ALERT – California Franchise Law

The Fine Line Between Franchisees and Independent Contractors May be Blurring

A "quasi-franchise" is a licensee whose relationship to its licensor is functionally similar, but legally different, from a franchisee-franchisor relationship. The purpose of such a relationship is generally to avoid the heightened scrutiny and protections imposed by California law on franchisors and franchisees. However, the perceived benefits of a "quasi-franchise" relationship may be coming to an end, based on a district court's recent decision in *Ambrose v. Avis Rent a Car System*, 2014 U.S. Dist. LEXIS 170406 (C.D. Cal. Dec. 8, 2014).

In *Ambrose*, Tammy Dotson ("Dotson") owned and operated a rental car business. Dotson signed an "Operator Agreement" with Budget Rent a Car System, Inc. ("Budget") which provided that Dotson was an "independent contractor" of Budget and "not a franchise." Dotson, in fact, paid Budget a fee to enter into this "independent contractor" relationship.

Notwithstanding the purported "independent contractor" relationship, Budget retained significant control (akin to a franchisor over a franchisee) over Dotson's business. Ultimately, Budget terminated the Operator Agreement and certain of Dotson's workers filed wage and hour claims against Budget, alleging that the workers had been improperly classified as independent contractors when they were, in fact, employees.

Both sides moved for summary judgment on the issue of whether the workers were properly classified. Budget argued that it was entitled to the protections afforded to franchisors under *Patterson v. Domino's Pizza* (2014) 60 Cal.4th 474, and *Juarez v. Jani-King of California, Inc.*, 2012 U.S. Dist. LEXIS 7406 (N.D. Cal. 2012). In both cases, the Courts held that the common law test for employment did not apply in a franchisee-franchisor model. In *Patterson*, the Court held that a franchisor is not vicariously liable for a workplace injury inflicted by an employee of a franchisee because doing so would disrupt the very nature of the franchisor-franchisee relationship. The *Juarez* Court reached a similar conclusion and held that the common law presumption of an employee relationship does not apply to a franchisor.

The *Ambrose* Court refused to extend the protections enjoyed by franchisors, set forth in *Juarez* and *Patterson*, to a quasi-franchise relationship. While the Court acknowledged that these protections may one day be extended to a licensor-licensee relationship, like that present in the *Ambrose* case, it was not prepared to do so at this point. In reaching this conclusion, the *Ambrose* Court maintained the distinction between the licensee-licensor and franchisee-franchisor relationships, but indicated that this distinction may be blurred in the future.

Ambrose has important implications for any business which operates under a licensee-licensor or "quasi franchise" relationship. The benefit of such relationships may become eroded as California courts move towards recognizing at least certain aspects of these relationships as akin to franchisee-franchisor relationships. If and when this happens, both licensees and licensors in quasi-franchise relationships will need to ensure that agreements memorializing this relationship are in conformance with the heightened requirements of California franchise laws.

California Court Rules that the California Franchise Relations Act is Both a Shield and a Sword for Out-of-State Franchisors.

A recent California case saw a franchisee argue unsuccessfully that its default under the franchise agreement resulted in the automatic termination of the agreement, which precluded liability due to a contractual statute of limitations. In making this argument, the franchisee turned the traditional script in a franchisor-franchisee dispute on its head, and used the automatic termination protections created under the California

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Franchise Relations Act ("CFRA") as a sword, instead of a shield, in a lawsuit against its franchisor.

In *Fantastic Sams Salons Corp. v. Moassesfar*, the franchisee (the Moassesfars) operated two (2) Fantastic Sams franchises. The Moassesfars fell significantly behind in royalty fees, but for unknown reasons the franchisor, Fantastic Sams, took no action to enforce the franchise agreement or collect unpaid fees for almost three (3) years.

Fantastic Sams eventually filed a lawsuit against the Moassesfars, where the sole issue before the court was the amount of damages owed to Fantastic Sams for the Moassesfars' operation of the franchises for two (2) years without paying royalty and/or franchise fees. The Moassesfars moved to dismiss the complaint on the grounds that: (1) the franchise agreement provided that the agreement automatically terminated after two (2) consecutive missed payments; and (2) Fantastic Sams' claims were barred based on language in the franchise agreement which required that any claims arising out of the franchise agreement be brought within one (1) year from the date of injury. In making these arguments, the Moassesfars relied on provisions of the franchise agreement which are generally intended to protect the franchisor. Fantastic Sams followed suit, and argued that the CFRA, which is intended to protect franchisees operating in California, precluded the automatic termination of the Moassesfars' franchise agreement because there was no "reasonable opportunity to cure" provided. The Court agreed with Fantastic Sams.

The section of the CFRA at issue is codified in California Business and Professions Code § 20020, which provides that a franchisor may not terminate a franchise prior to the expiration of its term, without good cause. "Good cause" is defined as the failure of a franchisee to comply with any lawful provision of the franchise agreement after being given notice of the violation and a reasonable opportunity to cure. In *Fantastic Sams*, the Court found that the automatic termination provision in the franchise agreement did not comply with the CFRA because no "reasonable opportunity to cure" was provided, and therefore the Moassesfars could not rely on this provision to dismiss Fantastic Sams' case.

Fantastic Sams' victory on the motion to dismiss was pyrrhic. The Court did find that because Fantastic Sams waited too long to pursue any claims against the Moassesfars, it was limited to recovering damages for only the one (1)-year period prior to filing its claim, pursuant to the terms of the franchise agreement.

The *Fantastic Sams* case offers two (2) important lessons. First, franchisors should never sit on their rights, and allow a franchisee to remain in a state of default under a franchise agreement. In the event of any default, the franchisor should take appropriate steps to inform the franchisee and enforce any rights prior to the expiration of any statute of limitation term in the franchise agreement. Second, this case demonstrates that the CFRA is a two-way street, and may be applied to both franchisees and franchisors, depending on the specific facts of the case. Out-of-state franchisors operating in California must be aware of the application of the CFRA, and should take appropriate steps to tailor their franchise agreements in order to conform as closely as possible with the requirements of the CFRA.

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