No. 91610-1
WASHINGTON STATE SUPREME COURT

WASHINGTON STATE DEPARTMENT OF LABOR AND INDUSTRIES,

Respondent,

v.

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

Appellant.

MEMORANDUM BY AMICUS CURIAE INTERNATIONAL FRANCHISE ASSOCIATION IN SUPPORT OF PETITION FOR REVIEW

Douglas C. Berry
Daniel J. Oates
MILLER NASH GRAHAM & DUNN LLP
Pier 70
2801 Alaskan Way, Suite 300
Seattle, Washington 98121
206.624.8300
International Franchise Association

TABLE OF CONTENTS

TABLE OF AUTHORITIES

Cases

Statutes

Regulations

Other Authorities

I. INTRODUCTION

Amicus International Franchise Association®, a nationwide trade association of approximately 15,000 franchisors, franchisees, and suppliers, files this memorandum in support of Lyons' Petition for Review. While the Industrial Insurance Act ("**IIA**"), and the case law largely relied on by the Court of Appeals, predates the explosive growth of franchising after the 1950's (and enactment of the Washington Franchise Investment Protection Act ("**FIPA**") in the 1970's), it has always been understood that the unique franchisor/franchisee relationship was outside the IIA. Before this case, the Department of Labor and Industries never sought to treat a franchisee as its franchisor's covered worker, and before this case, no Washington court has considered whether the IIA might apply to the franchisor/franchisee relationship, a relationship already heavily regulated under FIPA.

The Court of Appeals itself recognized that the case "is highly complex, involving the intersection of detailed statutes with somewhat confused common law." *Department of Labor and Industris v. Lyons Enterprises, Inc.*, 186 Wn. App. 518, 542, 347 P.3d 464, 476 (2015). Yet, the Court did not consider or cite to FIPA. It did not consider the unique nature of the franchisor/franchisee relationship. And it did not consider the adverse consequences its decision will have on franchising and thousands of franchised businesses in this state. Among other things, the decision that Lyons' franchisees are covered workers:

- Provides a competitive advantage to non-franchised businesses over franchised businesses;

- Effectively disqualifies all (or virtually all) franchised businesses from the exemption under RCW 51.08.195.

- Overlooks that franchisors, if their franchisees are deemed covered workers, universally cannot comply with the IIA's reporting requirements. *See* WAC 296-17 *et seq.*

In the wake of the Court of Appeals' decision, the Department is attempting to collect industrial insurance premiums from other franchisors based on their franchisees' operations. It is after all the Department's new position that franchisees generally are covered workers of their franchisor. 217/13 Hr. at 49:2-10; CP 2360. Already, the decision is having a chilling effect on the franchising industry in this state. This Court should accept review, consider the unique nature of the franchise relationship, and reverse the decision by the Court of Appeals.

II. BACKGROUND

The franchise business model is based upon a franchisor granting a franchisee the right to operate a business following a "system prescribed in substantial part by the franchisor" under a license of the franchisor's trademark, in exchange for a "franchise fee." RCW 19.100.010(4).

Franchising arrangements are ubiquitous today operating in numerous retail and business-to-business sectors of the economy. There is a good reason for this. As a form of business expansion, it offers significant benefits to franchisees and to franchisors. Indeed, franchising makes it possible for thousands of entrepreneurs to own and operate their

own businesses, something that otherwise would not be feasible or even possible without the franchisor's training, support, systems, or the power of the franchisor's brand. *See* Chisum, *State Regulation of Franchising: the Washington Experience*, 48 WASH. L. REV. 291, 296 (1973); Kaufmann, *Franchising and the Choice of Self-Employment,* J. Bus. Venturing 345 (1999).

While franchising is prevalent today, the history of franchising is recent, post-dating the IIA. It was not until federal enactment of the Lanham Act after World War II that made modern franchising possible. Historically, trademarked goods were viewed as identifying the source of products, so that consumers would know which company had actually placed them into commerce. Licensing a company other than the trademark owner to distribute trademarked products was considered a deceptive practice, because consumers would be misled as to the source of the products. *See, e.g., Macmahan Pharmacal Co. v. Denver Chem. Mfg. Co.*, 113 F. 468, 474-75 (8th Cir. 1901).

The Lanham Act changed all of this. A trademark owner could now license the use of its mark, but, under the Lanham Act, it *must* exercise control over its licensees' use of the mark. A "registrant's mark may be canceled if the registrant fails to control its licensees' use of the licensed mark." *In re Mini Maid Services Co. v. Maid Brigade Systems, Inc.*, 967 F.2d 1516, 1519 (11th Cir. 1992). Quality control must be sufficient to ensure that "all licensed outlets will be consistent

and predictable." *Barcamerca, Int'l USA Trust v. Tyfield Importers, Inc.*, 289 F.3d 589, 598 (9th Cir. 2002).

