by Rochelle B. Spandorf

Who's *the* Boss?

Franchisors must be able to demonstrate *the separate and distinct businesses* that they and their franchisees operate

OWNING A FRANCHISE has always seemed to guarantee a franchisee's legal status as an independent contractor—the right to be one's own boss. Specifically, franchisees pay a fee for the right to use a franchisor's brand name and business concepts in operating their own business and have the ability to sell the business. These characteristics are distinctly at odds with employment relationships. Employees, after all, do not pay for the right to be hired and have no business to sell.

However, simply calling an arrangement a franchise does not guarantee that a court or government agency will not reclassify the franchisor's franchisees as employees. Outside of the franchise context, workers retained by companies as independent contractors have been winning "employee misclassification" lawsuits, in which they (or their own employees) or government agencies acting on their behalf have recovered unpaid wages, unpaid employer taxes, unemployment compensation, or other employee benefits from the hiring firm. Now, with a decision issued last year, franchisors face the prospect of their own exposure for misclassification.

In March 2010, in an apparent case of first impression, a Massachusetts district court in *Awuah v. Coverall North America, Inc.*,[1] found a franchisor liable for misclassifying its franchisees as independent contractors. The decision has rocked a significant sector of the U.S. economy that has always thought franchise arrangements were immune to employee misclassification claims.[2] California practitioners must now arm themselves appropriately to assist their franchisor clients in reducing exposure for misclassification lawsuits.

Misclassification Defined

Individuals who perform services in exchange for compensation fall into one of two categories: employee or independent contractor.[3] The traditional common law distinction turns on the amount of control that the hiring

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party imposes over how the assigned work is performed.[4]

Different statutory tests of employee status exist at the federal and state levels, and these override common law.[5] Multiple employment tests, each with different criteria, may exist within the same jurisdiction.[6] While two jurisdictions may adopt the same employment test, judicial interpretations may produce different outcomes despite similar facts. Consequently, a company with workers in different states, or even within the same state, may find its workforce classified differently depending on where a person works or what is at stake.[7]

Cost is the primary reason companies seek to classify their workers as independent contractors.[8] Employee costs typically add 30 percent to the personnel expenses of a business compared to retaining contract workers.[9] Employers must pay payroll taxes, unemployment insurance, disability and workers' compensation coverage, Social Security contributions and other employer taxes, and possibly overtime pay. Retaining independent contractors allows a company to bypass all these costs. Using independent contractors also 1) eliminates worries about timely wage laws, rest period laws, and medical leave rules, 2) reduces the likelihood of vicarious liability for a worker's acts or omissions, 3) thwarts labor unions from organizing workers, and 4) spares a company from having to offer contract workers the same discretionary benefits as employees—such as stock options, vacation and sick leave, health insurance, and retirement benefits.[10]

To stay lean, especially in a down economy, businesses not only pare their workforce but also outsource worker functions to contract, freelance, seasonal, and temporary workers, whom the businesses classify as independent contractors.[11] Indeed, in bad economic times, companies are known to fire employees only to hire them back to perform their old jobs as independent contractors.[12]

Misclassification results when a business improperly classifies its employees as independent contractors. For workers, misclassification suits are a means to recover unemployment compensation and other employee benefits or rectify workplace offenses, including discrimination and harassment. For the government, misclassification suits not only protect workers but also generate significant revenue and advance a public policy that requires employers to shoulder a share of public welfare costs.[13] Consequently, courts and government agencies interpret employee status tests broadly.[14] Workers are presumed to be employees unless the hiring firm can prove otherwise.[15]

The federal government estimates its losses from misclassification as $5 billion annually in lost taxes, Social Security contributions, and penalties. As a result, it has significantly stepped up its enforcement activities.[16] With swelling unemployment and dwindling treasuries, state governments, too, have cracked down by passing legislation to expand the definition of who is an employer under state employment laws and by beefing up enforcement and coordinating state investigations with the Internal Revenue Service.[17]

Serious financial liabilities cascade from employee misclassification. Companies that misclassify workers face potential penalties for:

- Not paying workers minimum wage, overtime pay, or for meal and rest periods.
- Not documenting time worked or issuing itemized paycheck statements.
- Not withholding state and federal income taxes (resulting in employer liability for unpaid taxes).
- Not paying the employer portion of Social Security and Medicare taxes.
- Not paying state and federal unemployment taxes.
- Not paying workers' compensation insurance.

