No. 91610-1

No. 45033-0-II

COURT OF APPEALS
DIVISION II
OF THE STATE OF WASHINGTON

WASHINGTON STATE DEPARTMENT OF LABOR AND INDUSTRIES,

Respondent,

vs.

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

Appellant.

BRIEF OF AMICUS CURIAE

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I. NATURE OF THE CASE AND DECISION

This appeal is from an order by the Pierce County Superior Court affirming in part and reversing in part the decision of the Washington Board of Industrial Insurance Appeals (the "BIIA"). Specifically, the BIIA held that independent franchisees of Appellant Lyons Enterprises, Inc. d/b/a Jan-Pro Cleaning Systems ("Lyons") were "workers" under Washington's Industrial Insurance Act ("IIA"), and, as a result, Lyons is responsible for paying their industrial insurance premiums. The BIIA also held that franchisees that employed other individuals were not "workers" under the IIA. The Superior Court not only affirmed the BIIA's decision that Lyons' individual franchisees were "workers" under the IIA, but also overruled the BIIA and held that employees of Lyons' corporate franchisees were also Lyons' "workers" under the IIA.

Amicus International Franchise Association® (the "IFA"), a nationwide trade association of approximately 15,000 franchisors, franchisees, and suppliers, files this memorandum in support of Lyons' appeal. The legal principles announced by the BIIA, and extended by the trial court, are an unprecedented and expansive departure from the established law of this State, and will result in far-reaching unintended consequences for the State's franchising industry and Washington consumers.

II. BACKGROUND

Franchising has become "one of the dominant forms of organization of our times." JEFFREY L. BRADACH, FRANCHISE

ORGANIZATIONS 3 (1998). Quick service restaurant brands are well-known, but franchise brands also predominate in a wide variety of other sectors of the economy, including sectors as diverse as hotels and resorts to real estate brokerage services. Indeed, franchised businesses make up a significant percentage of the nation's and the state's overall economy. Based on a report released in 2010 by the U.S. Census Bureau, 828,138 franchised businesses operated in the United States in 2007. PWC, *The Economic Impact of Franchised Businesses: Volume III, Results for 2007* at I-14 (Feb. 7, 2011).[1] These independently owned franchises produced an economic output (total sales) of $802.2 billion, and were directly responsible for 9,125,700 jobs, approximately the same number as employed by *all* manufacturers of durable goods (*e.g.,* manufacturers of computers, engines, machinery, electronic equipment, cars, trucks, planes, steel and other metals, lumber and wood products, medical instruments, furniture and fixtures, and stone, clay, and glass products) *Id.* Franchised businesses played as significant a role in the Washington State economy as they did nationally. During the same period, the 14,823 franchised businesses in Washington produced an output of $15.1 billion, and were directly responsible for 164,700 jobs and a total payroll of $5.8 billion. *Id.*

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[1] *Available at* http://www.buildingopportunity.com/impact/reports.aspx. 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).

at I-77.

There is a good reason why franchising has become such an important part of the U.S. economy. As a form of business expansion, it offers significant benefits to both franchisees and franchisors. For example, franchising allows a franchisee to operate his or her own business based on the franchisor's training, know-how, and support, while also capitalizing on the franchisor's experience and brand.[2] Donald S. Chisum, *State Regulation of Franchising: the Washington Experience*, 48 WASH. L. REV. 291 (1973) ("the franchisee . . . gains access to an established brand name, tested marketing techniques, advertising and training aids. More importantly, the franchisee remains . . . an independent businessman."). At the same time, franchising allows the franchisor to expand its brand by using franchisee capital (rather than through debt or equity financing), while also reaping the benefit of the entrepreneurial efforts of independent business owners. *See id.*; *see also Kerl v. Dennis Rasmussen, Inc.,* 273 Wis.2d 106, 123, 682 N.W.2d 328 (2004).

