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TRICKY ISSUES

FRANCHISOR OR FRANCHISEE: WHO IS THE EMPLOYER?

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Courts and administrative tribunals are generally sensitive to the vulnerability of employees in employment relationships due to the often unequal bargaining power between employers and most employees. Various corporate structures, including franchise arrangements, that may be recognized for commercial law purposes, may not be recognized for employment law purposes, particularly if doing so would result in an injustice to vulnerable employees.

In franchise arrangements, franchisors might assume that only the franchisees are responsible for their employees. This is particularly true when the franchisor and franchisee have entered into a written agreement to this effect. However, franchisors may be surprised to learn that they too may be responsible in law as the employer of the employees working for a franchisee, notwithstanding the terms of any written agreement to the contrary.

Tests to Assess Who is the Employer

Determining whether a franchisor has also become responsible in law as the employer of the employees working for a franchisee requires a detailed analysis of the facts in every case. Courts and administrative tribunals often cite the following criteria considered by the Ontario Labour Relations Board in *York Condominium Corp.*, [1977] OLRB Rep. Oct. 645 ("*York Condo*") when there is confusion about which entity is responsible in law as the employer of certain employees:

(a) The party exercising the direction and control over the worker performing the work.

(b) The party bearing the burden of remuneration.

(c) The party imposing the discipline.

(d) The party hiring the worker.

(e) The party with the authority to dismiss the worker.

(f) The party who is perceived to be the employer by the worker.

(g) The existence of an intention to create the relationship of employer and employee.

The test that has been applied more recently is the "fundamental control test", according to which the indicia of day-to-day control set out in *York Condo* must be considered within the whole of the facts of each case in order to determine which factors most accurately reflect and identify the employer. This is particularly relevant in the context of franchise arrangements.

Assessing if a franchisor is responsible in law as the employer of employees working for a franchisee should reflect the business realities and the distinct nature of franchise arrangements. Franchise arrangements by their very nature

typically involve a degree of direction and control exerted by a franchisor over a franchisee. A certain degree of direction and control is usually necessary to ensure consistency and uniformity in the products and services offered by franchisees. Indeed, it is this consistency and uniformity that provides value to the franchisees, which if not upheld by one franchisee can harm the other franchisees and the franchisor.

The direction and control exerted by a franchisor can take many forms, including the implementation and enforcement of standard policies and procedures. These standard policies and procedures can be extended to the workplace in various ways, such as: standard employee uniforms and standard customer greetings by employees. Despite these types of standard policies and procedures, franchisors often have very little other control over the employees working for the franchisee. For example, the franchisor often has no involvement in deciding who the franchisee will hire or fire or how the franchisee will supervise or discipline its workforce. As such, in assessing whether the franchisor exerts direction and control over the employees working for the franchisee, the fact that the franchisor enforces certain standard business policies and procedures should not be determinative of the issue and the weight assigned to standard business policies and procedures should be balanced against the business realities in franchise arrangements.

In addition, in assessing if a franchisor is responsible in law as the employer of employees working for a franchisee, it must be kept in mind that the terms of a written franchise agreement are not determinative of the issue. Rather, courts and administrative tribunals often look to the terms of the written agreement between the parties only to understand who they themselves intended would be responsible as the employer of the employees working for the franchisee. Courts and administrative tribunals will consider many factors beyond the terms of the written franchise agreement to determine whether a franchisor is responsible in law as the employer of the employees working for the franchisee.

Case Law

The following is a review of case law in which the issue of whether the franchisor was responsible in law for the employees working for a franchisee was considered. A review of these cases suggests that the mere existence of a franchise arrangement, generally, will not render the franchisor responsible in law as the employer of the employees working for the franchisee. Conversely, when the franchisor becomes involved in the employment matters of employees working for franchisees, the franchisor may become responsible as the employer. Also, the terms of a statute can extend liability and responsibility to franchisors for the employees working for the franchisee.

Franchisor Assumes Day-to-Day Operations and Becomes Liable

In *Youngblut v. Jim Jaklen Holdings Ltd.*, 2002 SKQB 463 (CanLII) ("*Youngblut*"), the Saskatchewan Court of Queen's Bench reversed a decision of the Director of the Labour Standards Branch that held the franchisor was not liable to the employees who had worked for the franchisee, for pay in lieu of notice of termination under *The Labour Standards Act* of Saskatchewan. In *Youngblut*, the franchisee of a Tomas Cook restaurant notified the franchisor, Mr. Thomas, that the restaurant was struggling financially and the franchisee would be shutting down the restaurant. The franchisor wanted to keep the restaurant open and find a new franchisee. It was agreed that the franchisor would assume the management of the restaurant, including the day-to-day operations, and all future liabilities in order to find a new franchisee. Despite the franchisor's efforts, the restaurant failed before the franchisor could find a new franchisee. The employment of the employees was terminated without the notice or pay in lieu of notice required under *The Labour Standards Act* of Saskatchewan.