If a reclassified worker has his or her own employees, misclassification liability extends to those individuals as well. Besides taxes and penalties, companies may be vicariously liable for the acts and omissions and past discrimination of their reclassified workers. Additionally, misclassification can support claims for unfair business practices and even criminal penalties.[18]

Distinguishing Franchise and Nonfranchise Independent Contractors

Franchise and nonfranchise relationships are similar methods for enabling a company to enlist others—presumed to be independent contractors—to offer, sell, or distribute the company's goods and services at retail or wholesale. Operationally, little separates franchise and nonfranchise arrangements. However, from a regulatory perspective, franchises and nonfranchises are as different as night and day.[19]

Franchises are strictly creatures of statute. They are classically defined by the presence of three elements: 1) a trademark license, 2) significant assistance offered to, or control over, the licensee's business, which may take the form of a prescribed marketing plan or what some jurisdictions more broadly describe as a community of interest, and 3) payment of a required fee to the brand owner for the right to use or associate with the brand owner's trademark.[20] If any one statutory element is missing, the relationship is not a franchise.[21] What the parties call their relationship is irrelevant. Franchises often masquerade under different names, including dealership, distributorship, license, strategic alliance, joint venture, and marketing alliance, among others.[22]

While nonfranchises are unregulated private consensual arrangements, franchise relationships are highly regulated. In the United States, franchisors are subject to a comprehensive federal presale disclosure law. Some 15 states add additional disclosure and filing duties.[23] Another two dozen states restrict the conditions under which a franchise may be terminated or not renewed.[24] Some states dictate substantive terms for the franchise relationship.[25] A franchisee cannot waive these statutes even if it wants to.[26] Furthermore, many franchise laws impose joint and several personal liability on the franchisor's owners and key management for a franchisor's statutory mistakes.[27]

Nonfranchise arrangements typically possess the first two statutory elements of a franchise—the trademark license and marketing plan or community of interest. The trademark license may be expressed in the parties' contract or implied in the parties' relationship by virtue of the licensee deriving more than an insignificant percentage of its overall revenue from the distribution or sale of the licensor's branded merchandise or services. The marketing plan and community of interest are expressed through various assistance or controls that licensors provide to, or impose on, independent operators, such as minimum purchasing obligations, product and sales training, sales scripts and demonstration kits, exclusive territories, mandatory merchandising requirements, prohibitions against carrying competing merchandise, trade dress requirements, and financial reporting and accounting protocols.[28]

What most commonly distinguishes franchises from nonfranchises is the third statutory element—the payment of a required fee. Distributors and dealers typically buy inventory from a supplier for resale, sales agents procure third-party purchase orders, and all may perform postsale merchandising duties. Nevertheless, their payments do not qualify as a required fee.[29]

Under the franchise laws, inventory bought for resale at bona fide wholesale prices is expressly excluded from the definition of a required fee.[30] Payments to third parties for operating expenses are not required fees because they are not paid to the trademark licensor. The classic distributorship, dealership, and sales agency is not a franchise because the distributor, dealer, or sales agent pays no required fee to the supplier to associate with the supplier's brand.

The payment of a required fee has been assumed to be an essential fact keeping franchise relationships distinct from employment

relationships. A telltale sign of an employment relationship is that the employer, not the employee, supplies the tools of work, and the employee pays nothing for the right to be hired. However, the payment of a required fee—the fact that legally separates franchises from nonfranchises—may be unimportant to whether a franchisee is truly independent and not the franchisor's employee.

Misclassifying Nonfranchise Independent Contractors

Employee misclassification cuts across all industries, including such varied occupations as seasonal farm workers, healthcare workers, and construction workers. In California, nonfranchise courier services have been favored targets of misclassification lawsuits. In 1999, FedEx drivers brought a misclassification lawsuit under California law for lost overtime and expense reimbursements. Nearly 10 years later, FedEx settled the case by agreeing to pay over $27 million in damages and legal fees.[31] In 2007, California's Department of Industrial Relations penalized JKH Enterprises, a small courier business, $1,000 per worker for misclassifying its drivers as independent contractors.[32]

In a July 2010 California courier misclassification case, *Narayan v. EGL, Inc.*,[33] the Ninth Circuit overturned a summary judgment awarded to Eagle Freight Systems, a Texas-based global transportation company, and reinstated employment claims brought by drivers who performed freight pickup and delivery services in California. EGL required its drivers to sign contracts acknowledging their status as independent contractors. The drivers argued they had been improperly classified as independent contractors and sought overtime pay, expense reimbursements, and meal periods under the California Labor Code.

