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BY JIM MULCAHY

Are Franchisees Employees?

Until recently, a franchisee was considered an independent business operator doing business in the style, under the trademark, and in the name of the franchisor. However, district court filings by franchisees in Massachusetts, Minnesota, Pennsylvania, and California are pushing the boundaries on the franchisor/franchisee relationship.

Jani-King, one of the largest commercial cleaning franchisors, has been busy defending itself from labor law claims brought by franchisees seeking minimum wage, overtime pay, and other benefits of employees (rather than as independent contractors). On June 8, 2012, a Massachusetts district court granted summary judgment in favor of the franchisee class, finding that the franchisees *were* employees of Jani-King.

According to Massachusetts District Court Judge Mark L. Wolf, Jani-King could not show that its purported franchisees were performing a service "outside the usual course of the business of the employer." In support of his conclusion, Judge Wolf referenced the Jani-King website, which reveals that Jani-King offers "commercial cleaning services." The website also touts that Jani-King is "the global leader in commercial cleaning services," and it is "ranked the world's No. 1 commercial cleaning franchise company year after year." Because the court did not see a difference between Jani-King's operation and the operation of its franchisees, the control exerted by the franchisor more closely resembled that of an employer, and not a franchise system.

Franchisees of Coverall North America, another janitorial franchise system, achieved a similar result. A Massachusetts district court ruled that the Coverall franchisees were misclassified as independent contractors, and found them to be employees. After remand to the state's Supreme Judicial Court on the issue of damages, Coverall, classified now as the "employer," was ordered to pay the franchisees $3 million, which included a refund of franchise fees and treble damages. On May 11, 2012, Coverall filed a notice of appeal.

Following the district court's rulings against Jani-King and Coverall, several commercial cleaning franchisors have reportedly stopped selling franchises in Massachusetts, with concern that other franchise models will soon follow suit. Such a result would leave many entrepreneurs without the channel to pursue business ownership, retarding business development, services, and job opportunities in the state.

In two similar cases, one in Minnesota and the other in Pennsylvania, Jani-King had to confront the same classification issues. One of the keys in these lawsuits is the control janitorial service franchisors exert in their systems. For example, the typical janitorial franchise model allows the franchisor to operate as the contracting party with the customer, responsible for billing and collecting money. After taking its fees, the franchisor then pays the remaining amount to its franchisees. It is this control that allowed the district court to characterize franchisees as employees of the franchisors.

Franchisors in California got some reprieve from the misclassification issues that have been plaguing parts of the East Coast. Earlier this year, a California district court granted summary judgment in favor of Jani-King, finding that the franchisor did *not* exercise sufficient control over the plaintiff franchisees to render them employees.

However, the issue of franchisor control has recently been revisited by the California Court of Appeals. In this case, a teenaged employee of a Domino's Pizza franchisee sued Domino's, among others, for alleged sexual harassment by a supervisor for the franchisee. The trial court granted summary judgment in favor of Domino's because the franchise agreement expressly provides that Domino's has no role in the franchisee's employment decisions. On June 27, 2012, however, the California Appellate Court reversed the trial court's decision, pointing to training software, employment qualifications, and employee guidelines established by Domino's for its franchisees as evidence of Domino's exhibiting sufficient control over its franchisee to create triable issues of fact.

Reclassifying franchisees as employees would open the income tax floodgates for benefiting cash-starved states and the federal government. This would likely cover not only wages, but back taxes for holiday pay, vacation pay, and workers' compensation. While tax dollars generated by reclassifying franchisees as employees might seem like an attractive Band-Aid for many states, there is a movement under way to preserve and protect the franchise model.

The Georgia Legislature has led the way in taking a proactive approach, formally recognizing the franchisor-franchisee relationship. In April of this year, the Georgia General Assembly unanimously passed House Bill 548, codifying franchisor-franchisee relationships by providing that "individuals who are parties to a franchise agreement shall not be considered employees." The enactment of this bill should allow franchising in Georgia to continue to thrive as a growing economic force in all business sectors. The bill became effective July 1.

These areas of "control" expanded upon by the courts are commonplace in the franchise community. If the franchisor does exert sufficient control over the franchisee to be vicariously liable for the franchisee's conduct, aggressive franchisee attorneys may again push the issue of franchisor control for employment classification purposes. ■

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