The Saskatchewan Court of Queen's Bench recognized that franchise arrangements generally involve a certain degree of control by the franchisor over the franchisee. The court made the following comments about the high level of involvement of the franchisor in this case, even before the franchisor assumed the management of the restaurant:

> [21] Thus, although the terms of the franchise agreement itself in this case reveal a high level of involvement and control by the franchisor Mr. Thomas, including franchisor approved management; display of promotional material in the restaurant approved by franchisor; frequent unannounced inspection by franchisor; compliance with standards, and provision of written monthly statements of account, these factors do not make Mr. Thomas anything but a franchisor

> with an interest in the business. Indeed, clause 23 of the agreement states clearly that "[n]either the Franchisee nor any person performing any duties or engaged in any work on the premises at the request of the Franchisee shall be deemed an employee or agent of the Franchisor".

However, the Saskatchewan Court of Queen's Bench noted how the relationship changed once the franchisor assumed the day-to-day operations of the restaurant and stated:

> [22] … The correct application of the law to the facts as found by the adjudicator in this case would suggest that Mr. Thomas' increased management control changed his status from being merely an interested franchisor to <u>also</u> being that of employer after September 24, 2001.

Accordingly, both the franchisor and the franchisee were held to be employers once the franchisor assumed the management of the restaurant. The franchisor and the franchisee were jointly and severally liable for the pay in lieu of notice of termination owing to the employees.

<u>Franchisor and Franchisee That Jointly Utilize Employee's Services Are Liable</u>

In *Kent v. Stop 'N' Cash 1000 Inc. et al*., 2006 CanLII 22660 (ON SC), the Ontario Superior Court decided that the franchisor and a corporate franchisee were liable for the wrongful dismissal of an employee, Ms. Kent. Ms. Kent, an employee who was dismissed from her employment without cause, brought a claim for wrongful dismissal against the franchisor, Stop 'N' Cash 1000 Inc. and one of its corporate franchisees, Stop 'N' Cash 1010. Initially, Ms. Kent worked for the franchisor. Within a couple of years, Ms. Kent was "promoted" to manager of Stop 'N' Cash 1010, a corporate franchisee. However, over the years, in addition to managing Stop 'N' Cash 1010, Ms. Kent continued to provide various services that benefited the franchisor, such as: training franchisees on opening new franchises; assisting new franchisees with selecting their furniture, layouts and colours; assisting a distressed franchise; and, preparing newsletters and marketing materials for franchisees. Over the years, Ms. Kent had been issued T4 tax forms reporting her employment income for income tax purposes from the franchisor or the franchisee or both. Further, the owners of the franchisor and the corporate franchise would oversee personnel matters affecting Ms. Kent including her leave of absence and vacations, and they would provide her directions on various activities and work locations. At no time had Ms. Kent been issued a Record of Employment in respect of the cessation of her employment with the franchisor, as normally occurs on a termination of employment.

The court held that the franchisor and the corporate franchisee were Ms. Kent's common employers and that her employment with the different corporate entities was continuous. As such, the franchisor and the corporate franchisee owed Ms. Kent reasonable notice of termination based on her years of service with both entities. The court quoted with approval the following from *Downtown Eatery (1993) Ltd. v. Ontario* (2000), 54 O.R. (3d) 161:

> Although an employer is entitled to establish complex corporate structures and relationships, the law should be vigilant to ensure that permissible complexity in corporate arrangements does not work an injustice in the realm of employment law.

<u>Liability Extended to Franchisor Based on Statute</u>

In *Petro-Canada v. Workers' Compensation Board of British Columbia* 2009 BCCA 396 (CanLII) (*"Petro-Canada")*, the British Columbia Court of Appeal decided that a franchisor could be held responsible for ensuring the health and safety of employees of a franchisee under the *Workers Compensation Act*. In *Petro-Canada*, a Workers' Compensation Board Prevention Officer inspected service stations in Langley and Surrey, British Columbia after the following incidents. In Langley, a worker behind the service counter was robbed at knifepoint. In Surrey, an attendant was struck when attempting to stop a driver who had filled his vehicle with gasoline and driven away without paying. Following the inspections, the Workers' Compensation Board issued orders against the franchisor, Petro-Canada, which included orders for failing to: (a) ensure the health and safety of the workers; (b) conduct a risk assessment of the workplace and eliminate any risk to the extent possible; and (c) report an unsafe condition, investigate it and take any necessary corrective action.