The multifaceted common law test applied by the Ninth Circuit to determine the drivers' status was comparable to the test followed by the federal government and 23 other states, which focuses on whether the putative employer has the "right to control" the worker's actions. Taking a "common sense" approach in analyzing the facts, the Ninth Circuit regarded the parties' mutual at-will termination rights as "a substantial indicator of an at-will employment relationship."[34] The record also showed that EGL controlled driver schedules, including vacation periods; disciplined drivers who showed up late; required drivers to display EGL's trademark on their trucks and uniforms; and described the drivers' job in driver training materials as key to EGL's entire shipping process. Drivers attended meetings about company policies, used company forms, and followed detailed instructions on how to conduct themselves.

The court rejected the self-serving provision in EGL's contract regarding the independent contractor classification of the drivers as well as the contract's Texas choice-of-law provision. In doing so, the court concluded that the issue of whether drivers were entitled to benefits under the California Labor Code was determined by statute rather than specific contract terms or even the existence of a contract between the parties.[35]

Misclassifying Franchise Independent Contractors

When analyzing misclassification issues in the context of franchise relationships, it is important to remember that a primary attraction of purchasing a franchise business is independence. Classification as an independent business owner is exactly how the franchisee sees itself, at least at the outset of the franchisor-franchisee relationship.[36]

Nevertheless, last year's headline-grabbing *Awuah* decision[37] pushed this attraction aside in ruling that a commercial cleaning franchisor had incorrectly classified its Massachusetts franchisees as independent contractors instead of employees.[38] The court applied Massachusetts's "ABC" test for the definition of "employee"—a three-prong test for unemployment compensation that more than half of the states (but not California) follow in some form. The result was a finding that Coverall, the franchisor, failed to prove that its franchisees performed a service outside of Coverall's usual course of business—a necessary element to proving independent contractor status under Massachusetts law.[39]

Like all franchisors, Coverall required its franchisees to perform services following its detailed operating standards, which allowed Coverall to maintain its strong brand identity. Coverall provided its prospective franchisees with a franchise disclosure document explaining these requirements and a franchise agreement identifying the franchisee as an independent contractor. Franchisees wore uniforms and identification badges with Coverall's logo and completed mandatory training. Like other janitorial franchise systems, Coverall priced and sold its franchises as a bundle of prenegotiated customer contracts, gave franchisees initial supplies, retained the exclusive right to negotiate new cleaning contracts (including setting prices), and handled customer billing and collection. It paid franchisees the balance of collections after deducting its royalty and other fees.

Filed in 2007 as a class action by Coverall's Massachusetts franchisees, *Awuah* had its origins in 2004, when a single Coverall franchisee filed for unemployment compensation after Coverall terminated her franchise. The franchisee's relationship with Coverall began as an employee of another franchisee for whom she worked exclusively at one nursing home. When the franchisee left the system,

leaving the employee without a job, Coverall sold the employee a franchise allowing her to continue working at the same nursing home. After Coverall terminated her franchise, she filed for unemployment compensation and ultimately won benefits on appeal. As luck would have it for Coverall, in 2006 the highest court in Massachusetts chose on its own to review the state agency's appellate decision in the matter. After doing so it upheld its analysis of the independent contractor statute in Massachusetts as applied to the state's unemployment compensation rules, agreeing that the franchisee was not engaged in an independently established trade apart from Coverall.[40]

Awuah, the class action, was filed in federal court on the heels of the 2006 ruling by the same lawyers who had won the individual misclassification lawsuit. In the class action, the lawyers sought damages on behalf of all Massachusetts Coverall franchisees for employment misclassification under the same Massachusetts independent contractor statute analyzed in 2006. The result was a grant of summary judgment on behalf of the plaintiffs. The court rejected Coverall's argument that it was engaged in a different business than its franchisees. Even though Coverall never engaged in any cleaning services, the court found that Coverall and its franchisees are in the same business—selling janitorial cleaning services to end users. The court noted that Coverall negotiated all customer contracts; set prices; handled back office billing and collection functions; controlled cleaning methods; provided uniforms, badges, and initial supplies; and took a percentage of every cleaning job performed.

