California State Bar Franchise Law Committee
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Court Denies IFA's Attempt To Block Seattle's Expedited Minimum Wage Increases On Franchisees

With the economic turmoil of the Great Recession seemingly in America's rearview mirror, many lawmakers have turned their attention to raising the pay and improving the job conditions for the minimum wage employees in this country.

The impasse in Washington over President Barack Obama's push to raise the federal minimum wage from $7.25 to $10.10 has left local municipalities to evaluate the needs of the minimum wage workers in their communities. This has resulted in significant increases to minimum wage floors in an unprecedented number of cities and counties.[1]

On June 3, 2014, the City of Seattle joined the nationwide movement by enacting Ordinance Number 124490 (the "Ordinance"), with the stated design of increasing the wages of over 100,000 Seattle workers unable to support themselves and their families.[2]

Under the terms of the Ordinance, Seattle-based employers must comply with incremental increases in the city's minimum hourly wage floor as it increases from $9.47 to $15. The "phase-in" period for the incremental increases may vary in length depending upon the size of the employer.

Schedule 1 Employers – defined as "employers that employ *more than 500 employees* in the United States" – are given three years to incrementally raise their minimum wages to $15. Alternatively, *Schedule 2 Employers* – defined as "employers that *employ 500 or fewer employees* regardless of where those employees are employed in the United States" – are provided seven years to reach the $15 minimum wage floor. [3] In other words, Schedule 1 Employers have until 2017 to reach the $15 minimum wage, while Schedule 2 Employers are given until 2021.[4]

The 500 employee threshold is not the only differentiating factor between Schedule 1 Employers and Schedule 2 Employers. The Seattle City Council has expressly expanded the definition of Schedule 1 Employer to include any franchisees that are "associated with" franchise networks that "***employ more than 500 employees in the aggregate in the United States***."

This expanded definition of Schedule 1 Employers subjects individual franchise operators – often employing only a handful of people – to a more stringent minimum wage phase-in schedule than companies employing up to 499 people. Needless to say, Seattle's inclusion of franchisees as Schedule 1 Employers has drawn the ire of the franchise community.

International Franchise Association v. City of Seattle[5]

Last year, the International Franchise Association and five individual franchise owners in Seattle (collectively, the "IFA") filed suit in the Western District of Washington in an attempt to compel Seattle to reclassify franchisees as Schedule 2 Employers subject to the longer seven-year minimum wage phase-in schedule.

The complaint was quickly followed by a preliminary injunction motion seeking an order compelling Seattle to "treat franchisees as 'small' businesses rather than 'large' businesses" for the duration of the lawsuit.[6]

Both the complaint and the preliminary injunction motion raise the same legal arguments. In short, the IFA alleges that the Ordinance (1) discriminates against interstate commerce in violation of the Commerce Clause, (2) violates the Equal Protection Clause, (3) violates the First Amendment, (4) is preempted by the Lanham Act, (5) is preempted by ERISA, and (6) violates the Privileges and Immunities Clause of the Washington State Constitution.

As explained below, the court rejected the IFA's arguments in toto and denied the preliminary injunction motion.

Commerce Clause argument rejected because franchisees better positioned to "handle the faster phase-in schedule"

As its first argument, the IFA argued that, by treating two otherwise identical employers differently based solely on the fact that one is affiliated with an interstate franchise, Seattle's Ordinance violates the Commerce Clause.

The dormant Commerce Clause bars state and local governments from erecting taxes, tariffs, or regulations that favor local businesses at the expense of interstate commerce.[7] According to the court, "[o]ne of its core purposes [of the dormant Commerce Clause] is to prevent states from engaging in economic protectionism – *i.e.*, shielding local markets from interstate competition."[8]

For a violation of the dormant Commerce Clause to be found, one of the following two scenarios must exist. First, (i) the statute must have a discriminatory purpose or effect, (ii) the state cannot justify the discrimination by showing that it is necessary to achieve a legitimate local purpose, and (iii) there are no reasonable non-discriminatory means for accomplishing the same objective. Second, if the law is non-discriminatory (*i.e.*, no discriminatory purpose or effect), then the plaintiff must show that the burden on interstate commerce is clearly excessive in relation to the putative local benefits.[9]

Following nearly thirty pages of opinion devoted to the Commerce Clause arguments, the court ultimately rejected the IFA's argument. In short, the court found that Seattle's categorization of franchisees as "large businesses" to have been motivated by the understanding that franchisees – as part of a national system with dedicated vendors, preferred pricing and franchisor support – "could handle the faster phase-in schedule" than a local family-run shop without any outside connections.[10]

Also, the court refused to invalidate the Ordinance because it had a stated design "to assist low wage workers, to decrease the gender gap, and to ensure that workers can better support and care for their families and fully participate in Seattle's civic, cultural and economic life."[11] Because all of these stated objectives are well within the scope of legitimate municipal policy making, the court found the Ordinance survived Commerce Clause scrutiny.

Equal Protection Clause not at issue because Seattle had "rational basis" to classify franchisees as "large businesses"

The IFA's second claim – violation of the Equal Protection Clause of the Fourteenth Amendment – was rejected by the court more expeditiously than the Commerce Clause claim. In support of this claim, the IFA argued that Seattle's discrimination against small franchisees was "so contrary to the Ordinance's own recognition of the need to treat small and large businesses differently that it violate[d] the Equal Protection Clause of the Fourteenth Amendment."[12]

For a violation of the Equal Protection Clause to be found, the law treating similarly situated businesses differently cannot express a "r*ational basis for the difference in treatment*."[13]

As reflected above, the court quickly found a "reasonably conceivable state of facts" that provided a rational basis for the classification of franchisees as large businesses.[14] Those facts included, among other things, national advertising, use of famous trademarks, market power for purchasing supplies and raw materials, and access to valuable and trustworthy information based upon the experiences of the franchise system.