While franchising provides an attractive business model, it is not

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[2] Franchisees usually lack the marketing, business, accounting, and operational skills or experience necessary to operate a business in a given industry. Moreover, a franchisee's connection with a brand opens doors to financing that simply are not available for a business start-up. As a result, franchising makes it possible thousands of entrepreneurs to own, operate, and grow their own businesses, something that otherwise would not be feasible or even possible. *See* Patrick Kaufmann, *Franchising and the Choice of Self-Employment,* J. Bus. Venturing 345 (1999).

without its drawbacks, including most notably the fact that it is heavily regulated under both federal and state law. Under federal law (the "FTC Rule") and under Washington's Franchise Investment Protection Act ("FIPA"), a franchise is defined as any contractual relationship (usually a long-term arrangement) in which:

> (a) the franchisee pays the franchisor a fee (typically an initial fee plus some royalty based on gross sales) for the right to operate the franchised business;
>
> (b) the franchisee is authorized to use the franchisor's service marks and/or trademarks; and
>
> (c) the franchisor exercises some degree of control (*i.e.*, the operation of the business is subject to certain standards proscribed by the franchisor) relating to the franchisee's business operations.

16 C.F.R. § 436.1(h); RCW 19.100.010(4). If an agreement meets the definition of a franchise, both the FTC Rule and FIPA apply and no franchise may be sold unless the prospective franchisee has been provided a "Franchise Disclosure Document" or FDD. 16 C.F.R. § 436.2(a); RCW 19.100.080(1). FDDs must be prepared at least annually, and must set forth in a precise and proscribed manner, detailed and comprehensive information about the franchisor, the franchised business, and the franchise agreement offered to prospective franchisees. 16 C.F.R. §§ 436.3-.5. Under FIPA, the FDD must also be registered with the Securities Division of the Department of Financial Institutions before the franchisor may offer to sell any franchises. RCW 19.100.020(1); RCW 19.100.070.

In addition to its onerous pre-sale registration and disclosure

requirements, FIPA also contains extensive franchisee protections (often referred to as the "Franchisee Bill of Rights") regulating the parties' post-sale relationship and it provides generous, even severe, administrative, civil, and criminal remedies. RCW 19.100.180(2); RCW 19.100.170; RCW 19.100.190; RCW 19.100.210. Unlike laws governing employment relationships, FIPA's Franchisee Bill of Rights imposes strict limitations on a franchisor's ability to terminate or nonrenew a franchise agreement.

Compliance with franchising's legal obligations is costly, and the consequences of non-compliance are significant, if not severe. In short, no one becomes a franchisor to avoid paying employment taxes.

III. ARGUMENT

A. THE DECISIONS BY THE BIIA AND SUPERIOR COURT RADICALLY ALTER THE STATUS QUO.

The Washington Department of Labor and Industries ("DLI") has never previously sought to hold franchisors liable for franchisees' industrial insurance premiums. Indeed, the BIIA is required by law to maintain a record of all of its "significant decisions,"[3] and to make that record available to the public. RCW 51.51.160. Yet a search of that record for the term "franchise" reveals that over the more than 40 years that Washington has regulated franchising there are only *three* significant decisions that even use the word "franchise," not one of which held or

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[3] "Generally, a decision or order is considered 'significant' only if it provides a legal analysis or interpretation not found in existing case law, or applies settled law to unusual facts." WAC 263-12-195(2).

even suggested that a franchisor is or may be responsible for its franchisees' industrial insurance premiums. *See In re Mr. Rooter-South Puget Sound,* BIIA Dec., 10 17889 (2010) ("Mr. Rooter-South Puget Sound is a franchise of the national Mr. Rooter Company."); *In re Rainbow Int'l,* BIIA Dec., 88 2664 (1990) (noting that Rainbow International was a franchisee and dealing with the franchisee's (not a franchisor's) status as an employer of its workers); *In re Joanne Roberts,* BIIA Dec., 40,893 (1973) (noting that the claimant, an injured worker, was not entitled to recover from her franchisee-employer).

"As a general rule, where a statute has been left unchanged by the legislature for a significant period of time, the more appropriate method to change the interpretation or application of a statute is by amendment or revision of the statute, rather than a new agency interpretation." *Dot Foods, Inc. v. Washington Dep't of Revenue,* 166 Wn.2d 912, 921, 215 P.3d 185 (2009). Contrary to the Supreme Court's admonishment against regulatory activism, DLI has adopted a new interpretation of the IIA and concluded that franchisors such as Lyons are responsible for paying their franchisees' industrial insurance premiums.[4]

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[4] Lyons is actually a subfranchisor and under its agreement with Jan-Pro is authorized to grant Jan-Pro® franchises within a defined territory. This technicality, however, is of no consequence here, since FIPA makes no distinction between franchisors and subfranchisors in relation to their respective registration and disclosure obligations, or with their relationships with their franchisees. *See* Sec. Div. Wash. Dep't of Fin. Insts., Re: Subfranchisor Registration Requirements, I Franchise Act Interpretive Statement FIS-01 (Jan. 1, 1991).

