NO. 91610-1

**SUPREME COURT OF THE STATE OF WASHINGTON**

WASHINGTON STATE DEPARTMENT OF LABOR AND INDUSTRIES,

Respondent,

v.

LYONS ENTERPRISES, INC. d/b/a JAN-PRO CLEANING SYSTEMS,

Petitioner.

# DEPARTMENT OF LABOR AND INDUSTRIES' ANSWER TO PETITION FOR REVIEW

ROBERT W. FERGUSON
Attorney General

STEVE VINYARD
Assistant Attorney General
WSBA No. 29737
Office Id. No. 90122
P.O. Box 40121
7141 Cleanwater Dr. SW
Olympia, WA 98504-0121
(360) 586-7715

## TABLE OF CONTENTS

## TABLE OF AUTHORITIES

### Cases



### Statutes

**Rules**

## I. INTRODUCTION

This case involves the application of well-established principles of workers' compensation law to the facts of individual workers. The Industrial Insurance Act covers all individuals who provide personal labor under a contract. It is the work they do that triggers coverage not the type of contract they have or the business model selected by a company. Lyons Enterprises, Inc. is a franchisor who contracts with customers for commercial janitorial services, and it assigns the cleaning contracts to its franchisees. Under the Industrial Insurance Act, an employer is responsible to provide industrial insurance coverage for its workers, and this includes coverage for an independent contractor when the essence of the contract is personal labor.

The Department of Labor and Industries (L&I) determined that Lyons's franchisees are its workers for the purposes of the Industrial Insurance Act because Lyons's janitors perform work under an independent contract and the essence of that work is the janitors' personal labor. Lyons argues that none of its franchisees are its workers, regardless of what work the franchisees perform for it, arguing instead that the franchise relationship itself is the essence of its contracts. The Court of Appeals properly rejected Lyons's argument, concluding the "essence" that matters is the essence of the work performed under the contract, not

how the parties describe their relationship with each other. *See Department of Labor & Indus. v. Lyons Enterprises, Inc.*, __ Wn. App. __, 347 P.3d 464 (2015). Because none of Lyons's arguments demonstrate a basis for review under RAP 13.4(b), this Court should deny review.

## II. ISSUE PRESENTED

Discretionary review is not merited in this case, but if review were granted, the following issues would be presented:

1. When deciding whether Lyons's franchisees were covered under the Industrial Insurance Act, is the work performed by Lyons's franchisees examined rather than the franchise relationship itself, when the case law establishes that the proper focus is on the essence of the work performed under a contract rather than the labels that the parties attached to their relationship?

2. Is an independent contractor exempt from coverage merely because the contractor had the ability to use another worker when *White v. Department of Labor & Industries*, 48 Wn.2d 470, 294 P.2d 650 (1956), held that an independent contractor is exempt only if he or she "employs others" to perform work?

3. Does the exception in RCW 51.08.195 for independent contractors who perform work under a contract apply to a franchisee whose work is not free from the direction and control of a franchisor and who is not customarily engaged in an independently established trade or business?

## III. STATEMENT OF THE CASE

### A. Lyons Contracts for Cleaning Services and Directs Its Franchisees to Provide Those Services to Lyons's Customers

Jan-Pro International provides janitorial services to 32,000 customers in 48 states and nine countries, using the "Jan-Pro System."

CP 1902-03. Lyons is a regional franchisor for Jan-Pro International, operating in western Washington. CP 2132.

Lyons enters into contracts with businesses to provide commercial cleaning services, and offers the account to one of its franchisees. *See* CP 1907-08, 1926, 2155, 2167. The franchisees perform commercial cleaning services, such as cleaning offices and other businesses. CP 1902, 1906. The franchisee may either accept or reject the offered cleaning contract. CP 1908. If the franchisee accepts the assignment, the cleaning contract remains the property of Lyons, and the franchisee is not a party to the contract. CP 316, 1908. If the franchisee rejects the assignment, then Lyons is to find another cleaning contract for the franchisee, although there may be a delay before a new account can be found. CP 1911.

