No. 45033-0-II

DIVISION II, COURT OF APPEALS
OF THE STATE OF WASHINGTON

WASHINGTON STATE DEPARTMENT OF LABOR AND INDUSTRIES,

Plaintiff-Respondent,

v.

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

Defendant-Appellant.

ON APPEAL FROM PIERCE COUNTY SUPERIOR COURT

APPELLANT LYONS ENTERPRISES, INC.'S RESPONSE TO BRIEF OF AMICI CURIAE SERVICE EMPLOYEES INT'L UNION LOCAL 6; WORKER INJURY LAW & ADVOCACY GROUP; AND NATIONAL EMPLOYMENT LAW PROJECT

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TABLE OF CONTENTS

Page

I. INTRODUCTION 1

II. ARGUMENT 1

A. The Department of Labor & Industries Has Already Rejected The Union's "Misclassification" Arguments; Lyons' Franchise Owners Are Independent Contractors, Not Employees 1

B. The Union Misrepresents Lyons' Purported "Control" Over The Franchise Owners And Their Employees 5

C. The Nature Of The Franchise Owners' Services Does Not Mandate Coverage Under The IIA; Sole Proprietors And Small Business Owners Are Exempt 12

III. CONCLUSION 14

TABLE OF AUTHORITIES

Page

CASES

Awuah v. Coverall N.A., Inc.,
707 F. Supp. 2d 80 (D.Mass. 2010), ... 10, 11

Coverall N.A., Inc. v. Comm'r of Div. of Unemploy. Ass.,
857 N.E.2d 1083 (Mass. 2006) 9, 10, 11

Dep't of Labor & Indus. v. Fankhauser,
121 Wn.2d 304, 849 P.2d 1209 (1993) 13

Juarez v. Jani-King of California,
2012 WL 177564 (N.D. Cal. Jan. 12, 2012) 11, 12

Novenson v. Spokane Culvert & Fabricating Co.,
91 Wn.2d 550, 588 P.2d 1174 (1979) 6

White v. Dep't of Labor & Indus.,
48 Wn.2d 470, 294 P.2d 650 (1956) 3, 6, 10

Xenith Group, Inc. v. Dep't of Labor & Indus.,
167 Wn. App. 389, 269 P.3d 414 (2012) 2, 3

STATUTES, REGULATIONS AND COURT RULES

RCW 19.100.010(4)(a) 7

RCW 19.100.010(5)(e) 7

RCW 19.100.080 4

RCW 51.08.180 ..... 1, 3, 6, 10, 12

RCW 51.08.195 ..... 1, 6, 12

RCW 51.08.195(1) 6

RCW 51.08.195(2) 11

RCW 51.08.195(3) 10

RCW 51.12.020 ..... 12, 13, 14

RCW 51.12.020(5) 12

RCW 51.12.020(8) 12

RCW 51.12.110 13

RCW 51.32.030 13

WAC 460-80-315 4

15 C.F.R. 436.5 4

15 C.F.R. 436.5(t) 4

15 U.S.C. § 1055 7

15 U.S.C. § 1127 7

OTHER AUTHORITIES

Donald S. Chisum, *State Regulation of Franchising: The Washington Experience*, 48 WASH. L. REV. 291 (1973) 7

I. INTRODUCTION

Appellant Lyons Enterprises, Inc., d/b/a Jan-Pro Cleaning Systems, respectfully submits this response to the Brief of Amici Curiae Service Employees International Union Local 6; Worker Injury Law & Advocacy Group; and National Employment Law Project (collectively, the "Union"). The Union's Brief reads like an Upton Sinclair novel: manipulative employers forcing exploited workers to face lethal working conditions out of sheer greed. None of it is true, and the Union's rhetoric is singularly irrelevant to the Washington law and the actual facts that control here.

The Union argues a legal theory that the Department conceded it could not prove and spins a factual story that is contradicted by the record. The franchise owners are not "employees"; they are independent business owners who agree to enter into a lawful franchise relationship with Lyons based on full disclosure of each parties' reciprocal obligations. And the only "control" Lyons exerts over the franchisees' separate businesses is the control that is incident to any valid franchise agreement.

II. ARGUMENT

A. The Department of Labor & Industries Has Already Rejected The Union's "Misclassification" Argument; Lyons' Franchise Owners Are Independent Contractors, Not Employees.