DLI attempts to downplay the impact of its radical new interpretation of the IIA by arguing that the change will only impact "service" franchises, as opposed to "product" franchises. RP 48 ("So that's why any franchise operation whose goal is to provide a service is going to come under the same analysis under the Industrial Insurance Act. . . ."). DLI was apparently forced to make this arbitrary distinction when it realized that its new interpretation of the statute would likely subject other franchises, such as the McDonald's restaurant franchising concept, to regulation. RP 29, 47-48. DLI reasons that franchisors like McDonald's will not be subject to regulation because they sell a product (hamburgers), and therefore "personal services" are not the essence of franchisee's contracts with the McDonald's Corporation. RP 47-48; *see also* CP 2271 ("Q: . . . [Y]ou indicated that the essence of the contract between [McDonald's] and the franchisees was . . . a hamburger, correct? A: Yes.").

DLI's proposed distinction between "service" franchises and "product" franchises fails to appreciate how franchised businesses actually work. For example, while McDonald's franchisees provide customers with a product (hamburgers), they also provide a service -- they prepare the hamburgers for the customer's consumption while the customer waits. McDonald's franchisees do not sell raw ingredients for the customer to assemble at home. As a result, McDonald's itself does not consider itself to be a purveyor of products. To the contrary, as a matter of federal trademark law, McDonald's is a service corporation, which licenses its

federally registered *service marks* to franchisees. *See* MCDONALD'S, U.S. Registration Nos. 3580970, 1631967, 1623967, 1352168, 1440244, 1061031, 0743572.[5]

At a minimum, McDonald's, and virtually every other business format franchise, is in the business of providing some combination of products and services to consumers. DLI's impossibly vague distinction between products and services will make it impossible for franchisors to determine whether they will be subject to additional taxation, giving rise to wide uncertainty among hundreds of franchisors whose franchisees primarily provide services to their customers, including franchisors of:

- auto maintenance and repair services (*e.g.*, windshields, brakes, transmissions, tune-ups, and auto body repair)
- real estate brokerage services
- hotels and resorts (franchise brands dominate all segments of the industry)
- accounting and tax preparation services
- landscaping, yard care, and pest removal services
- physical fitness (training, gyms, health clubs, and sports instruction) services
- home improvement, repair, and restoration services
- personal care services (*e.g.*, barbershops and salons)
- business training and coaching services
- home nursing and senior support services
- educational instruction (*e.g.*, math and language tutoring)

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[5] Under the Lanham Act, a service mark is used to identify services, while a trademark is used to identify and distinguish goods. 15 U.S.C. § 1127.

- small business support services (*e.g.*, shipping, packaging, printing, photocopying)
- laundry and dry-cleaning services
- moving and relocation services

Make no mistake, DLI's departure from the status quo is a radical change that will impact most franchised businesses in this State.[6]

B. FRANCHISORS DO NOT CONTROL THEIR FRANCHISEES' DAILY OPERATIONS.

The BIIA and trial court accepted DLI's argument that Lyons' franchisees were not "free from control or direction over the performance of the service." RCW 51.08.195(1). But the indicia of "control" relied on by DLI consists of nothing more than a listing of certain general contractual specifications common to most, if not all, franchise systems (*e.g.*, franchisees receive initial training, franchisees contractually obligated to operate in compliance with the system standards, franchisees required to purchase certain supplies from approved suppliers, transfer of the franchise requires the franchisor's consent). CP 2399.

