PERSPECTIVE
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# New battleground in contractor vs. employee dispute

**By Robert W. Wood**

A Texas jury slapped Domino's Pizza with a $32 million verdict over a pizza delivery accident that killed a 65-year-old woman and left her 70-year-old husband with permanent brain injuries. The elderly couple served as Christian missionaries for 20 years. Speeding on bald tires, the driver was liable, as was the local independent franchise store that sold the pizza.

But was Domino's, as the franchisor, also responsible? Given that the driver was speeding to meet Domino's 30-minute delivery policy and considering other aspects of the particular franchise relationship in question, the jury found Domino's liable. Domino's says it will appeal the verdict, but the case raises fundamental questions about worker status and agency. The examination of franchise arrangements is a comparatively new branch of the age-old independent contractor versus employee characterization inquiry.

Delivery work is often done by independent contractors, not employees. Independent contractor arrangements can be perfectly genuine or can be independent in name only, with no chance of standing up against the Internal Revenue Service, worker's compensation or other authorities. Classification battles over the status of workers are increasingly common and take place in a variety of contexts.

Whether in worker's compensation, labor and employment cases, tax, employee benefit, contract or tort cases, the damages can break a company. Yet a surprising number of business people don't consider the issue or how they might improve their facts until they are staring down a lawsuit. At that point it is usually too late.

Names and contracts don't tell the whole story. Even if a driver is labeled an "independent contractor," an injured party can ask the court to find whether the driver was really an employee. That would make the employer liable as well.

That's one reason why when a company hires an independent contractor delivery driver and the driver has an accident, the company will probably be sued too. If the plaintiff can show that the driver was really an employee, the company also has liability. In franchise operations like Domino's where each store is independently owned, the relationship can be even more attenuated.

The Domino's model dilutes the liability risk, but doesn't eliminate it. The facts and circumstances matter and not all cases come out the same way. In *Viado v. Domino's Pizza, LLC*, 230 Ore. App. 531 (Or. Ct. App. 2009) the court said a franchisor like Domino's can be responsible for the conduct of a franchisee's employee in some cases.

Of course, there is always some franchisor control over franchisees. However, if a franchisor's rules dilute a franchisee's control over day-to-day operations and its own employees, the franchisor may be liable for the acts of a franchisee.

We all know the basics of being an independent contractor. The employer withholds income, Social Security and Medicare taxes. The employer issues a Form W-2 showing the taxes withheld from the pay. For an independent contractor, there is no tax withholding and the company just files an IRS Form 1099-MISC.

From an employer's viewpoint, paying independent contractors offers the benefits of:

- No income tax withholding;
- No employment taxes;
- No liability for acts of employees — like driving a car on company business;
- No federal and state discrimination laws covering only employees; and
- No fringe benefit, pension, retirement, or other plans.

Many worker status cases look primarily at:

- The employer's degree of control over the worker;
- The worker's opportunity for profit or loss;
- The worker's investment in facilities;
- The worker's skill set; and
- How long-term the relationship is.

Most of the discussion is about how to tell independent contractors from employees. There is little discussion about what it means if workers are reclassified from independent contractors to employees. There may be big liabilities for failure to withhold taxes, plus penalties and interest. And there also can be huge liabilities over accidents.

Worker status is also broached in many franchise agreements. Typically, franchise agreements acknowledge that the franchisee is strictly an independent contractor, not an employee. In *Awuah v. Coverall North America Inc.*, 707 F. Supp.2d 80 (D. Mass. 2010), a Massachusetts court classified janitorial workers labeled "franchisees" as employees.

Coverall was the franchisor and individual janitors were treated as franchisees. The franchise agreement licensed the janitors to use Coverall's methods, procedures, standards, and equipment for cleaning commercial properties. However, a reading of the case and the pertinent documents makes it hard to think of individual janitors as separate businesses.

Customers generally contracted with Coverall, not with franchisees. In addition to signing a franchise agreement, each worker was required to wear approved uniforms and identification badges while on customers' premises. Coverall provided equipment and supplies and performed all billing and collection on customers' accounts. Coverall deducted its "franchise fees" before paying "franchisees."

Coverall provided training programs, cleaning techniques, management techniques, and an initial customer base. Furthermore, the court found that Coverall controlled many aspects of the services, including negotiating contracts and pricing directly with customers, billing customers, and providing a daily cleaning plan franchisees were required to follow. Although franchisees could solicit additional customers, any prospects who signed up became customers of Coverall directly, not customers of the franchisee.

The franchise model has been examined elsewhere. *Singh v. 7-Eleven Inc.*, 2007 U.S. Dist. LEXIS 16677 (N.D. Cal. 2007), involved the Fair Labor Standards Act. In Singh, workers at a convenience store sued the store owner (the franchisee) and 7-Eleven (the franchisor). The FLSA defines an employer as "any person acting directly or indirectly in the interest of an employer in relation to an employee."

The court noted the vertical nature of the relationship due to the franchise structure. In the 9th U.S. Circuit Court of Appeals, whether an entity is an employer under the FLSA is a question of law that must be determined by applying the economic reality test. The economic reality test encompasses a number of factors, including the power to hire and fire; supervision and control of work schedules or conditions of employment; the rate and method of payment; and maintenance of employment records. The court in *Singh* ultimately did not find an employer-employee relationship between the workers and 7-Eleven.

In *Rainey v. Langen*, 2010 ME 56 (2010), a motorcyclist was injured in an accident with a delivery driver for a Domino's Pizza franchise. The injured motorcyclist sued both the franchisor and Dominos, the franchisee. The plaintiff claimed that the Domino's had so much control over its franchisees that the driver should be characterized as an employee of Domino's itself.

However, the court declined to impose vicarious liability, finding that Domino's did not have a tight enough leash on its franchisee for the arrangement to be considered an employer-employee relationship. Despite such defense victories, franchise agreements should be structured carefully with worker status issues in mind.

In the past, we may have thought of franchise arrangements as simply outside the normal independent contractor versus employee gauntlet. Indeed, it may be fair to regard franchise arrangements as a step removed from the more traditional employee vs. independent contractor characterization issue. Yet increasingly and in multiple contexts, a new type of vicarious liability — for tort law, employment law and even tax disputes — appears to be dawning.

**Robert W. Wood** *is a tax lawyer with a nationwide practice (www.WoodLLP.com). The author of more than 30 books including "Taxation of Damage Awards & Settlement Payments" (4th Ed. 2009 With 2012 Supplement www.taxinstitute.com), he can be reached at Wood@WoodLLP.com. This discussion is not intended as legal advice, and cannot be relied upon for any purpose without the services of a qualified professional.*