In 1950, just after the adoption of the Lanham Act, there were still fewer than 100 franchised systems in the United States. Franchising experienced "explosive growth" thereafter.[1] By 2007, there were more than 825,000 franchised businesses in the U.S., and these independently owned and operated franchised businesses produced an economic output (total sales) of $802.2 billion.[2]

Given the growth of franchising, it probably was to be expected that franchising itself would become the focus of its own extensive regulation, both at the federal level under the Federal Trade Commission's Franchise Rule, 16 CFR Parts 436 and 437, and in Washington State under FIPA. FIPA, in particular provides a comprehensive, cradle-to-grave, regulatory framework, governing pre-sale disclosure, pre-sale registration, pre-sale advertising, as well as franchisee protections (often referred to as the "Franchisee Bill of Rights") regulating the post-sale franchisor/franchisee relationship, which, among other things, imposes strict limitations on a franchisor's ability to terminate or nonrenew a franchise agreement. *See generally,* Chisum, *State Regulation of Franchising: the Washington Experience*, *supra*; Berry, Byers, and Oates,

---

[1] FTC Statement of Basis and Purpose, Bus. Franchise Guide (CCH) ¶ 6302

[2] PWC, *The Economic Impact of Franchised Businesses: Volume III, Results for 2007* at I-14 (Feb. 7, 2011). The PWC report, prepared on behalf of the IFA Educational Foundation, succinctly summarizes the results of the U.S. Census Bureau's 2010 report, which is based on 2007 data. That data is available at http://factfinder2.census.gov/faces/tableservices/jsf/pages/productview.xhtml?src=bkmk).

State Regulation of Franchising: The Washington Experience Revisited, 32 SEATTLE U. L. REV. 811 (2009). Compliance with franchising's regulatory obligations is costly, and the consequences of non-compliance can subject a franchisor to significant, even severe, administrative, civil, and criminal remedies. RCW 19.100.190; RCW 19.100.210. In short, no one becomes a franchisor to avoid paying employment taxes.

III. THE ISSUES RAISED IN THIS APPEAL DESERVE FULL BRIEFING AND CONSIDERATION BY THIS COURT

Amicus simply cannot address in any depth within the 10-page limit it has been granted the problems that will result from, or the flaws in, the Court of Appeals' decision. It is no exaggeration to say, however, that the decision will adversely affect franchising in general, and presents a direct threat to the very existence of numerous franchised businesses in this state. This Court has never considered the application of the IIA to franchising, and the issues, apart from being novel, are sufficiently serious to deserve a full briefing and consideration by this Court. Within the limited space allowed, we address just a few of the aspects of the franchise relationship ignored or glossed over by the Court of Appeals.

First, as earlier noted, the Court of Appeals' decision will provide a competitive advantage to non-franchised businesses over franchised businesses, since the franchisees the Court held were Lyons' covered workers would all be exempt from mandatory coverage under the IIA were they not parties to a franchise agreement with Lyons. Specifically, each of the franchisees for which Lyons' is responsible for IIA premiums

is a sole proprietor or a member of a limited liability company. As the operator of an independent business, each would be exempt from mandatory coverage under the IIA. RCW 51.12.020(5) and (8). Under the Court's decision, these businesses become covered workers solely because they are parties to a franchise agreement that allowed them to operate their business under the Jan-Pro trademarks. It defies common sense that an independent business owner should be exempt from mandatory coverage, while a franchised business owner is considered the covered worker of its franchisor.

Second, the Court of Appeals' decision effectively forecloses any franchisor from taking advantage of the exemption from coverage provided in RCW 51.08.195. This provision provides a six-part exception from IIA coverage which includes situations were a putative covered worker is "free from control" over the performance of his work by the putative employer, and where the putative worker was "customarily engaged in an independently established . . . business." RCW 51.08.195(1) & (3). These provisions, which clearly were not drafted with franchising in mind, simply should not be read in a way that would preclude application to all franchise systems.