That Lyons or any franchisor retains some control over its franchisee's operations should not be surprising, since a business relationship is not a "franchise" unless such controls are in place. Under

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[6] The risk posed by uncertainty is not illusory. It will force companies to vertically integrate, rather than franchise, and it will certainly mean higher prices for those that continue to franchise. *See,* Dean T. Fournaris, *The Inadvertent Employer: Legal and Business Risks of Employment Determinations to Franchise Systems*, 27 FRANCHISE L.J. 224, 228 (Spring 2008).

the FTC Rule, for instance, the very definition of a "franchise" demands that the franchisor must "exert a significant degree of control over the franchisee's method of operation, or provide significant assistance in the franchisee's method of operation[.]" 16 C.F.R. § 436.1(h)(2). The FTC has promulgated guidance as to what constitutes a "significant degree of control or assistance," noting that it includes, among other things, virtually all of the factors relied upon by the trial court to find control under the IIA. *See, e.g.,* FEDERAL TRADE COMM'N, FRANCHISE RULE COMPLIANCE GUIDE at 2-4 (May 2008).

While these, and other, "controls" are universally recognized as the hallmarks of a franchise relationship, they do not exist so that the franchisor can dictate the franchisee's day-to-day business operations, but rather to protect the franchisor's trademark rights and to insure the uniformity of customer experience. Chisum, *State Regulation of Franchising: the Washington Experience*, 48 WASH. L. REV. at 295 ("[C]ontrol is essential to the validity of the franchisor's trademark since trademarks function in part to guarantee the consistent quality of the product identified by the trademark."); *see also* 15 U.S.C. § 1055, 1127.

FIPA was also drafted with the understanding that franchise investments include "elements of product conformity and quality standards which must necessarily be met and which will result in a sacrifice of at least some measure of the franchisee's independence." James Fletcher, *Franchise Investment Protection Act* 13 (June 1971) (unpublished thesis, University of Washington) (on file with University of

Washington Law School Library).[7] As a result, to meet the definition of a franchise in Washington, the franchise agreement must entail a marketing plan prescribed or suggested by the franchisor. RCW 19.100.010(6)(i). The "marketing plan" element is very similar to the control element under the FTC Rule. *See, e.g.,* RCW 19.100.010(11); 2 W. M. GARNER, FRANCHISE DESK BOOK WA-43-44 (2d. ed. 2011) (FIPA's "marketing plan requirement was intended to capture relationships where there exists a greater degree of franchisor involvement or control of the franchisee's operations than is traditionally associated with other forms of distribution.").

Though franchisors by definition retain some control over franchisees, the "control" inherent in any franchise relationship is fundamentally different from the "control" found in a typical employment relationship.[8] *See Lobdell v. Sugar 'N Spice, Inc.*, 33 Wn. App. 881, 887,

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[7] "Mr. Fletcher was a draftsman of [FIPA] while working as a legal intern for the Washington Attorney General's Office. His thesis contains the successive drafts of the various bills proposed with comments thereon." Chisum, *State Regulation of Franchising: the Washington Experience*, 48 WASH. L. REV. at 334 n.211.

[8] Washington State law consistently treats franchisors very differently than employers. For example, in the employment context, employers are directly responsible for paying their employees' wages, and can be criminally prosecuted for failing to pay employees' wages. RCW 49.48.010-.020. Conversely, franchisors are not responsible for ensuring that franchisees are paid, or even that their businesses are profitable. Similarly, the legislature expressly authorizes franchisors to charge franchisees a fee for the right to operate a franchised business. RCW 19.100.010(6)(a)(3). This is directly contrary to the legislature's pronouncements in the traditional employment context, where it is a crime to receive payment from a worker in exchange for the right to work.

658 P.2d 1267 (1983) ("Franchisees occupy an undefined middle ground, possessing some of the autonomy of retail or wholesale dealers, yet some of the dependence of employees or agents.").

In light of the unique nature of the relationship, both the Washington Supreme Court and courts in other jurisdictions have held in other contexts that franchisors are not responsible for their franchisees' conduct based on the control inherent in the franchise relationship. *Folsom v. Burger King*, 135 Wn.2d 658, 673, 958 P.2d 301 (1998) (holding that franchisor was not vicariously liable for franchisees conduct where franchisor's "authority over the franchise was limited to enforcing and maintaining the uniformity of the [franchisor's] system."); *see also Cislaw v. Southland Corp.*, 4 Cal. App. 4th 1284, 1292, 6 Cal. Rptr. 2d 386, 391 (1992) ("The cases, taken as a whole, impliedly recognize that the franchisor's interest in the reputation of its entire system allows it to exercise certain controls over the enterprise without running the risk of transforming its independent contractor franchisee into an agent.").