Lyons can remove a franchisee from a cleaning contract either for cause or without cause. CP 318, 1918. If Lyons removes a franchisee from a customer account within one year of the date that the janitor began providing cleaning services to that customer, and if Lyons does so for a reason "other than Franchisee Misconduct," Lyons shall "within a reasonable time" find a new account for the franchisee. CP 318. "Franchisee misconduct" is defined as "faulty workmanship, untrustworthiness, dishonesty, providing services in a manner

unsatisfactory to one or more customers, or otherwise defaulting under this Agreement or its service contract with the Customer." CP 318.

Lyons collects a ten percent royalty fee and a five percent management fee on all of its cleaning contracts. CP 1928. In some cases, Lyons charges the franchisee one or more additional fees. CP 1915-16, 1932-33. Lyons must remit three percent of the gross billing amount to Jan-Pro International. CP 1931. After collecting all applicable fees, Lyons then sends the remainder to the franchisee. CP 1930.

Under the terms of the franchise agreement, a franchisee may only provide commercial cleaning services through Lyons during the life of the franchise agreement and cannot perform any commercial cleaning services of any kind for a year after the franchise agreement is terminated. CP 344-45, 1920.[1] If a franchise is terminated, Lyons has the right to purchase all of the former franchisee's assets related to the commercial cleaning industry, including items that do not bear the Jan-Pro trademark,

[1] Lyons argues that a former franchisee is not required to terminate his or her business after the franchise agreement ends, and suggests that the former franchisee is merely restricted from directly competing with Lyons for customers for one year. Pet. at 19. However, while the franchise agreement does not expressly require the former franchisee to "terminate" its business, the franchise agreement precludes the franchisee from either operating a commercial cleaning business for one year or even owning any interest in any company that has any involvement in the commercial cleaning industry, aside from owning a less than five percent share in a publicly owned company. *See* CP 344-45. Therefore, a former franchisee would have to either terminate the business completely or relinquish all of his or her ownership in it upon the expiration of the franchise agreement, or the former franchisee would be violating the noncompete clause. *See* CP 344-45.

at a "fair market value," which is either set at an agreed amount, or, in the case of dispute, set by an appraiser of Lyons's choosing. CP 344.

A franchisee may advertise and seek customers on its own, but, if the franchisee convinces a new customer to sign up for cleaning services, the new customer must sign a contract with Lyons and the cleaning contract becomes the property of Lyons. CP 1933.

Before a franchisee can provide any cleaning services, he or she must complete a 30-hour training course, over a five-week period, regarding the proper methodology for cleaning when using the Jan-Pro System. CP 1912. New franchisees are provided with a 422-page training manual outlining the Jan-Pro System, a roughly 200-page safety manual, and a roughly 100-page policies and procedures manual. CP 1938, 2027-28. The franchise agreements reference those manuals, and provide that the franchise agreement may be terminated if the franchisee fails to follow the procedures set forth in those manuals. CP 335, 340.

Lyons conducts audits on at least a quarterly basis of all of its customer accounts to ensure that the franchisees are providing appropriate janitorial services. CP 2173-74.

Lyons may terminate a franchise agreement if, among other things, it concludes that the franchisee's actions have tarnished Jan-Pro's reputation. CP 339-42, 2199-2201.

## B. The Court of Appeals Concluded That Many of Lyons's Janitor Franchisees Were Likely Its Workers

After an audit, L&I found that several of Lyons's franchisees were "workers" as defined by the Industrial Insurance Act, RCW 51.08.180. CP 1744-46. Lyons appealed to the Board of Industrial Insurance Appeals, which decided that the franchisees who employed workers of their own were exempt from industrial insurance coverage, but that the remaining franchisees were covered workers. CP 22-31. The superior court found that all franchisees were covered. CP 2391-99. The Court of Appeals held that only the franchisees who did not have their own separate employees were covered. *Lyons*, 347 P.3d at 470-74. The Court of Appeals rejected Lyons's arguments that the franchisee relationship excluded them from coverage because the essence of the work performed under the contract was the franchisee's personal labor. *Id.* at 471. It also rejected Lyons's arguments under RCW 51.08.195. *Id.* at 473-74.

The Court of Appeals concluded that the record was insufficient to allow for a determination regarding how many of Lyons's franchisees actually used workers of their own to provide cleaning services and how many did not. *Id.* at 474. It therefore remanded the case to the Board. *Id.*

Lyons then filed a petition for review with this Court.