After ruling on the summary judgment motion, the court allowed the four named plaintiffs to try their employment claims before a jury, which they did unsuccessfully in May 2010. The plaintiffs were unable to prove they had suffered any real damages as a result of the misclassification.[41]

Despite the positive ending for Coverall, the court's initial ruling remains intact and puts at risk many fundamental assumptions about franchise relationships. Until *Awuah*, franchisors thought that by collecting a required fee and adding a franchise veneer to their independent contractor arrangements, they were safe from the kinds of employee misclassification claims that nonfranchise distribution systems have faced for years. However, in reclassifying the franchisees as Coverall's employees, the *Awuah* court paid little attention to the plaintiffs' upfront payments to purchase accounts.

Unsurprising Results

Companies turn to franchising to expand their footprint using other people's money. Franchising allows trademark owners to grow without the attendant overhead costs of hiring and supervising employees to manage new locations. Moreover, as long as the franchisee's business remains profitable, there is no reason a franchisee would question its classification as an independent contractor.

However, as *Awuah* demonstrates, things can change when relationship problems surface or an independent operator's business fails. This is true whether the operator is a franchisee or a nonfranchise independent contractor. To a so-called independent contractor facing the sudden at-will cancellation of affiliation rights or left without a livelihood, employee status offers a financial bailout. Overtime pay for long hours worked, unemployment benefits, Social Security contributions, and medical benefits make employee status look like a far better deal than being one's own boss.

Franchise or not, misclassification claims require the application of the appropriate legal test to determine the validity of a company's unilateral decision to classify workers as independent contractors. *Awuah* suggests that a worker's payment of a required fee—the fact that typically separates franchises from nonfranchises—is not dispositive to the classification issue. The express or implied trademark license—a characteristic that franchise and nonfranchise programs share—appears to supply the legal foundation for franchisees to bring misclassification lawsuits like their nonfranchise counterparts.

Federal trademark law requires trademark owners, whether they are franchisors or not, to control the quality and uniformity of the goods and services associated with their brand or otherwise risk abandonment of trademark rights. Consequently, both in the franchise and nonfranchise arenas, brand owners must dictate detailed standards and specifications over a licensee's distribution activities.[42] A licensor's specified operating controls can easily resemble workplace rules. This is especially true when a licensee has neither a workforce of its own nor bricks-and-mortar locations and operates as a sole proprietor, such as the plaintiffs in *Narayan* and *Awuah*. Under these facts, the licensee looks less like an independent business owner and more like an employee, which makes it difficult for licensors to convince a trier of fact that operating controls are entirely brand-justified.

Licensors are accustomed to defending quality controls as justifiable in support of the brand. Not infrequently, licensors are sued by third parties under agency theories for acts or omissions by licensees. In defense, licensors cite the brand purpose of their controls to explain why the licensee's use of their brand does not make the licensee their agent or make them responsible for the licensee's mistakes. While licensors have used the brand-justification defense to defeat vicarious liability claims, they have not had equal success with the argument to defeat misclassification liability.

Misclassification and vicarious liability involve different legal issues and policy considerations. The legal tests to prove employee status are different than the tests to prove agency, and the political stakes in employee misclassification cases are significantly higher than in vicarious liability cases, since misclassification involves multiple victims—including the contractor-worker as well as the governments (federal, state, and local) that are denied their tax revenue.

Undoubtedly more franchisee misclassification claims will follow after *Awuah*, especially if the economic recession continues to increase franchisee terminations. With the right facts, it should surprise no one if California franchisee plaintiffs prevail in extending *Narayan* and the reasoning of cases like *Awuah* to California franchisees.