In this context, the "control" necessary for franchisor liability to attach is proof that the franchisor retains authority to dictate or make day-to-day operational decisions. *Folsom v. Burger King*, 135 Wn.2d 658, 673, 958 P.2d 301 (1998). This same kind of control over the details of a franchisee's daily operations (and not the general controls present in all franchise agreements) is the type of "control" required by the IIA. RCW

RCW 49.52.050(1).

51.08.195(1) (requiring actual "[c]ontrol . . . over the performance of the service.") (emphasis added); *Western Ports Transp., Inc. v. Employ. Sec. Dep't,* 110 Wn. App. 440, 452, 41 P.3d 510 (2002) (holding that the crucial issue in the control analysis is the right to control the methods and details of worker's performance). There was no evidence of such control by Lyons of its franchisees, and it would be an unusual case for such control to exist with any franchisor.

Moreover, while all franchise agreements contain contractual provisions requiring compliance with the franchisor's brand standards, a franchisor's actual control over a franchisee's operations is in reality limited. An employer of a contractor or a worker can effectively say "it's my way or the highway." A franchisor has no such power. Unlike an employer, a franchisor has no ability to adjust wages or demote, suspend, or reassign a franchisee. A franchisor's only enforcement tool is termination of a franchise, but a franchisor's ability to actually use this tool is severely constrained by FIPA, which generally bars termination unless the franchisee has breached a "material" provision of the franchise, and then only after the franchisee has been provided written notice of its defaults and afforded an opportunity to cure any breach.[9] RCW

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[9] One court has even gone so far as to hold that under FIPA a franchisor cannot terminate a franchisee that has engaged in fraud and theft without first providing notice and granting the franchisee an opportunity to cure its default by tendering back money that was stolen. *Malek v. Southland Corp.*, Bus. Franchise Guide (CCH) ¶ 11,386 (W.D. Wash. Apr. 10, 1998).

19.100.180(2)(j). The fact that a franchisor has only limited powers to compel compliance with system standards is a significant difference between the employer/employee and franchisor/franchisee relationships. *See Evans v. McDonald's Corp.,* 936 F.2d 1087, 1090 (10th Cir. 1991) (holding that a franchisor was not an employer under Title VII because "[o]utside of the necessary control over conformity to standard operational details inherent in many franchise settings, [franchisor's] only real control over [franchisees] was its power to terminate [franchisees'] franchises.").

By their very nature, franchisors do not exert control over franchisees' performance of their daily operations, and their control is severely limited by statute. As such, it is "silly" and "absurd" to attempt to categorize franchise relationships using "antiquated" notions of control that "predate franchising's advent by decades and in some cases centuries." Kevin M. Shelly & Susan H. Morton, *"Control" in Franchising and the Common Law*, 19 FRANCHISE L.J. 119 (Winter 2000). Accordingly, courts in other jurisdictions that recognize the fundamental difference between franchises and traditional business models have refused to find that franchisors are liable for their franchisees' industrial insurance premiums. *See, e.g., Thorne v. Welk Inv., Inc.,* 197 F.3d 1205, 1210 (8th Cir. 1999) (affirming trial court decision finding that franchisor was not an employer under Missouri's worker compensation law). DLI's attempt to drive the round peg of franchising into the square hole of the traditional control analysis should therefore be rejected.