The IAJ that initially heard the case concluded Lyons' franchisees satisfied RCW 51.08.195(1), that franchisees were not "free from [franchisor] control" simply because the franchisor had brand standards, and provided training and other support services. The Board concluded otherwise, and while the Court of Appeals does not directly address the

issue, its decision can be read as hinting agreement with the Board. In any event, it is certainly the Department's position that franchisor branding controls and assistance common to all franchise systems necessarily means that franchisees in any system are not free from their franchisor's control. CP 2360 ("[It] is exactly the extreme element of direction and control required by the nature of a franchise operation so that every franchisee provides the same type of service or product to every customer that causes the failure under RCW 51.08.195.")

As previously mentioned, "controls" are universally recognized as a hallmark of a franchise relationship. By definition, a franchise does not exist under FIPA without such controls, and under the Lanham Act, such controls are necessary to the preservation of the franchisor's trademark. But such controls do not exist so that the franchisor can dictate the franchisee's day-to-day business operations. They exist to protect the franchisor's trademark rights and to insure a reliable and consistent customer experience. A franchisor should not be disqualified from the exemption provided by RCW 51.08.195(1) simply because it expects its franchisees to comply with brand standards, or otherwise provides franchisees with start-up training, advertising and marketing support, or other general assistance. Instead, the standard ought to be whether the franchisor in fact exercises "control [of] the methods and details" of work a franchisee performs for its customers. *Western Ports Transp., Inc. v. Employ. Sec. Dep't*, 110 Wn. App. 440, 452, 41 P.3d 510 (2002). *Cf, Folsom v. Burger King*, 135 Wn.2d 658, 958 P.2d 301 (1998);

Patterson v. Domino's Pizza, LLC, 60 Cal.4th 474, 333 P.3d 723 (2014).

It is undisputed that the Lyons' franchisees, like all franchisees, operated independent businesses in the sense that they paid the capital necessary to operate, were responsible for all business operating expenses, prepared their own books, filed their own tax returns, were responsible for their own insurance, provided all necessary business supplies, set their own scheduling, made all staffing decisions, and assumed the risk of business failure as well as the rights to profits from operations. Yet the Court of Appeals (and the Board) determined that the Lyons' franchisees were not "customarily engaged in an independently established . . . business," and hence not exempt under RCW 51.08.195(3), because they had not been engaged in the janitorial business before they became franchisees, and were prohibited from competing with other Lyons franchisees under noncompete provisions of their franchise agreements. *Lyons,* 186 Wn. App at 473-75, n. 11. This determination cuts to franchising's heart.

The fundamental premise of franchising is that it allows would-be employees to become business owners. Though there are certainly exceptions, franchisees in most systems have no previous experience operating a business in the same field as the franchised business. Indeed, the power of franchising is that it often allows someone without any experience in an industry to start-up and operate a business, whether it is a janitorial business or any of hundreds of other types of businesses. A

business should not cease to be considered an "independently established . . . business" simply because it was started by a franchisee.

Moreover, franchise agreements in virtually all franchised systems contain noncompete clauses. Klarfeld and VanderBroek, *Law on Covenants Against Competition Shifts Toward Greater Enforceability by Franchisors*, 31 FRANCHISE L. J. 76 (Fall 2011). It only makes sense for a franchisor to protect its brand and its rights to continuing royalties by preventing a franchisee from accepting the franchisor's training, trade secrets, and know-how, and then using them to operate an independent business in competition with other outlets, and without paying royalties to the franchisor. As the Court recognized in *Armstrong v. Taco Time Int'l, Inc.*, 30 Wn. App. 538, 635 P.2d 1114 (1981), a noncompete is necessary to the protection of a franchisor's intellectual property, as well as "its ability to sell new franchise rights, and the protection of existing franchisees from competition by a fellow franchisee." *Id.* at 546. *See also, Hometask Handyman Services, Inc. v. Cooper,* 207 WL 3228459 (W. D. Wash. 2007); *Bundy American, LLC v. Hawkeye Transportation,* Bus. Franchise Guide (CCH) ¶14,282 (CCH), 2012 WL 3778571 (W.D. Wash. 2009). The existence of a non-compete in a franchise should not negate satisfaction of RCW 51.08.195(3).