The orders were made pursuant to the Occupational Health and Safety Regulation and section 115(1) of the *Workers Compensation Act*, which provides:

> 115(1) Every employer must
>
> (a) ensure the health and safety of:
>
> (i) all workers working for that employer, and
> (ii) any other workers present at a workplace at which that employer's work is being carried out …

In framing the issue before the court, the court stated in paragraph 48:

> The difficult question for the purposes of s. 115, then, is not whether Petro-Canada is an "employer" - it clearly is. Rather, the Review Officer had to consider whether the service stations operated by the franchisees were workplaces at which Petro-Canada's work was being carried-out.

In concluding that the work of the franchisor was being carried out at the service stations of the franchisees, the court accepted the following findings of the Review Officer in paragraph 31:

> The truth is that this employer owns the premises, owns the products sold, chooses, dictates, supplies and prices the products, requires exclusivity on the part of the licensee [franchisee] and requires the licensee to hold all monies in trust until it receives them and pays the licensee a commission. It even labels the licensee as its agent, for the purpose of sales transactions. Therefore, in the circumstances, there can be no doubt that in operating the service stations, the licensee and its employees are carrying out the employer's "work" in an overall sense.

Accordingly, the court upheld the orders against the franchisor, Petro-Canada. The decision in *Petro-Canada* was reasonable in light of the wording of the statute in issue and the goal of the statute to protect the health and safety of workers.

Of greater concern is the decision of the Manitoba Appeal Commission *Decision No. 99/2011* (unreported, 20 July 2011) ("*Cleaners")*. In *Cleaners*, the Appeal Commission held that franchisees with earnings below a minimum threshold were "deemed" to be workers of the franchisor for workers' compensation premium assessment purposes. As such, the franchisor was required to remit workers' compensation premiums on behalf of those franchisees. However, workers' compensation premiums are generally calculated based on an employer's payroll and these franchisees were not on the franchisor's payroll. As such, the Assessment Committee further deemed the franchisees' payroll to be a percentage of the net amount remitted by the franchisor to the franchisee. Notably, the franchisor cannot recover the premiums it must pay in respect of the franchisees from its franchisees because that is prohibited under *The Workers Compensation Act*.

In *Cleaners*, the franchisor sold janitorial cleaning licenses to franchisees. Under the franchisee agreement, franchisees were responsible for registering with the workers' compensation board and paying the required premiums. Following an audit by the workers' compensation board, the Assessment Committee determined that franchisees with earnings below a minimum threshold were deemed to be workers of the franchisor, such that the franchisor was required to remit the workers' compensation premiums in respect of the franchisees, notwithstanding the terms of the parties' agreement.

On appeal, the Appeal Commission upheld the Assessment Committee's determination. The Appeal Commission's decision cited section 60(2.1) of *The Workers Compensation Act*, which states:

> 60(2.1) Deemed worker and employer
>
> Notwithstanding the other provisions of this Act, where a person who is not a worker under this part performs work for the benefit of another person, the board may deem the first person to be a worker, and the second person to be the employer of the first person, within the meaning of the

> Act; and the board may determine an amount that shall be deemed to be the earnings of the first person, for the purposes of this Part.

Pursuant to section 60(2.1) of *The Workers Compensation Act*, the Appeal Commission could have rendered a decision based on an assessment of whether the franchisees should be deemed to be workers of the franchisor because they performed work for the benefit of the franchisor. This would have involved an analysis similar to the analysis in *Petro-Canada* and a decision based on the specific wording of the statute in issue.

Unfortunately, the Appeal Commission focused on whether the relationship was more akin to that of an employer-employee relationship, such that the franchisees were properly deemed to be workers for the purposes of assessment under *The Workers Compensation Act*. The Appeal Commission then decided the relationship was more akin to that of an employer-employee relationship based on factors not traditionally considered in determining which entity is the employer. For example, the Appeal Commission seemed to put little or no weight on the fact that the franchisees: (a) were responsible for supervising their workers; (b) were responsible for the scheduling and delivery of cleaning services; and, (c) could accept the jobs they wanted.