C. THE WORK PERFORMED BY LYONS' FRANCHISEES IS DISTINCT FROM THEIR FRANCHISE AGREEMENT.

The IIA does not apply unless Lyons' franchisees (and the franchisees' employees) meet the statutory definition of "workers." The IIA defines a "worker" as including any person "who is working under an independent contract, the essence of which is his or her personal labor for an employer." RCW 51.08.180(1). DLI contends that Lyons' franchisees are workers because franchisees are in the business of providing janitorial services and, as such, the essence of the franchise agreements must be to provide such services on behalf of the franchisor, and not the creation of a franchise relationship. Respondent's Brief at 23 (citing *Dana's Housekeeping, Inc. v. Dep't of Labor & Indus. of State of Wash.*, 76 Wn. App. 600, 607, 886 P.2d 1147 (1995)). But DLI's single-minded focus on work franchisees perform as part of the operation of their businesses misses the point entirely. In *Dana's Housekeeping,* this court noted that the nature of the parties' relationship *is a relevant question* when determining whether the person is "working" (*i.e.*, performing personal labor) "under an independent contract." *Id.* at 607 n.3. It is in this context that the nature of the franchise relationship is relevant to the determination of whether a franchisee meets the definition of a "worker," because the nature of the franchise relationship is such that franchisees do not provide personal labor "under the franchise agreement" or on the franchisor's behalf.

Franchisees do not provide personal labor "under a franchise agreement" because even if the essence of the franchisee's business is the

performance of personal labor, the franchisee's business is wholly separate, and "conceptually distinct," from the franchise itself. *Coast to Coast Stores, Inc. v. Gruschus*, 100 Wn.2d 147, 152, 667 P.2d 619 (1983). Indeed, the franchise consists only of the "agreement between the franchisor and the franchisee, whereby the franchisee is granted a license to use a trade name, service mark, or the like." *Id.* Therefore, the work performed by franchisees in the course of their business is not "under the franchise agreement" because the franchise is merely a license to do business that "might exist quite independently of the franchisee's business, as for example where the franchise agreement is concluded before any business operations commence." *Id.*

By focusing only on work franchisees do as part of the operations of their businesses, DLI has failed to understand that the franchise contract is "the agreement between the parties, <u>and not the business operated by the franchisee</u>." *Id.* (emphasis added); *see also Corp v. Atl. Richfield Co.*, 122 Wn.2d 574, 582, 860 P.2d 1015 (1993). Instead, the franchise is merely a license to operate a business, which is legally and conceptually distinct from the franchisee's business, and by extension, the services provided by franchisees to their customers in the ordinary course of their business.[10] As the franchisee's business operations are not the equivalent of the franchise, the personal labor performed by franchisees is not "under the

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[10] Franchisees are in the business of providing products and services to customers; franchisors, on the other hand, are in the business of recruiting, training, and supporting their franchisees.

contract," and franchisees therefore do not meet the definition of "worker" under the IIA.

D. DLI'S REINTERPRETATION OF THE IIA'S SCOPE VIOLATES THE WASHINGTON CONSTITUTION.

As previously discussed, DLI's determination that a franchisor must pay their independent franchisees industrial insurance premiums is a policy change that runs counter to countless prior audits and DLI's long enforcement history. *See, e.g.,* CP 873-79; 2137-38. Yet, franchisors and franchisees struck their bargains with the understanding and expectation that franchisors would not be liable for the payment of franchisees' industrial insurance premiums. Franchise agreements are not priced to account for taxes the DLI now claims a franchisor may owe. Franchisors generally, if not universally, have no control under their franchise agreement over a franchisee's hiring decisions. And franchisors' generally, if not universally, have no rights to even access a franchisee's records bearing on the identity of its employees, the number of hours any employee may have worked, the name of any employee, an employee's job classification, or any other information required to be reported to the DLI by an "employer." *See* WAC 296-17 *et seq.*

Moreover, a franchisor's current agreements cannot be amended unilaterally to account for the DLI's policy shift. Franchise agreements are generally long-term arrangements that cannot be terminated at will or based on the DLI's new approach. Gillian K. Hadfield, *Problematic Relations: Franchising and the Law of Incomplete Contracts*, 42 STAN. L.

REV. 927, 946 (1990); RCW 19.100.180(2)(j). As a result, DLI's reimagination of the IIA's breadth and scope fundamentally alters the expectations and assumptions upon which all franchise agreements are based, and consequently, substantially impairs the obligations of virtually all franchise agreements in this State. Using Lyons' specific case as an example, the cost of complying with this newly imposed and unexpected burden will significantly exceed the company's entire annual profit, effectively putting it out of business. *Compare* CP 2135 (noting that the company has annual profits of approximately $125,000) *with* CP 196 (noting that Lyons' annual IIA premiums would be approximately $150,000). Other franchisors will face a similar fate.