This is not, and never has been, a "misclassification" case. The Department has never argued that Lyons' Jan-Pro franchise is a sham or,

as the Union falsely suggests, that Lyons seeks to "evade its responsibility to provide workers' compensation coverage" by "labeling" its workers franchisees. Union's Br. at 1-2, 12, 18. There is no dispute that Lyons' franchise system is legitimate, that it complies with the Franchise Investment Protection Act, RCW 19.100 *et seq.*, and, perhaps most importantly, that it has been reviewed and approved repeatedly by Washington's Department of Financial Institutions. CP 2168-70 (9/26/11 Tr. at 110-12); CP 1652 (Ex. 25). Nor has Lyons argued that it or its franchisees are exempt from the Industrial Insurance Act ("IIA") by virtue of their franchise relationship. The franchise owners are exempt because they are not "workers" within the meaning of RCW 51.08.180 or .195.

The real motive behind the Union's "misclassification" theory is revealed by its claim that the franchisees are not "independent contractors" at all, but rather "employees" (who can be unionized, no doubt). Union's Br. at 1 ("misclassification of employees as independent contractors is a nationwide problem"); *id.*, 12 ("They function as Jan-Pro's employees."); *id.*, 20 ("These workers are not independent contractors under common legal tests of that relationship."). But, here too, the Department conceded long ago that the franchisees are <u>not</u> Lyons' employees, and the Board never reconsidered that issue. CP 146 ("The department is not making a determination that the franchisees are employees."); *Xenith Group, Inc. v.*

Dep't of Labor & Indus., 167 Wn. App. 389, 400-01, 269 P.3d 414 (2012) ("whether an individual works under an independent contract, the essence of which is ... personal labor, involves a different analysis than whether the individual is an employee"). This Court cannot consider it either.

For this reason, the Union's reliance on studies, statistics and articles oriented at federal tax or labor law is irrelevant to the Washington law that controls here—even if those materials concern franchises (which is entirely unclear).[1] In Washington, employers must pay IIA premiums for employees and independent contractors—but, for the latter, only if (a) the "essence" of the contract is "personal labor," RCW 51.08.180, and (b) none of the three exceptions set forth in *White v. Dep't of Labor & Indus.*, 48 Wn.2d 470, 294 P.2d 650 (1956) apply. On these issues—the central issues in this appeal—the Union's brief is virtually silent. Worse yet, the Union wholly ignores the record in this case, citing almost exclusively to "facts" derived from these inapt materials to create a false impression that Lyons dupes unsuspecting individuals into purchasing franchises that have

[1] For example, while the Union repeatedly references statistics regarding labor law violations generally in the "janitorial industry," Union's Br. at 6-7, it does not disclose whether those statistics pertain to the State of Washington or to franchised companies such as Lyons.

no hope of ever generating a profit, resulting in a constant churn of new franchisees and franchise fees for Lyons. Union Br. at 8-9.[2]

Of course, none of this is true and, indeed, it would be extremely bad for Lyons' business if it were. Before selling a franchise, federal and Washington law require franchisors to provide a lengthy franchise disclosure document ("FDD") to prospective franchisees that includes a wealth of information about the franchised business. 15 C.F.R. 436.5; RCW 19.100.080; WAC 460-80-315. Among other things, FDDs must include disclosures that are specifically designed to protect against the problem of franchise churning. *See, e.g.,* 15 C.F.R. 436.5(t) (franchisors must disclose, among other things, the number of franchised locations opened, transferred, terminated, non-renewed, re-acquired, or closed for other reasons over the preceding three years). Here, the record reflects that Lyons provided prospective franchisees with a FDD that contains these disclosures, which specifically showed the number of franchisees

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[2] For example, the Union provocatively asserts that franchisees *like* Lyons' franchisees are cast into tens of thousands of dollars in debt while, at the same time, franchisors *like* Lyons attain profits of "up to 41 percent." Union's Br. at 8, 9. Meanwhile, according to the Union, franchisors *like* Lyons strategically shuffle customer accounts between franchisees to drum-up additional 'finder's fee[s]'," and, similarly, franchisors *like* Lyons arbitrarily terminate franchisees so that they can "reap windfall-up front revenues ... when it signs up new recruits." *Id.* The Union cites nothing in the record that suggests that Lyons engages in any conduct that is "*like*" what the Union has described. It doesn't.

terminated, not renewed or that otherwise ceased doing business for the preceding three fiscal years. CP 420 (Ex. 5, Item 20). Lyons' FDD shows no terminations and de minimis franchisees leaving the system. *Id.*

Moreover, by relying on misclassification literature to insinuate that Lyons' franchisees are not independent contractors, the Union ignores the undisputed evidence that clearly distinguishes the franchisees from mere employees. Unlike employees, the franchise owners invest in their own businesses; have their own business licenses; have their own insurance; maintain their own books; pay their own taxes; purchase their own supplies; hire and train their own employees; decide when and how to service their accounts; grow their businesses by finding new customers; reject accounts they do not like; get paid only if their customers pay; cannot be fired at-will; and can transfer or sell their businesses. In sum, the Union's "misclassification" argument not only misses the mark, it betrays a *faux* paternalism that ignores the true independence and entrepreneurial aspects of the franchise owners' businesses.