Indicia of Potential Vulnerability

In misclassification lawsuits, the outlook for franchise and nonfranchise companies is similar. Given the recent successes of misclassification cases and the significant dollars at stake, private and public enforcement efforts will continue to proliferate.[43] *Awuah* in the franchise context and *Narayan* in the nonfranchise context expose the vulnerability of self-proclaimed independent contractor arrangements, especially when the contractor has no bricks-and-mortar base of operations. This is a worrisome development in an era of proliferating contract, freelance, temporary, and seasonal workers, along with shrinking payrolls and dwindling tax revenues.[44]

Of course, not all franchise and nonfranchise independent contractor arrangements are equally vulnerable. It is important to underscore the similar characteristics of the truck drivers in *Narayan* and franchisees in *Awuah*—characteristics prototypical of potential misclassification claimants:

- Small businesses with few, if any, employees.
- Sole proprietorships, not legal entities.
- Workers without a bricks-and-mortar presence who perform services at home, in the field, or at the customer's location.
- Workers who make minimal investments in equipment to perform their jobs and drive their own or a company-furnished vehicle to job sites when work is performed away from home.[45]

These characteristics fit a broad assortment of contract worker arrangements across all industries, backgrounds, and incomes, both franchise and nonfranchise. They can be

found in businesses in which workers repair homes, clean offices, bathe pets, tutor children, operate courier services, or perform senior care or home healthcare services. They also describe contract workers with special skills or higher levels of education, including computer trainers, freelance journalists, graphic designers, software programmers, and business coaches.

The franchisees in *Awuah* fit this profile. They were reclassified as employees because Coverall could not convince the court that its program for training and licensing others to operate a janitorial business was a separate and distinct business apart from the franchisees' cleaning service. Undoubtedly, Coverall was doomed by bad facts.

Taking Precautions

By choosing to franchise a business model, franchisors should be able to accentuate the separate and distinct businesses that they and their franchisees operate. Franchisors are in the business of designing uniform operating systems and protocols, recruiting network members, training recruits, running marketing campaigns, developing brand identity, and protecting the licensed brand. Some franchisors do more: they source ingredients and supplies, perform procurement and purchasing functions, supply point-of-sale computer solutions, and provide support for back-office billing, accounts receivable, and bookkeeping. Franchisees, by contrast, are in the business of selling branded goods or services to customers.

Franchisors can proactively enhance their position that their franchisees are independent contractors. As precautionary steps, they should:

- Provide franchisees with best practices advice but actively police only those standards that are truly essential to brand identity and confine controls to those that can be best justified as crucial to brand protection.
- Refrain from requiring franchisees to adopt particular employment policies.
- Take no part in the hiring and firing decisions of franchisees.
- Require each franchisee to operate its business through a business entity, not as a sole proprietor.
- Require franchisees to purchase uniforms from designated third parties and use their own tools and vehicles on the job.
- Emphasize their separate identity in communications with existing and prospective franchisees, lenders, suppliers, the trade press, public filings, landlords, and others. A franchisor should emphasize, with concrete examples, that despite sharing a common brand name with franchisees, it operates a very different business.
- Require each franchisee to notify its own employees, suppliers, and customers in obvious places like invoices, purchase orders, advertising, business cards, in-store signs, and the like of the independence of the franchisee's business. A franchisee should note that while it operates under a license from a franchisor, the franchisor is not responsible for the franchisee's activities or financial obligations.

Any company that enlists others to distribute its branded goods or services faces two potential dire outcomes. It can belatedly learn that its independent contractor network is a franchise and face liability for violating franchise laws. Also, it can misclassify its franchisees as independent contractors and face liability for violating employee status laws. Experienced legal counsel can offer structuring alternatives to keep a distribution program outside the ambit of franchise laws and guide a company in implementing sound practices to maximize legal defenses to employee misclassification claims.

Misclassification cases are fact-intensive statutory claims that are expensive to defend, impervious to self-serving contract provisions, susceptible to class certification, resistant to pretrial summary dismissal, and costly to lose. While neither franchisors nor their nonfranchise counterparts seek to face these actions, of the two franchisors ultimately may have the better prospect for defeating misclassification claims. ■

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[1] Awuah v. Coverall N. Am., Inc., 707 F. Supp. 2d 80 (D. Mass 2010).

[2] Franchise businesses with at least one employee account for 11% of the nation's businesses. http://www.ibtimes.com/articles/62257/20100914/census-franchise-business.htm (Sept. 14, 2010).

[3] For general guidance on the various employee tests, *see* Phillip R. Maltin, *By Any Other Name*, Los Angeles Lawyer, Sept. 2001, at 53, *and* R. Carlson, *Why the Law Still Can't Tell an Employee When It Sees One and How It Ought to Stop Trying*, 22 Berkeley J. Emp. & Lab. L. 295 (2001) [hereinafter Carlson].