## IV. ARGUMENT

Lyons demonstrates no basis for this Court's review. No issue of substantial public interest is raised by the routine application of the well-established principle that it is not the label of the business relationship that controls; it is the nature of the work performed.

Lyons also shows no conflict with the decisions of this Court or the Court of Appeals. Contrary to Lyons's arguments, *White* did not hold that the fact that an independent contractor had the right to use another to perform the work under a contract defeats coverage regardless of whether the independent contractor actually used another to perform the work or not. *White* instead held to the contrary. *White*, 48 Wn.2d at 472-74.

Nor is there any reason to question the Court of Appeals' holding under RCW 51.08.195, which construes the plain language of the statute to mean that if there is control over the worker, the employer is not exempt. Lyons's argument amounts to a request that that statute be amended to comport with Lyons's notions of what is in the public interest, which is a request best directed to the Legislature. This Court should deny Lyons's petition for review.

### A. Focusing on the Work Performed Under the Contract Does Not Present an Issue of Substantial Public Interest Because an Independent Contractor is Covered Whenever the Essence of the Work Under the Contract Is Personal Labor

Lyons, like any other business that uses independent contractors to perform labor, is responsible to pay premiums for the franchisees who perform work for it if the essence of the work that is performed is the franchisee's personal labor. *See* RCW 51.08.180; *White*, 48 Wn.2d at 472-74. Lyons argues that the Court of Appeals erred by focusing on the work that its franchisees performed for it rather than on the franchise relationship itself, and that this error is a matter of substantial public interest. Pet. 7-12. Lyons's argument fails because both the Industrial Insurance Act and the case law show that the proper focus is on the essence of the work that an independent contractor performs under a contract rather than any labels that are used to describe the parties' relationship. RCW 51.08.180; *Dana's Housekeeping, Inc. v. Dep't of Labor & Indus.*, 76 Wn. App. 600, 607, 886 P.2d 1147 (1995) (holding that essence of contract between Dana's and subcontractors was personal labor when the subcontractors provided cleaning services to the Dana's customers, and rejecting Dana's argument that essence of contract was "an agreement to accept referrals and share a fee").

### 1. The Proper Inquiry Is the Work Performed by the Franchisee

The Industrial Insurance Act requires every "employer" to secure workers' compensation coverage by insuring with the state (through premiums) or by self-insuring. RCW 51.14.010. Although the common law distinguishes "employees" and "independent contractors," the Industrial Insurance Act was amended in 1937 to expressly provide coverage for independent contractors who provide personal labor. RCW 51.08.180; *see Norman v. Dep't of Labor & Indus.*, 10 Wn.2d 180, 183, 116 P.2d 360 (1941).

Thus, the Industrial Insurance Act broadly defines both "worker" and "employer" to include independent contractors and those who hire them. An "employer" is any person or entity "all while engaged in this state in any work covered by the provisions of this title, by way of trade or business, or who contracts with one or more workers, *the essence of which is the personal labor of such worker or workers*." RCW 51.08.070 (emphasis added). The Legislature intended "to broaden the industrial insurance act, and bring under its protection *independent contractors whose personal efforts constitute the main essential in accomplishing the objects of the employment*, and this, regardless of who employed or contracted for the work." *Norman*, 10 Wn.2d at 184 (emphasis added).

The Legislature's mandate for broad coverage furthers the important goal, inherent in the Industrial Insurance Act, of liberally construing the Act in order to reduce to a minimum the suffering and economic hardship associated with workplace injuries. RCW 51.12.010.

In determining what the "essence" of a contract is, the court's focus is on "the essence of the work under the independent contract, not the characterization of the parties' relationship." *Dana's*, 76 Wn. App. at 607 (emphasis in original). Lyons's argument that the true essence of its contracts is the franchise relationship itself (Pet. 7-12) is indistinguishable from arguments that the Court of Appeals considered and rejected in *Dana's*. *See Dana's*, 76 Wn. App. at 607.