B. The Union Misrepresents Lyons' Purported "Control" Over The Franchise Owners And Their Employees.

The Union's primary claim is that the franchisees are Lyons' employees because of the "strict controls" Lyons purportedly has over the performance of their work. Union's Br. at 12. Not only is this argument

wholly untethered from the Department's position (and concession) that the franchise owners are not employees, it is not even relevant to the threshold issue under RCW 51.08.180—that is, whether the "essence" of the franchise agreements is "personal labor." While control is an element of an employer-employee relationship, *Novenson v. Spokane Culvert & Fabricating Co.*, 91 Wn.2d 550, 553, 588 P.2d 1174 (1979), no Washington case has ever held that the existence of "control" similarly satisfies RCW 51.08.180's "essence" test for independent contractors.

In the context of independent contractors, "control" only matters if the essence of the contract is personal labor, and then only as a further means of exempting the independent contractor from worker status under RCW 51.08.195's alternative test. Because the essence of Lyons' franchises is not personal labor—under the "realities of the situation" and *White*'s third prong—this Court never has to reach that issue. But even if it did, the Union's argument simply ignores the record and misstates the facts in its zeal to falsely paint the franchisees as exploited employees rather than independent business owners. The actual evidence from this record—not generalizations culled from articles and websites—shows that Lyons' franchisees are, in fact, "free from control or direction over the performance of the service." RCW 51.08.195(1).

The Union repeatedly claims that "Jan-Pro's workers are told when and where to work and how to perform the work." Union's Br. at 9; *id.* at 19 (Jan-Pro "strictly guides how, where, and when the work is performed and for whom"). The Union does not and cannot cite to the record to support its claim because it is not true. It is undisputed, as every franchise owner who testified confirmed, that it is the franchisee, not Lyons, that controls the day-to-day details of the work; it is the franchisee, not Lyons, that establishes a schedule directly with the customer; it is the franchisee, not Lyons, that decides who will do the work and when; and it is the franchisee, not Lyons, that decides where and from whom to buy equipment and supplies. CP 24 (Final Order); 1909, 1936-37, 1947-48, 1950, 1960-64, 1979-81, 2015-16, 2026-27, 2039 (9/7/11 Tr. at 19, 46-47, 57-58, 60, 70-74, 89-91, 125-26, 136-37, 149).[3]

[3] The Union likewise fails to recognize that, as a franchisor, Lyons is required by law to insist that its franchisees comply with a "marketing plan" to ensure uniformity and protection of the brand. *See* RCW 19.100.010(4)(a); 19.100.010(5)(e); *see also* Donald S. Chisum, *State Regulation of Franchising: The Washington Experience*, 48 WASH. L. REV. 291, 295 n.7 (1973) ("An owner of a trademark may license others to use it only if he retains the right to exercise control 'in respect to the nature and quality of the goods or services in connection with which the mark is used.") (citing 15 U.S.C. §§ 1055, 1127). Indeed, the Union demonstrates the same basic misunderstanding of franchise law as the Department — wrongly suggesting that real franchises sell only "goods" from a brick-and-mortar store, not services. Union's Br. at 7 ("In a traditional franchise system, a franchisee purchases the right to own and operate an establishment and sells a product to the general public").

The Union likewise ignores the facts when it suggests that the franchise owners cannot procure their own accounts or negotiate contracts, and that they are forced to service any account Lyons assigns to them. Union's Br. at 7-8, 18-19. Again, not true. Franchise owners are encouraged to find their own customers, can and do negotiate contracts themselves and, when they do, they pay no additional fees to Lyons. CP 1913-14, 1981 (9/7/11 Tr. at 23-24, 91); 2197-99 (9/26/11 Tr. at 139-41). By the same token, when Lyons offers an account to a franchise owner, the owner can reject the account for any reason and, when it does, Lyons must find a substitute account for no additional fees. CP 1908, 1911-12, 1926, 1949-50, 1981 (9/7/11 Tr. at 18, 21-22, 36, 59-60, 91). In short, the franchise owners have a contract *with* Lyons; they do not work *for* Lyons.