Instead, the Appeal Commission focused on various business controls exerted by the franchisor over the franchisee. However, business controls are common in franchisee arrangements and are not determinative whether an employment relationship exists. For example, the Appeal Commission considered that the janitorial contracts were between the franchisor and the clients, and that the franchisor handled the administration of the funds, such as: sending invoices to clients, collecting the payments and remitting the amounts owing to the franchisee pursuant to the franchise agreements. It also considered how the franchise agreement provided the franchisor various other controls over a franchisee, such as: the workers must wear uniforms; the franchisee must obtain approval of shop premises and business income and cannot use equipment or supplies that are not pre-approved by the franchisor. However, these are business and administrative matters over which franchisors commonly retain control. These factors do not amount to control over the employment matters, which is the test that ought to have been considered, as set out above in *York Condo*.

The Appeal Commission also considered that because the franchisee did not set the contract amounts or own the clients, they were not truly in business for themselves, with the corresponding assumption of risk and opportunity for gain. However, this failed to recognize that if the clients did not pay their accounts, ultimately the franchisees bore that financial risk. This also failed to recognize that the franchisees' risk of loss and opportunity for gain depended on how efficiently the franchisees ran their franchises.

The Appeal Commission also drew an artificial distinction between which franchisees were deemed to be workers of the franchisor based on the minimum amount of insurance that can be obtained from the workers' compensation board. There is no explanation of how or why this factors into whether a franchisee is deemed to be a worker of a franchisor or an independent operator.

The decision in *Cleaners* adds confusion to the factors that ought to be considered when determining which entity is the employer. Caution should be taken in relying upon the reasoning in *Cleaners* because it departs from the factors typically considered in an analysis of which entity is the employer. Nonetheless, the decision stands and should be taken into consideration when examining the responsibilities of franchisors and franchisees.

Franchise Arrangement Itself Does Not Extend Liability to Franchisor

In *Toshi Enterprises Ltd. v. Coffee Time Donuts Inc.*, 2008 CanLII 68167 (ON SCDC) ("*Toshi*"), the Ontario Divisional Court reversed a decision of the Small Claims Court, in which the franchisor was held vicariously liable for the negligence of its franchisee because they were in a relationship that could be described as an employment relationship. In *Toshi*, a fire occurred at a Coffee Time franchise owned by Jolin Groups Inc. ("Jolin"). The fire spread to the neighbouring restaurant, Toshi Enterprises Ltd. ("Toshi Enterprises"). Toshi Enterprises claimed damages against the franchisor, Coffee Time.

In deciding that Coffee Time was not liable as the employer of Toshi Enterprises, the Ontario Divisional Court stated in paragraphs 15 and 16:

> [15] … Inevitably, there are some provisions of the franchise agreement according to which Coffee Time exercises control over the franchisee. Such provisions are regular and expected inclusions in a franchise agreement. Franchise agreements by nature "entail some degree of control by the franchisor, even though the franchisee is generally an independent business person operating the franchise": *Youngblut v. Jim Jaklen Holdings Ltd.*, 2002 SKQB 463 at para. 15.
>
> []16] The franchise agreement in this case is clear: there is no agency relationship between the franchisor and the franchisee; the franchisee is an independent contractor completely separate from the franchisor; the franchisee hires and fires its own employees, handles its own finances, maintains its own accounting and business records, financial statements and tax returns; maintains its own insurance on the premises and the property; exercises its own business judgment in the operation of the business; and is the owner of assets. Jolin was clearly a franchisee and not an employee.

This commentary does not mean that if there is no employment relationship between a franchisor and a franchisee, the franchisor will never be liable for the acts of a franchisee. Rather, outside of the context of employment law, a franchisor may be liable to third parties for the acts of a franchisee if a third-party believed it was dealing with a franchisor. For example, in *Fraser v. U-Need-A-Cab Ltd.* (1985), 50 O.R. (2d) 281 (C.A.) ("*Fraser*"), the Ontario Court of Appeal held a franchisor liable for the conduct of a franchisee. In *Fraser*, an elderly passenger fell out of a taxi cab and injured herself when trying to exit using a defective door on the taxi cab. The taxi cab was independently owned by the driver. However, the passenger called the cab company's number using a free telephone installed by the cab company at the hospital and placed the order with the cab company itself. The court noted that the contract was with the cab company and it was not relevant that the cab company happened to send an independent car, instead of one it owned, and that the passenger paid the driver.

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