[4] Carlson, *supra* note 3, at 369 (The common law test is inherently imprecise.).

[5] S. G. Borello & Sons, Inc. v. Department of Indus. Relations, 48 Cal. 3d 341, 352 n.6 (1989).

[6] Several California agencies are involved in classification decisions: the Employment Development Department, the Division of Labor Standards Enforcement, and, to a lesser extent, the Franchise Tax Board, the Division of Workers' Compensation, the Department of Industrial Relations, and the Contractors State Licensing Board. Each has its own regulations concerning independent contractors. *See* http://www.dir.ca.gov/dlse/faq_independentcontractor.htm (last visited Dec. 15, 2010) ("[S]ince different laws may be involved in a particular situation…it is possible that the same individual may be considered an employee for purposes of one law and an independent contractor under another law.").

[7] J. Tom, *Is a Newscarrier an Employee or an Independent Contractor? Deterring Abuse of the "Independent Contractor" Label via State Tort Claims*, 19 Yale L. & Pol'y Rev. 489, 491 (2001).

[8] J. Moran, *Independent Contractor or Employee? Misclassification of Workers and Its Effect on the State*, 28 Buff. Pub. Int. L.J. 105, 130 (2009-10) [hereinafter Moran].

[9] http://smallbusiness.chron.com/costs-employee-vs-independent-contractor-1077.html (last visited Dec. 15, 2010).

[10] Vizcaino v. Microsoft Corp., 97 F. 3d 1187, 1189 (9th Cir. 1996).

[11] http://www.insidecounsel.com/Issues/2010/July-2010/Pages/Worker-Misclassification-Under-Fire-from-Federal-and-State-Agencies.aspx (last visited Dec. 15, 2010).

[12] Moran, *supra* note 8, at 122-23.

[13] http://www.auditor.leg.state.mn.us/ped/pedrep/missclass.pdf (last visited Dec. 15, 2010).

[14] http://www.labornotes.org/2010/03/when's-worker-contractor-when-boss-wants-cheat (last visited Dec. 15, 2010).

[15] Narayan v. EGL, Inc., 616 F. 3d 895, 900 (9th Cir. 2010) (citing Robinson v. George, 16 Cal. 2d 238, 242 (1940)).

[16] http://www.patriotsoftware.com/Employer-Training-Blog/bid/31442/Misclassifying-Independent-Contractors-More-Legislation-Pending (last visited Dec. 17, 2010).

[17] http://www.nyreport.com/articles/77158/how_the_government_is_going_after_employee_misclassification (last visited Dec. 17, 2010).

[18] JKH Enters. v. Department of Indus. Relations, 71 Cal. Comp. Cas. 1257 (2006).

[19] Rochelle B. Spandorf, *Franchise Player*, Los Angeles Lawyer, Dec. 2006, at 34.

[20] Two California statutes regulate franchises and define the term "franchise" in an identically substantive way: the California Franchise Investment Law, Corp. Code §31005 (franchise sales); and the California Franchise Relations Act, Bus. & Prof. Code §20001 (franchise relationships).

[21] Federal and state franchise laws do not define "franchise" uniformly.

[22] Gentis v. Safeguard Bus. Sys., 60 Cal. App. 4th 1294 (1998) (distributorship held to be franchise); To-Am Equip. Co. v. Mitsubishi Caterpillar Forklift Am., 152 F. 3d 658, 659-60 (7th Cir. 1998).

[23] Some states with filing requirements subject franchise disclosure documents to a full review. California is among this group. Other states utilize a notice-filing system.

[24] California's Franchise Relations Act requires a franchisor to have good cause to terminate or refuse to renew a franchise regardless of the contractual language agreed to by the parties. Bus. & Prof. Code §§20020, 20021, 20025.

[25] For example, California's Franchise Relations Act voids an out-of-state venue provision in a franchise agreement. *See* Bus. & Prof. Code §20040.5.

[26] *See*, *e.g.*, Corp. Code §31512.

[27] Joint and several liability exists for violations of California's Franchise Investment Law (Corp. Code §31302) but not the Franchise Relations Act.

[28] The California Department of Corporations administers the Franchise Investment Law and identifies these factors as indicia of a "marketing plan." *See* California Department of Corporations, Release 3-F, When Does an Agreement Constitute a "Franchise"? (rev. June 22, 1994), http://www.corp.ca.gov/Commissioner/Releases/3-F.asp (last visited Dec. 15, 2010) [hereinafter Release 3-F].