In *Dana's*, the putative employer, Dana's, entered into contracts with homeowners to provide cleaning services, and assigned one or more housecleaners, who it characterized as independent contractors, to the job. *Dana's*, 76 Wn. App. at 602-03. Customers would pay Dana's for the cleaning services, and Dana's would keep a percentage of the payment. *Id.* Dana's argued that the essence of its contracts with its housecleaners was "an agreement to accept referrals and share a fee" rather than the personal labor of the housecleaners. *Id.* at 607. The Court of Appeals rejected this argument, explaining, "the 'essence' with which the statute is concerned is the essence of the work under the independent contract, not the

characterization of the parties' relationship." *Id.* (emphasis in original). The Court of Appeals concluded that the essence of the work performed under the contracts—house cleaning services—was the personal labor of the housecleaners. *Id.*

Here, the relevant issue is the essence of the work performed by Lyons's franchisees under their independent contracts, not on how either Lyons or the franchisees characterize their relationship with each other. *See Dana's*, 76 Wn. App. at 607. The essence of the work performed under their cleaning contracts is the franchisees' personal labor: the manual labor necessary to provide janitorial services. *See Dana's*, 76 Wn. App. at 607.

Thus, the Court of Appeals here properly focused on the nature of the work that the franchisees performed for Lyons (janitorial cleaning work) rather than the labels that the parties attached to their relationship. *Lyons*, 347 P.3d at 471. This is consistent with the Industrial Insurance Act's broad extension of coverage to independent contractors whenever the essence of contract is personal labor. Lyons has not established that the Court of Appeals erred by focusing on the work that its franchisees perform for it when deciding whether its franchisees are its workers, let alone shown that this is an error relating to a matter of substantial public interest warranting this Court's review.

### 2. The Analysis Does Not Rest on the Type of Franchisee Contract

Lyons also suggests that, under the Court of Appeals' opinion, all franchisees that provide "services" rather than "goods" are covered workers. Pet. 9-10. However, nowhere did the Court of Appeals endorse that view in its opinion, and the Department expressly acknowledged in its answer to the amicus brief filed by the International Franchise Association that such a position would be overly simplistic, as questions of coverage under the Industrial Insurance Act are complex and inherently case-specific, and cannot be resolved by making a simple dichotomy between "goods" and "services." Answer To Amicus IFA at 12-14.

Lyons also erroneously claims that the Court of Appeals focused only on the cleaning contracts between Lyons and Lyons' customers rather than the franchise contracts between Lyons and the franchisees. Pet. 8. However, the Court of Appeals considered both the franchise agreements and the cleaning contracts themselves, and this is proper as both are relevant to the question of whether the franchisees are the workers of Lyons. *See, e.g., Lyons*, 347 Wn. App. at 471 (discussing both the franchise agreements and cleaning contracts). Lyons has shown no error.

### 3. RCW 51.08.070 Applies to Qualified Independent Contractors Regardless Whether They Are Sole Proprietors

Finally, raising an argument it did not present to the Court of Appeals, Lyons suggests that franchisees should be exempt based on RCW 51.12.020, which exempts sole proprietors and other business owners from mandatory coverage. Pet. at 11. This Court should not consider that argument because Lyons did not raise it below. *See Pappas v. Hershberger*, 85 Wn.2d 152, 153-54, 530 P.2d 642 (1975).

But, assuming this Court considers the argument, it fails, as it would render RCW 51.08.180's extension of coverage to independent contractors meaningless. Any individual who goes into business for him or herself automatically forms a sole proprietorship if he or she does not form another sort of business entity, such as a corporation. *See Dolby v. Worthy*, 141 Wn. App. 813, 173 P.3d 946 (2007). Thus, under Lyons's argument, any independent contractor who performed labor for an employer under a contract would automatically be exempt as the independent contractor would either be a sole proprietor or otherwise exempt under RCW 51.08.020. It is implausible that the Legislature intended for RCW 51.08.180 to have no legal effect. Lyons's novel argument does not warrant this Court's review.

### B. The Court of Appeals Decision Does Not Conflict With *White* Because *White* Did Not Hold That the Contractual Ability to Use Another to Perform the Work of the Contract Precluded Coverage

The Court of Appeals properly rejected Lyons's argument that the mere fact that Lyons's franchisees had the ability under their contract to use others to perform work prevented its franchisees from being Lyons's workers, whether the franchisees actually used any others to perform work or not. *Lyons*, 347 P.3d at 471-72. Lyons, however, contends that the opinion's rejection of its argument conflicts with *White*, insisting that, under *White*, the contractual ability to use another to perform work is enough to deprive an independent contractor of the protection of the Industrial Insurance Act. Pet. 14. However, it is Lyons's argument, not the opinion, that conflicts with *White*, and this Court need not grant review to consider Lyons's argument. *See White*, 48 Wn.2d at 472-73.