The same is true with respect to the Union's mischaracterization of the franchise agreement's billing provisions. Billing is an administrative service that Lyons agrees to provide the franchise owners; it is a key inducement of the franchise and one which the owners uniformly want. CP 1988 (9/7/11 Tr. at 98). Indeed, even though they have the option to handle billing themselves, not a single franchise owner has elected to do so. CP 2158-59, 2190 (9/28/11 at 100-101, 132). Regardless, whether a customer sends a check to the franchise owner or Lyons in the first instance, the funds belong to the owner. The franchisee pays Lyons

royalties and fees; Lyons does not pay the franchisee a salary. Thus, as noted, unlike an employee, it is the franchise owner who bears the risk of loss if the customer does not pay. CP 2192-93 (9/26/11 Tr. at 134-35).

The Union goes so far as to suggest that Lyons not only controls the franchise owners themselves, but also their employees. Union's Br. at 19 ("Jan-Pro's control ... does not allow the franchisees to exercise any measurable control over the 'helpers'"). Here too, the Union does not cite to the record because its claim is simply false. It is the franchisee, not Lyons, that hires and fires the employee; it is the franchisee, not Lyons, that trains the employee; it is the franchisee, not Lyons, that supplies the employee; it is the franchisee, not Lyons, that tells the employee where and when to work; it is the franchisee, not Lyons, that pays the employee; and, as discussed below, it is the franchisee, not Lyons, who pays IIA premiums for the employee. CP 24 (Final Order); 1909-10, 1973-74, 2027-28 (9/7/11 Tr. at 19-20, 83-84, 137-38); 2148, 2153-54, 2200-01 (9/26/11 Tr. at 90, 95-96, 141-42). There is no "control" here.

Finally, this Court can reject the Union's misplaced reliance on Massachusetts cases to show that the franchise owners are workers under Washington law. In *Coverall N.A., Inc. v. Comm'r of Div. of Unemploy. Ass.*, 857 N.E.2d 1083 (Mass. 2006), the court determined that the plaintiff was an "employee" under Massachusetts law. In Massachusetts, an

independent contractor who performs any "service ... under contract" is an "employee" for purpose of unemployment compensation unless the employer satisfies the so-called ABC test. *Id.* at 1087 (citing Mass. G.L. c 151A, §§ 1(k) & 2). Thus, the *Coverall* court did not engage in a threshold inquiry as to whether the "essence" of the franchise agreement was "personal labor." RCW 51.08.180. And, of course, *White*'s three-prong test has no applicability under Massachusetts law either.

Nor does the *Coverall* case undermine Lyons' alternative showing that the franchise owners were exempt under RCW 51.08.195. In upholding an agency determination that the employee was not engaged in an "independently established trade, occupation, profession or business," which is similar to RCW 51.08.195(3), the *Coverall* court noted that the worker was "supervised by a Coverall field consultant," "required to allow Coverall to negotiate contracts and pricing directly with clients," "provide a daily cleaning plan," and was "discharged" apparently without cause. 857 N.E.2d at 1085, 1088. As discussed above, none of those facts are present here; the franchise owners bear no semblance to employees.

Similarly, in *Awuah v. Coverall N.A., Inc.*, 707 F. Supp. 2d 80, 82-83 (D.Mass. 2010), again on far different facts, the court concluded that the workers were "employees" under Massachusetts law because their services were not "performed outside the usual course of the business of

the employer." Critically, while that test is similar to RCW 51.08.195(2), the IAJ found that Lyons satisfied that element—and the Department did not appeal that finding to the Board or on judicial review. CP 124 (Initial Decision); CP 27-28 (Final Order); Resp. Br. at 38-42. In sum, even apart from their distinguishing facts, neither *Coverall* nor *Awuah* address the relevant Washington statutes or case law that control here.

Indeed, if any non-Washington case is instructive, it is *Juarez v. Jani-King of California*, 2012 WL 177564 (N.D. Cal. Jan. 12, 2012). The district court concluded that the franchisees were not employees because the franchisor did not have a "right to control the manner and means" of the franchisees' work. The facts are nearly identical to those at issue here:

> [The franchisees] had the discretion to hire, fire, and supervise their employees, as well as determine the amount and manner of their pay. [The franchisees] had the contractual right to decline accounts and, in practice, they did so. [The franchisor] could not terminate [the franchisees] without cause. [The franchisees] purchased their own cleaning supplies and equipment. [The franchisees] could bid their own accounts and sell their businesses. [The franchisees] decided when to service certain accounts, subject to timeframes set forth by their clients. Instead of an hourly wage, [the franchisees] compensation came in the form of gross revenues, less fees paid to [the franchisor]. ...

