www.morganbrown.com

CLIENT ALERT: Massachusetts Supreme Judicial Court's Franchise Decision May Create Compliance Challenges for Commonwealth Franchisors

On March 24, 2022, the Massachusetts Supreme Judicial Court ("SJC") held that the Commonwealth's independent contractor test applies to the franchisee-franchisor relationship. In *Patel v. 7-Eleven, Inc.*, the Court found that franchise owners, or franchisees, can be considered employees of the franchisor, entitling them to coverage under the state's wage and hour laws and other laws relevant to employees. Notably, the SJC rejected 7-Eleven's argument that the Federal Trade Commission's ("FTC") Franchise Rule, which requires certain disclosures in franchisor-franchisee relationships, preempts application of the Massachusetts independent contractor test. The SJC did not determine whether or not the plaintiffs—each, 7-Eleven franchisees in the Commonwealth of Massachusetts—were actually employees of 7-Eleven under the state independent contractor test. This issue remains to be decided by the U.S. District Court, District of Massachusetts (the "District Court") on remand.

Massachusetts' independent contractor test, commonly referred to as the "ABC test," is one of the country's most stringent tests relating to employee classification. Under the ABC test, a worker is considered an employee unless each of the following conditions is met: (1) the individual is free from control and direction in connection with his performance of the service; (2) the service is performed outside the usual course of the entity's business; and (3) the individual is engaged in an independently established trade, occupation, profession, or business of the same nature as the service performed. In its Franchise Rule, the FTC defines the franchisor-franchisee relationship as a continuing commercial relationship where the franchisor "exert[s] or has authority to exert a significant degree of control over the franchisee's method of operation, or provide[s] significant assistance in the franchisee's method of operation."

In *Patel*, the 7-Eleven franchisees claimed that they were "obligated to operate their convenience stores around the clock, stock inventory sold by 7-Eleven's preferred vendors, utilize the 7-Eleven payroll system to pay store staff, and adhere to a host of other guidelines." They further claimed that they were not paid wages in exchange for their work, but were instead permitted to draw from the gross profits of the store after paying 7-Eleven franchise fees. 7-Eleven argued that the FTC Franchise Rule preempts the ABC test because the two statutes have an inherent conflict. Specifically, 7-Eleven claimed that the "control" portion of the FTC Rule makes it nearly impossible for a franchisor in a traditional franchisor-franchisee relationship to treat a franchisee as an independent contractor under the ABC test, thereby undermining a central component of the franchisor-franchisee business model. The District Court agreed with 7-Eleven, observing an "inherent conflict" between the independent contractor statute and the FTC Franchise Rule such that the independent contractor test did not apply to franchisee-franchisor relationships. The Plaintiffs appealed, and the First Circuit Court of Appeals certified the question of preemption to the SJC.

The SJC rejected any suggestion that a conflict exists between the FTC Franchise Rule and the ABC test, reasoning that the FTC Franchise Rule relates to pre-sale disclosures rather than the substantive terms of the franchisor-franchisee employment relationship. The SJC also disagreed that all franchisees in Massachusetts must now be classified as employees. The Court explicitly distinguished between the "control over the franchisees' method of operation" envisioned by the FTC and the control element of the ABC test. Citing analogous decisions in California, New Jersey, and Georgia, the SJC reasoned that a franchisor is capable of exercising control over the method of operations, *e.g.* dictating which food items are on its menu, but at the same time, refraining from exercising control and direction over the franchisee's performance of services, *e.g.* hiring and firing decisions, wages paid to staff, day-to-day store operations, and discipline. In other words, the SJC observed that a franchisor could oversee a franchisee and still properly classify the franchisee as an independent contractor, so long as the franchisor provides the franchisee with significant autonomy in daily operations *and* meets the other prongs of the ABC test.

The SJC also noted that although it is impermissible to require an *employee* to pay franchise fees out of his wages, it may be permissible for a franchisor to collect franchise fees that come out of gross revenue as a cost of doing business, even if the franchisee is considered an employee. If the plaintiffs are found to be employees instead of independent contractors, they could recover damages including but not limited to costs of litigation, purported lost wages, liquidated damages, attorneys' fees, statutory interest, and—as the SJC appeared to signal—potentially franchise fees to the extent the court concluded these fees were deducted from wages rather than gross revenue.

While the *Patel* decision speaks only to franchisees, franchisors should also be aware of the potential implications this decision may have on a much larger group of workers: the employees of the *franchisee*. This decision may be used to support a franchisee's employee contention that both the franchisee and the parent company are joint employers.

Employers are encouraged to contact their MBJ attorney with any questions about the proper classification of workers.

Alexandra Pichette and Aaron Spacone are attorneys with Morgan, Brown & Joy, LLP, and may be reached at (617) 523-6666 or at apichette@morganbrown.com and aspacone@morganbrown.com. Morgan, Brown & Joy, LLP focuses exclusively on representing employers in employment and labor matters.

This alert was prepared on March 28, 2022.