[29] *See* Thueson v. U-Haul Int'l, Inc., 144 Cal. App. 4th 664, 676 (2006).

[30] Corp. Code §31011; Release 3-F, *supra* note 28.

[31] Estrada v. FedEx Ground Package Sys., Inc., 154 Cal. App. 4th 1 (2007). In a separate action in federal court, approximately 27,000 FedEx drivers in 2005 consolidated 42 different misclassification class actions against FedEx in a single multidistrict lawsuit in Indiana. On December 13, 2010, the Indiana federal district court, distinguishing *Estrada*, ruled for FedEx on a

majority of the claims. The court found that FedEx drivers were independent contractors in a majority of states. The litigation is far from over: drivers are expected to appeal the ruling, and a number of claims have been remanded for further factual development. http://www.workplaceclassaction.com/class-action/fed-ex-triumphs-in-jpmdl-class-actions-as-to-independent-contractor-classification-issues (last visited Jan. 17, 2011). Meanwhile, several state attorneys general are suing or have recently settled misclassification cases against FedEx. http://www.natlawreview.com/article/new-york-joins-other-states-suing-fedex-misclassification-its-ground-division-drivers-indepe (last visited Dec. 17, 2010).

[32] http://www.dir.ca.gov/dlse/MisclassificationOfWorkers.htm (last visited Dec. 17, 2010).

[33] Narayan v. EGL, Inc., 616 F. 3d 895, 900 (9th Cir. 2010).

[34] *Id*. at 903. At-will termination provisions are also characteristic of many independent contractor arrangements.

[35] *Id*. at 904.

[36] By contrast, hiring companies in nonfranchise distribution arrangements frequently thrust independent contactor status on workers without explaining the implications. *See* http://www.labornotes.org/2010/03/when%E2%80%99s-worker-contractor-when-boss-wants-cheat (last visited Dec. 15, 2010).

[37] Awuah v. Coverall N. Am., Inc., 707 F. Supp. 2d 80 (D. Mass 2010).

[38] *Id*. at 84-85 (citing MASS. GEN LAWS ch. 149, §148B).

[39] The Massachusetts ABC test presumes a worker is an employee unless the putative employer can show the worker: A) is free from control and direction in performing services, B) performs services outside the usual course of the employer's business or outside of the employer's place of business, and C) is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the services performed. The *Awuah* court held that Coverall's inability to prove that franchisees performed services that were "independent, separate and distinct" from Coverall's business meant the franchisees were Coverall's employees.

[40] Coverall N. Am., Inc. v. Commissioner of the Div. of Unemployment Assistance, 447 Mass. 852 (2006).

[41] Pius Awuah v. Coverall N. Am., Inc., 2010 U.S. Dist. LEXIS 101876 (D. Mass. 2010) (separate challenge to *Awuah* damages decision).

[42] Rochelle Spandorf, *Structuring Franchises to Avoid the Inadvertent License*, LANDSLIDE, Mar./Apr. 2010, http://www.abanet.org/intelprop/landslide.

[43] Employee misclassification class actions increased by 50% in 2010 over 2009 filings. *See* http://www.usatoday.com/money/economy/employment/2010-12-13-contractjobs13_ST_N.htm (last visited Dec. 17, 2010).

[44] Five leading janitorial franchisors are currently defending franchisee misclassification class actions, including two in California. http://www.sturdevantlaw.com/Cases.php?Case=34 (last visited Dec. 17, 2010). *See also* note 31, *supra*.

[45] *See* Carlson, *supra* note 3, at 353 ("In most cases in which independent contractor or employee status is questioned, the workers in question have no employees of their own."). Some companies finance their operators' initial costs or own the building, fleet, or equipment that the operators need to perform their jobs. The companies may pay their operators a commission net of specific deductions to recoup their setup and carrying costs, which they would otherwise have to absorb with an employee workforce. Commission deductions do not constitute a required payment under California's franchise laws. *See* Thueson v. U-Haul Int'l, Inc., 144 Cal. App. 4th 664, 676 (2006), *and* Adees Corp. v. Avis Rent a Car Sys., 157 Fed. Appx. 2 (9th Cir. 2005) (unpublished).