Under *White*, the mere fact that an independent contractor has the contractual ability to use another to perform work does not prevent coverage under the Industrial Insurance Act. *See id. White* sets a three-part test to determine if personal labor is the essence of a contract: personal labor is *not* the essence of the contract if the independent contractor (1) "must of necessity own or supply machinery or equipment (as distinguished from the usual hand tools)," (2) "obviously could not

perform the contract without assistance," or (3) "of necessity or choice *employs others* to do all or part of the work he [or she] has contracted to perform." *White*, 48 Wn.2d at 474 (emphasis added). Thus, under the third prong of *White*, an independent contractor is not covered if he or she *actually* "employs others" to do work, but the mere fact that the independent contractor *could* have assigned the work to another person without violating the contract does not defeat coverage under the Industrial Insurance Act. *White*, 48 Wn.2d at 474.

Indeed, the *White* Court expressly disavowed language that the Court had used in two of its earlier decisions, which had suggested, as Lyons argues here (Pet. 12-14), that the mere contractual ability to use another to perform work was enough to defeat coverage under the Industrial Insurance Act. *See id.* at 472-73 (expressing disagreement with *Crall v. Department of Labor & Industries*, 45 Wn.2d 497, 275 P.2d 903 (1954) and *Cook v. Department of Labor & Industries*, 46 Wn.2d 475, 282 P.2d 265 (1955)). *White* explained:

> We are now convinced that the language in the *Crall* and *Cook* cases is too broad, and that the legislature in 1937, in adopting the section of the workmen's compensation act with which we are now concerned, had something more in mind than the protection in those extremely rare cases in which the party for whom the work is done requires the personal services of the independent contractor and is unwilling that any part of the work be done by someone else.

*Id.* at 473-74.

*White* unambiguously rejects the very proposition that Lyons says *White* stands for: namely, that the contractual ability to use another worker to perform part of the work of a contract defeats coverage under the Industrial Insurance Act even if the independent contractor actually performs all of the work under the contract. *White*, 48 Wn.2d at 473-74.

Furthermore, contrary to Lyons's argument (Pet. 12-14), neither *Massachusetts Mutual Life Insurance Co. v. Department of Labor & Industries*, 51 Wn. App. 159, 752 P.2d 381 (1988) nor *Silliman v. Argus Services, Inc.*, 105 Wn. App. 232, 19 P.3d 428 (2001), stands for the proposition that the hypothetical ability to use another to perform work under a contract is sufficient to preclude an independent contractor from receiving the protection of the Industrial Insurance Act. *See Silliman*, 105 Wn. App. at 237 (holding that the security company was not a coworker of the individual who worked at a plant, because the security company used others to perform all work under its contract); *Massachusetts Mutual*, 51 Wn. App. at 164-65 (holding that the insurance agents were not covered workers because they "may and do" delegate their duties to others). In each of those cases, an independent contractor was not covered by the Industrial Insurance Act because he or she actually used others to perform

work, not because he or she could have done so but did not. *Silliman*, 105 Wn. App. at 237; *Massachusetts Mutual*, 51 Wn. App. at 164-65. The Court of Appeals' opinion does not conflict with either case.

### C. The Court of Appeals Properly Concluded That the Franchisees Are Not Exempt Under the Six Factor Test in RCW 51.08.195

The Court of Appeals properly declined to rule that Lyons's franchisees are exempt from coverage under RCW 51.08.195. Under RCW 51.08.195, an independent contractor is not covered if all six of a demanding set of criteria are met.

Under RCW 51.08.195(1), an independent contractor must be "free from control or direction over the performance of the service, *both under the contract of service and in fact* . . . ." (emphasis added). Under RCW 51.08.195(3), an independent contractor must either "be customarily engaged in an independently established trade, occupation, profession, or business" or have a "principal place of business" that is "eligible for a business deduction for federal income tax purposes." Lyons's franchisees are neither "free from its direction or control" nor "customarily engaged in an independently established trade, occupation, profession or business," and, therefore, they are not exempt from coverage under RCW 51.08.195.

