

Massachusetts' Strictest-in-the-Nation Definition of "Employee" May Encompass Franchise Operators

Labor & Employment Law Alert

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When a worker is classified as an employee, a panoply of local, state, and federal laws regulate many facets of the relationship between the worker and the person or entity the worker serves. When a worker is not an "employee," on the other hand, government takes a much more hands-off approach, generally leaving most of the details of the relationship to whatever agreement the parties may enter into. Independent contractors, unlike employees, are not subject to payroll tax withholding, workers' compensation laws, most anti-discrimination laws, wage and hour regulations, unemployment compensation taxes, and a number of other laws that govern only employees. Given this difference, there is a financial incentive for organizations to classify workers as independent contractors even when they should be employees. For several decades, such misclassification has provided fodder for state and federal regulators and for lawsuits.

Since 2004, Massachusetts has defined the employment relationship more broadly than any other state in the country. Under Massachusetts General Laws chapter 149, § 148B, every individual performing "any services" is classified as an "employee" unless each of the following is true:

1. the individual is free from control and direction in connection with the performance of the service, both under his contract for the performance of service and in fact; **and**
2. the service is performed outside the usual course of the business of the employer; **and**
3. the individual is customarily engaged in an independently established trade, occupation, profession, or business of the same nature as that involved in the service performed.

Mass. Gen. Laws ch. 149 § 148B. In addition, Massachusetts law provides for mandatory treble damages for violations of the wage law, such as failure to pay minimum wage, overtime premium, or premiums for Sunday and holiday work. This dramatically raises the stakes for even good faith misclassifications of workers as something other than employees.

Now, Massachusetts' highest court is being asked to decide whether that law applies to individuals who own and operate franchise retail stores. Several individuals who operated convenience stores under franchise agreements with 7-Eleven, Inc. sued the company claiming that they were actually employees

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of the company. The franchisees claimed that because 7-Eleven exercised a large degree of control and direction over the way they operated their stores, and because operating convenience stores was within the usual course of business of 7-Eleven, the company could not overcome the statutory presumption that these individuals were employees. As employees, the franchisees argued, they were entitled to minimum wages and other protections of Massachusetts wage and hour law.

The federal trial court dismissed the case, agreeing with 7-Eleven that a regulation of the Federal Trade Commission (FTC) required franchisors such as 7-Eleven to exercise a certain degree of control over their franchisees, and that therefore the exercise of such control could not convert the franchise owners to employees. Thus, the trial court determined, the Massachusetts law did not even apply to franchise owners governed by the FTC rules.

The franchise owners appealed to the United States Court of Appeals for the First Circuit. The appeals court appeared skeptical of 7-Eleven's argument, but instead of ruling that the Massachusetts law applied to franchise owners and then applying that law, the Court instead decided to ask the Massachusetts Supreme Judicial Court (SJC) to decide the question. The appeals court certified the following question to the SJC:

Whether the three-prong test for independent contractor status set forth in Mass. Gen. Laws ch. 149 § 148B applies to the relationship between a franchisor and its franchisee, where the franchisor must also comply with the FTC Franchise Rule.

The SJC has not yet decided the case, and a decision is at least several months away. But the decision is likely to have wide-ranging consequences whichever way the SJC answers the question.

If the SJC rules that the test for employee status does not apply to individuals who own franchises subject to the FTC Franchise Rule, it seems likely that such franchise arrangements will proliferate in some circumstances as a potentially simpler way to manage operations. If, on the other hand, the Court rules that the Massachusetts test for employee status does apply, lawsuits like the one against 7-Eleven would become more common and the franchise model would somewhat retreat in Massachusetts.

Businesses operating in Massachusetts under a franchise model, whether as franchisor or franchisee, should look closely at their arrangements and consider whether to alter them in anticipation of the upcoming decision. This is particularly true in cases in which, as in the 7-Eleven case, the franchisee is an individual rather than a more traditional business organization such as a corporation.

All businesses operating in Massachusetts, whether they use a franchise model or not, should take this case as a reminder of the breadth of the Massachusetts law defining employees and review the status of their workers in order to limit potential liability.