CLIENT ALERT: Supreme Judicial Court Rules That Typical Franchise Operators Are Independent Contractors, Not Employees

On September 5, 2024, the Massachusetts Supreme Judicial Court ("SJC") held that 7-Eleven franchisees operating in a "typical" franchisor-franchisee relationship were independent contractors and not "employees" of 7-Eleven, the franchisor. In Patel v. 7-Eleven, the SJC held that the franchise operators did not "perform any service" for the franchisor and were not the franchisor's employees under Massachusetts law.

This decision resolves ambiguity for franchisors operating in Massachusetts about the status of their franchisees, after years of litigation and multiple appellate decisions.

Legal Background

The Massachusetts independent contractor test casts one of the country's widest nets for finding that workers are employees, not independent contractors. Under the so-called ABC test, a worker cannot be a contractor, and instead will be an employee, unless *all three* of the following statutory conditions are met:

1. The worker must be free from the primary business's control and direction in performing the service.
2. The service that the worker performs must be outside the usual scope of the primary business.
3. The worker must be engaged in an independently established trade, occupation, profession, or business, coinciding with the service being performed.

An employer who misclassifies an employee as an independent contractor faces significant exposure. Regulators can pursue civil and criminal penalties for unpaid wages, benefits, and taxes. Misclassified employees can also recover triple their unpaid or underpaid wages via the Massachusetts Wage Act, which imposes mandatory treble damages and attorney's fees. Given the sizeable potential liability, courts have frequently interpreted and applied each of the three prongs of the ABC test.

However, there is a preliminary inquiry even before applying the three prongs of the ABC test. The worker in question must be "performing any service" for a putative employer. This rarely analyzed threshold question ultimately determined the outcome in the recent SJC decision, and provided franchisors a measure of certainty about their usual business model with franchisees.

Factual Background

In Patel, a group of 7-Eleven franchise owner-operators alleged that they were really employees, misclassified as independent contractors. In support of their argument, these operators cited the obligations and restrictions imposed in their franchise agreements with 7-Eleven. The franchise agreements called for 7-Eleven to provide equipment, operational support, and a license to use 7-Eleven's intellectual property at specific locations. In exchange, the operators were required to staff the location using approved uniforms, to buy specific inventory from particular vendors, and to pay a percentage of the location's gross profits as a franchise fee.

Seemingly unsatisfied with their financial standing and investment as franchise operators, the operators argued that they worked at the franchisor's control and direction, and therefore were employees entitled to wages and benefits that they never received as franchise operators.

The SJC Protects the Typical Franchisor-Franchisee Relationship

After a winding road through state and federal courts that included a previous trip to the SJC, the First Circuit Court of Appeals certified a question of law to the SJC on whether the franchisor-franchisee relationship meant that the operators were "performing any service" for 7-Eleven. The SJC concluded that the operators were not "performing any service" for 7-Eleven and therefore could not be categorized as employees. Instead, they worked as franchise operators, for themselves.

The SJC noted the difficulty of applying traditional employment laws to the "typical" franchisor-franchisee relationship. The Court characterized the typical relationship as a business arrangement, where a franchisor grants a license to a franchisee to operate an independent business, displaying the franchisor's brand, which is intellectual property. Rather than creating and developing their own unique brand, franchise operators choose to run an independent business, but using the franchisor's well-known brand.

In concluding that the franchise operators worked for themselves, the SJC noted that the franchises served customers from the general public, as opposed to serving only 7-Eleven's existing customer accounts. The Court also emphasized that the franchise operators earned money from the profits they generated, as opposed to being paid by the franchisor. Moreover, the SJC recognized that the typical franchisee restrictions were necessary for protecting the franchisor's brand, and that these restrictions do not create employment relationships.

Takeaways

For a wide range of brand-name franchisors operating in the Massachusetts legal climate, this decision is a satisfying conclusion to the Patel saga. A contrary ruling would have been a major disruption in the longstanding business relationships between franchisors and franchisees. The SJC recognized this reality.

Franchisors should avoid misclassification liability as to franchise operators, and keep those relationships "typical" within the description set forth by the SJC. This is not a heavy burden. Franchisee-operators should not be restricted to solely providing services to the franchisor's existing customer base. Franchise operators should have the ability to earn more as their franchises flourish, without compensation limits set by the franchisor. Franchisors may continue to restrict their franchisees' operations to ensure the franchisor's standards are met, and the franchisor's goodwill and brand are protected.

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