Third, if franchisees are deemed a franchisor's covered workers, then the IIA requires them to file detailed quarterly reports relating to, *inter alia*, their franchisees' hours, wage rates, and job classifications. *See* WAC 296-17 *et seq.* Failure to report or keep appropriate records would

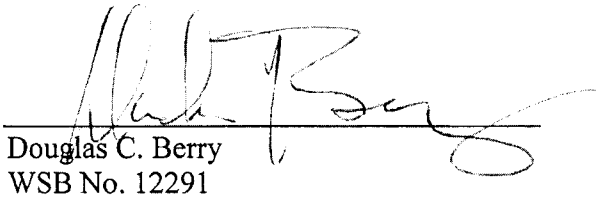
subject them to penalty. RCW 51.48.030. Yet, and here is the catch, franchisors universally do not have access to a franchisee's business records relating to its franchisee's staffing decisions, including the identity of the persons who work on behalf of the franchisee, how much a franchisee elects to pay himself or herself (or their employees), how or in what manner a franchised business owner staffs his or her business, or the hours a franchisee (or any of its workers) devotes to the business during any period. Indeed, the law generally deters franchisors from any involvement into a franchisee's employment or staffing decisions; as such involvement would or could subject the franchisor to liability for a franchisee's employment practices. *See, e.g., Folsom v. Burger King, supra.; Patterson v. Domino's Pizza, LLC, supra.* As a result, it is impossible for a franchisor to comply with the IAA's reporting requirements.

IV. CONCLUSION

The issues raised in this case affect thousands of franchised business in this State. They are also new, as never before has a Washington court attempted to pound the square peg of franchising into the round hole of the IIA. Because of the importance of the issues to franchising industry in general, Amicus respectfully requests that this Court grant Lyons' Petition for Review.

DATED this 31st day of July, 2015.

MILLER NASH GRAHAM & DUNN LLP



Douglas C. Berry
WSB No. 12291
Daniel J. Oates
WSB No. 39334
Attorneys for Amicus Curiae
International Franchise Association

CERTIFICATE OF SERVICE

I, Angie L. Smith-Babbit, declare and state as follows:

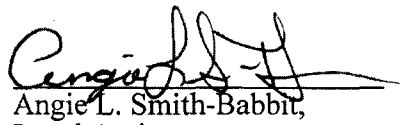
On the 31st day of July, 2015, I sent via U.S. Mail, First Class, postage prepaid, the foregoing Memorandum by Amicus Curiae International Franchise Association in Support of Petition for Review directed to:

Ryan P. McBride
Robin Dale
Lane Powell
1420 Fifth Avenue, Suite 4200
Seattle, WA 98111

Steve Vinyard
Assistant Attorney General
Attorney General of Washington
7141 Cleanwater Drive SW
PO Box 40121
Olympia, WA 98504-0121

I declare and state under penalty of perjury under the laws of the State of Washington that the foregoing is true and correct.

Signed this 31st day of July, 2015, at Seattle, Washington.



Angie L. Smith-Babbit,
Legal Assistant

OFFICE RECEPTIONIST, CLERK

To: Smith-Babbit, Angie
Cc: Berry, Doug C.; Oates, Dan J.
Subject: RE: No. 91610-1 - Washington State Department of Labor and Industries vs. Lyon Enterprises, Inc. d/b/a Jan-Pro Cleaning Systems

Received 7-31-15

Supreme Court Clerk's Office

Please note that any pleading filed as an attachment to e-mail will be treated as the original. Therefore, if a filing is by e-mail attachment, it is not necessary to mail to the court the original of the document.

From: Smith-Babbit, Angie [mailto:Angie.Smith-Babbit@millernash.com]
Sent: Friday, July 31, 2015 9:21 AM
To: OFFICE RECEPTIONIST, CLERK
Cc: Berry, Doug C.; Oates, Dan J.
Subject: No. 91610-1 - Washington State Department of Labor and Industries vs. Lyon Enterprises, Inc. d/b/a Jan-Pro Cleaning Systems

Dear Supreme Court Clerk's Office:

No. 91610-1 - Washington State Department of Labor and Industries vs. Lyon Enterprises, Inc. d/b/a Jan-Pro Cleaning Systems.

Attached to this email for filing is the Memorandum by Amicus Curiae International Franchise Association in Support of Petition for Review, filed by International Franchise Association's attorney Douglas C. Berry (WSBA No. 12291) and Daniel J. Oates (WSBA No. 39334), for Case No. 91610-1.

If you need anything further from us, please do not hesitate to contact Douglas C. Berry, WSBA No. 12291 (Doug.Berry@millernash.com) or Daniel J. Oates, WSBA No. 39334 (Dan.Oates@millernash.com).

Sincerely,

Angie Smith-Babbit
Assistant to Doug Berry, Mike Fandel, Dan Oates, and Vanessa Wheeler

Miller Nash Graham & Dunn LLP
Pier 70 | 2801 Alaskan Way - Suite 300 | Seattle, Washington 98121
Direct: 206.777.7578 | *Office*: 206.624.8300 | *Fax*: 206.340.9599
E-Mail | Web | Social | Blogs