The Washington Constitution provides that "no . . . law impairing the obligations of contracts shall ever be passed."[11] WASH. CONST. art. I, sec. 23. A contract is impaired by a change in the law which alters the

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[11] The provision is based upon the Contracts Clause found in Article I, Section 10 of the United States Constitution, and courts generally give the clauses the same effect. *Carlstrom v. State*, 103 Wn.2d 391, 394, 694 P.2d 1 (1985). The two clauses are not construed identically, however, as Washington's Constitution has been interpreted more broadly in some respects. *Compare Silverstreak, Inc. v. Washington State Dep't of Labor & Indus.*, 159 Wn.2d 868, 890, 154 P.3d 891 (2007) (holding that DLI could not, without violating the contracts clause in the Washington Constitution, change its interpretation of a governing statute after parties had entered into contracts in reliance on the agency's prior interpretation) (plurality opinion) *with Ross v. Oregon*, 227 U.S. 150 (1913) (noting that the Contracts Clause contained in the federal constitution "is aimed at the legislative power of the state, and not at the decisions of its courts, or the acts of administrative or executive boards or officers. . .").

contract's terms (express or implied), imposes new conditions or lessens its value. *Caritas Servs., Inc. v. Dep't of Soc. & Health Servs.*, 123 Wn.2d 391, 404, 869 P.2d 28 (1994); *Silverstreak, Inc. v. Washington State Dep't of Labor & Indus.*, 159 Wn.2d 868, 890, 154 P.3d 891 (2007) (DLI change in interpretation of statute that substantially diminished value of existing contract would violate Washington Constitution Contracts Clause). "[I]mpairment is substantial if the complaining party relied on the supplanted part of the contract, and contracting parties are generally deemed to have relied on existing state law pertaining to interpretation and enforcement." *Margola Assocs. v. City of Seattle,* 121 Wn.2d 625, 653, 854 P.2d 23 (1993).

DLI's new interpretation that any franchisor of a franchise that features services is responsible for its franchisees' industrial insurance premiums would substantially impair those franchise agreements; it certainly does in Lyons' case, as it renders those agreements less than valueless to Lyons. As such, DLI's new interpretation is presumed to be unconstitutional. *Johanson v. Dep't of Soc. & Health Servs., State of Wash.*, 91 Wn. App. 737, 744, 959 P.2d 1166 (1998). The State bears the burden of showing a significant and legitimate public purpose in making the change, and that the change is reasonably necessary to achieve that purpose. *Tyrpak v. Daniels*, 124 Wn.2d 146, 156, 874 P.2d 1374 (1994); *see also Bidwell v. City of Bellevue*, 65 Wn. App. 43, 50, 827 P.2d 339 (1992). "The severity of the impairment increases the level of scrutiny applied to the legislation in question." *Mearns v. Scharbach*, 103 Wn.

App. 498, 513, 12 P.3d 1048, 1055 (2000) (citing *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978)). Yet DLI offers no rational explanation for the change, nor has it identified any significant legitimate public purpose. Instead it acknowledges that it was already collecting taxes directly from franchisees, who are also responsible as "employers" for payment. CP 2256. The change therefore amounts to nothing but an attempt to expand the State's coffers, without any rationalization (much less evidence) supporting a need for the expansion, or an explanation as to how this change is reasonably necessary to achieve that purpose. The State Constitution requires more. *Tyrpak*, 124 Wn.2d at 156.

IV. CONCLUSION

"[F]ranchising is perhaps the one true hope for small businessmen to remain a viable and effective force in our economy." Fletcher, *Franchise Investment Protection Act* at 2. DLI's reinterpretation of the scope of the IIA undermines that hope by increasing uncertainty in franchising contracts, and thereby creating substantial disincentives for franchisors to conduct business in this state. Despite these disincentives, and without any legislative or rule-making process to evaluate the consequences, DLI has implemented the change with no consideration of the consequences, and no public participation. Given what is at stake, the Court should not countenance such wanton, arbitrary exercise of authority by the executive, and the trial court's decision should be overturned.

DATED this 23rd day of April, 2014.

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CERTIFICATE OF SERVICE

I, Elizabeth G. Pitman, declare and state as follows:

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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 23rd day of April, 2014 at Seattle, Washington.

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