Lyons seeks an exemption from the plain requirements of the statute. Lyons contends that any form of control that is a "traditional

element of a franchised business" does not constitute "control" for the purposes of RCW 51.08.195(1). Pet. 15-18. However, RCW 51.08.195(1) unambiguously provides that that criterion is met only when the independent contractor is "free" from direction and control; where control is exercised, RCW 51.08.195(1) is not met regardless of why an employer chose to exercise control over the independent contractor.

Furthermore, Lyons's characterization of the control it exercises as "non-supervisory" understates the extent of the control it exercises over its franchisees. Pet. 15. Lyons regularly audits its franchisees to ensure that the franchisees perform cleaning work that satisfies Lyons's expectations. CP 2173-74. Lyons owns all of the cleaning contracts with all of its customers, and it can reassign any contract from one franchisee to another at any time, with or without cause. CP 318, 1907-08, 1918. Lyons is required to find replacement work if it removes a franchisor from a contract without cause, but may do so within "a reasonable time" (CP 318), and the franchisee's income would be reduced or even eliminated in the meantime. The control Lyons exercises over its franchisees is "supervisory" by any reasonable standard.

The Court of Appeals concluded that Lyons's franchisees did not satisfy RCW 51.08.195(3) because they were not "customarily engaged" in an "independently established trade," as most of the franchisees had not

performed janitorial work before becoming franchised with Lyons, none could pursue janitorial work independent of Lyons during the life of the franchise agreement, and the "noncompete" clause within the franchise agreement would require them to stop all business activities related to commercial janitorial work for a year once the franchise agreement ended. *Lyons*, 347 P.3d at 473-74. Lyons argues that none of those facts show that its franchisees were not customarily engaged in an independently established trade, because the franchisees were all "licensed businesses" and were responsible "for their own books, taxes, insurance, employees, scheduling, and more." Pet. 18. However, the key under RCW 51.08.195(3) is not whether a franchisee is pursuing a business, but whether the franchisee was "customarily engaged" in an "independently established" business. The janitorial businesses the franchisees pursue are wholly dependent on Lyons and Jan-Pro.

Although not couched as such, Lyons essentially argues that it is contrary to public policy for it to have to establish that a franchisee is customarily engaged in an independently established business, touting the benefits of the franchise business model and its importance to the economy. However, Lyons's argument that RCW 51.08.195's requirements are too exacting is an argument best directed to the Legislature and it is not a basis for review here.

## V. CONCLUSION

The Court of Appeals properly concluded that Lyons's franchisees are its workers with the exception of those franchisees who actually employ others to perform work under a contract. And, *White*, the very case that Lyons purports to rely upon, rejected the argument that Lyons advances here. Moreover, Lyons's argument that franchisors should be per se exempt fails as the statute has no such exemption. Lyons invites this Court to attach more importance to the labels it and its franchisees use to describe their relationship than to the fact that Lyons directs is franchisees to perform personal labor for it in the form of providing janitorial services to Lyons's customers. This Court should deny review.

RESPECTFULLY SUBMITTED this 24th day of June, 2015.

ROBERT W. FERGUSON
Attorney General

STEVE VINYARD
Assistant Attorney General
WSBA No. 29737
Office Id. No. 90122
P.O. Box 40121
Olympia, WA 98504-0121
(360) 586-7715

## OFFICE RECEPTIONIST, CLERK

**To:** Marshall, Autumn (ATG)
**Cc:** Vinyard, Steve (ATG)
**Subject:** RE: DLI v. Lyons Enterprises, Inc., Cause No. 91610-1

Received 6/25/2015.

-----Original Message-----
From: Marshall, Autumn (ATG) [mailto:AutumnM@ATG.WA.GOV]
Sent: Wednesday, June 24, 2015 3:53 PM
To: OFFICE RECEPTIONIST, CLERK
Cc: Vinyard, Steve (ATG)
Subject: DLI v. Lyons Enterprises, Inc., Cause No. 91610-1
Importance: High

Good afternoon,

Please find attached for filing the Department's Answer to Petition for Review and Declaration of Mailing for the above matter. Thank you.

Your message is ready to be sent with the following file or link attachments:

DeptsAnswerPFR.pdf

Note: To protect against computer viruses, e-mail programs may prevent sending or receiving certain types of file attachments. Check your e-mail security settings to determine how attachments are handled.