employee relationship between Jani-King and its franchisees. Class certification was denied. *Juarez v. Jani-King of California* 2011 WL 835196 (N.D.Cal. Mar. 4, 2011).

Franchising does not guaranty that workers will be independent contractors. Last year, a federal court ruled that another janitorial franchisor misclassified franchisees, and found them to be employees. *Awuah v. Coverall North America* 707 F.Supp.2d 80 (D.Mass. 2010). However, that ruling was not based on the control-of-the-work test or common law factors used in California. The court applied a three-element test used in Massachusetts, in which one who performs services is automatically an employee, unless the employer negates all three elements. The court considered only one element — whether the worker is in an independent, separate and distinct business. Finding that Coverall could not establish that its janitorial workers were independent, separate and distinct businesses, the court ruled the franchisees were statutory employees.

Some California decisions, in relations akin to franchises, raise the specter of franchisees being classified as employees. A case from the 1950s involved vacuum cleaner salespeople. Dealer agreements said they were independent contractors. They furnished their own cars and gas, set their own hours and bought products for resale from their supplier. But they were trained by the supplier, required to attend daily sales meetings, worked in groups, and all sales taxes were reported under the supplier's name. A trial court finding that the dealers were controlled in the material details of their work and were employees was affirmed. *Sudduth v. Employment Stabilization Commission* 130 C.A.2d 304 (1955).

In another case, a federal court in California affirmed class action status for "drivers/distributors" of branded food products. The class alleged wage and hour law violations, claiming they were misclassified as independent contractors. *Chun-Hoon v. McKee Foods* 2006 WL 3093764 (N.D. Cal. 2006). Distributors received instruction books for their dealings with the supplier, participated in standardized dealer orientations, followed uniform policies for warehouse space and order and delivery dates, were monitored in ride-alongs by the supplier's regional managers and were required to name the supplier as an insured on their vehicle insurance. The court found the uniform level of training and supervision established common questions as to whether the distributors were employees, justifying class certification.

Today, some franchise systems evince an extensive level of controls over franchisees. Most franchises include initial training, and instruction books in the form of operations manuals. Many franchisors specify details of retail facilities, equipment, uniforms, grooming, and operating hours. In restaurant programs, franchisors designate suppliers, provide recipes, and specify food portions. In hotel systems, franchisors specify such details as the type of carpeting, and weight and thread-counts of bedding and pillowcases. Where controls go beyond what is needed to protect franchisor trademarks, greater risk exists that franchisees will be found to be employees.

Franchising may be a tool for some companies to strengthen their claim that entrepreneurial, independent workers operating with a profit motive are properly classified as independent contractors. But other systems that exert extensive control over franchisees may face increasing risks of being found to be in statutory or common law "employer-employee" relationships with those they had perceived to be independent contractors.

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