Because Seattle's rational basis for differentiating between franchisees and other businesses was so readily apparent to the court, judicial intervention under the Equal Protection Clause was "unwarranted."[15]

First Amendment interests do not block Seattle's rational regulation of economic transactions by commercial associations

As its third ground for injunctive relief, the IFA argued that the faster phase-in schedule violated the franchisees' freedom of speech and association. Specifically, "[t]he [O]rdinance unconstitutionally burdens fundamental First Amendment rights by penalizing small Seattle businesses for associating with interstate franchise networks and out-of-state franchisors and by penalizing the speech of such franchisees and their franchisors."[16]

Again, the court found the IFA's argument "unconvincing." Citing to the concurring opinion of former Supreme Court Justice Sandra Day O'Connor in *Roberts v. U.S. Jaycees*, 468 U.S. 609, 634 (1984), the court explained that "there is only minimal constitutional protection of the freedom of commercial association," and that in all events, "no First Amendment interest stands in the way of a State's rational regulation of economic transactions by or within a commercial association."

Ultimately, the court found that the Ordinance does not penalize speech or association. Rather, "it uses certain factors common to franchises to identify them as one type of business subject to the faster phase-in schedule."[17] Because of this, the IFA could not show a likelihood of success on the merits of its First Amendment claim.

The Court Finds The IFA's Remaining Claims "Untenable"

The IFA's remaining claims – *i.e.*, Lanham Act preemption, ERISA preemption, and violation of the privileges and immunities clause of the Washington Constitution – were also rejected by the court.

In sum, the court found (1) the Ordinance does nothing to conflict with the stated purpose of the Lanham Act;[18] (2) certain health plan-related provisions of the Ordinance "simply have no impact" on the franchise-related provisions at issue;[19] and (3) the Washington Constitution was not violated because "nothing in the Ordinance prevents anyone from exercising their right to 'carry on business.'"[20]

With the court's denial of each of these remaining claims, the IFA's request for a preliminary injunction was defeated.

More troubling for the IFA, however, is the likely long-term effect of the adverse ruling. While the issues were presented to the court for a preliminary ruling, the court's analysis and finding of a "rational basis" for the Ordinance does not appear to be subject to change upon the discovery of additional facts. As a result, the court's denial of the preliminary injunction motion will likely end the lawsuit.

Appreciating the gravity of the court's adverse ruling, the IFA requested a stay of the proceeding pending appeal. This stay was granted by the district court on March 31, 2015.

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[1] City Minimum Wage Laws, Recent Trends and Economic Evidence on Local Minimum Wages, Nat'l Emp. L. Project, 1 (Dec. 2014), http://www.nelp.org/page/-/rtmw/City-Minimum-Wage-Laws-Recent-Trends-Economic-Evidence.pdf?nocdn=1 (see, e.g., San Jose, $10.15; Santa Fe, $10.66; Washington, DC, $11.50; Oakland $12.25; Chicago, $13.00; San Francisco $15.00).

[2] Ordinance, § 1.
[3] Ordinance, § 2, "14.19.010 Definitions."
[4] Small businesses were given this extra time because they lack the same resources as large businesses and will face particular challenges in implementing the law. Ordinance, § 1, ¶ 9
[5] 2015 U.S. Dist. LEXIS 33744 (W.D. Wash. Mar. 17, 2015).
[6] *Int'l Franchise Ass'n*, 2015 U.S. Dist. LEXIS 33744 at *5.

[7] *Int'l Franchise Ass'n*, 2015 U.S. Dist. LEXIS 33744 at *13 (internal citation omitted).
[8] *Id.* at *13-14.
[9] *Id.* at *14 (internal citations omitted).
[10] *Id.* at *28.
[11] *Id.* at *42.
[12] Pltf's Mtn. for Prelim. Inj., p. 2 (August 5, 2014).
[13] *Vill. of Willbrook v. Olech*, 528 U.S. 562, 564 (2000).
[14] *Int'l Franchise Ass'n*, 2015 U.S. Dist. LEXIS 33744 at *45.

[15] *Id.* at *50.
[16] Pltf's Mtn. for Prelim. Inj., p. 21 (August 5, 2014).
[17] *Int'l Franchise Ass'n*, 2015 U.S. Dist. LEXIS 33744 at *52.
[18] The stated purposes of the Lanham Act, identified at 15 U.S.C. § 1127, are to:

> [R]egulate commerce within the control of Congress by making actionable the deceptive and misleading use of marks in such commerce; to protect registered marks used in such commerce from interference by State, or territorial legislation; to protect persons engaged in such commerce against unfair competition; to prevent fraud and deception in such commerce by the use of reproductions, copies, counterfeits or colorable imitations of registered marks; and to provide rights and remedies stipulated by treaties and conventions respecting trademarks, trade names, and unfair competition entered into between the United States and foreign nations.

[19] *Int'l Franchise Ass'n*, 2015 U.S. Dist. LEXIS 33744 at *55.
[20] *Id.* at *63.