Id. at *4 (citations omitted). The court also rejected the argument that the franchisees were employees because the franchisor "owned" the customer contracts, performed billing services for the franchisees or addressed customer complaints. As the court rightly recognized, all of "these

controls were no more than necessary to protect [the franchisor's] trademark, trade name, and good will." *Id.* at *5. The same is true here.

C. The Nature Of The Franchise Owners' Services Does Not Mandate Coverage Under The IIA; Sole Proprietors And Small Business Owners Are Exempt.

In the end, the Union's argument devolves to a plea—divorced from the text and intent of RCW 51.08.180 and/or .195—that the Court expand the reach of the IIA simply because Lyons' franchisees engage in physical labor with a supposed high risk of injury. Union's Br. at 6, 15-17. Although the Union's statistics exaggerate the hazards of the actual commercial cleaning services at issue here, Lyons acknowledges the hard work its franchise owners devote to their businesses. But the issue is not whether the franchisees could benefit from IIA coverage. Some might. The issue is whether coverage for them is mandatory or optional and, if optional, whether it remains the exclusive province of the legislature (as opposed to the courts) to expand the scope mandatory coverage.

The legislature long-ago determined that not all who engage in work, even dangerous work, are covered by the IIA. The Act excludes from coverage, for example, domestic servants, home gardeners and maintenance workers, jockeys and others. RCW 51.12.020. In particular, the legislature determined that, while business owners cannot exempt their employees from the IIA system, the owners themselves are automatically

exempt—even if they are the ones who perform the work. This exemption includes sole proprietors, partners, controlling corporate officers and members of LLCs. *See* RCW 51.12.020(5) & (8); *Dep't of Labor & Indus. v. Fankhauser*, 121 Wn.2d 304, 309, 849 P.2d 1209 (1993) (exempt small business owners are not "workers" or "employees" automatically covered under the IIA). To receive IIA coverage, the exempt individuals must affirmatively opt into the system. RCW 51.12.110; RCW 51.32.030.

Most of Lyons' franchisees are sole proprietors; those that aren't are organized as limited liability companies. Because they are not "workers," the Department has recognized—at least until now—that the franchise owners fall within RCW 51.12.020's exemption. Some have chosen to remain exempt, others have elected to opt in. CP 1947 (9/7/11 Tr. at 57). Regardless, if a franchise owner hires its own employees, which they can and often do, then coverage for those employees is mandatory—and it is the franchise owner's obligation, not Lyons', to pay the IIA premiums for those employees. CP 1974, 1992, 2028-29 (9/7/11 Tr. at 84, 102, 138-39); 2165-66 (9/26/11 Tr. at 107-108).

That is precisely the result the legislature intended. The only ones without coverage are those franchise owners who elected not to opt into the IIA system. The IIA affords the franchise owners that choice because the legislature recognized that, unlike "employees" and "workers," sole

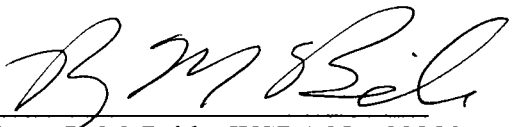
proprietors and other small business owners should retain the economic freedom to choose what is best for them and their businesses, including opting out of IIA system in favor of private insurance or self-insurance. In sum, the Union's argument that IIA coverage is mandatory simply because "[j]anitorial work is hard physical labor," Union's Br. at 17, is inconsistent with RCW 51.12.020, which exempts certain employments regardless of the nature of the work. Much like the Department's position in this case, the Union's arguments are better directed to the legislature than the courts.

III. CONCLUSION

The Union's unsupported policy argument is contrary to Washington law and the facts. Lyons is in the business of selling and supporting franchises. There is no claim (or evidence) that Lyons' operates a franchise business (with all its attendant burdens) as some sort of elaborate scheme to avoid paying IIA premiums. By the same token, the franchise owners are not Lyons' "employees," but rather independent contractors who understand and want the benefits of the franchise model as the means of starting and profitably operating their own separate businesses. The "essence" of the parties' relationship is not "personal labor," nor does Lyons "control" the franchisees' work.

RESPECTFULLY SUBMITTED this 19th day of June, 2014.

LANE POWELL PC

By 
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I, Kathryn Savaria, hereby certify under penalty of perjury of the laws of the State of Washington that on June 19, 2014, I caused to be served a copy of the attached document to the following person(s) in the manner indicated below at the following address(es):

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